INSURANCE COUNCIL OF AUSTRALIA

28 April 2020

Air Chief Marshall Binskin AC
The Hon. Dr Bennet AC SC
Professor Macintosh
Commissioners
Royal Commission into Natural Disaster Arrangements

Submitted online

Dear Commissioners

ROYAL COMMISSION INTO NATIONAL NATURAL DISASTER ARRANGEMENTS

The Insurance Council of Australia[1] (**Insurance Council**) appreciates the opportunity to provide a submission to the Royal Commission into National Natural Disaster Arrangements.

The Insurance Council would like to acknowledge and commend the outstanding efforts of each of the State fire agencies including their leadership, the fire fighters and the support staff during the 2019-20 bushfires (**Black Summer Fires**). They all displayed immense courage, determination and resilience. Without such dedicated and professional individuals, Australia would be seeking to recovery from an even more significant loss. We make some specific comments in Annex One in relation to the Black Summer Fires.

Annexes Two, Three and Four of this submission focus on arrangements for improving Australia's resilience and adaptation to climatic conditions. This includes comment on the actions that should be taken to mitigate the impacts of natural disasters. We examine the need to enhance accountability for natural disaster risk management, preparedness, resilience and recovery. The merits of a nationally consistent accountability and reporting framework and national standards are considered.

In this regard the Insurance Council submits that the only means to effect lasting improvements to hazard exposure in Australia is by adopting a systematic approach to disaster risk reduction consisting of the following:

- Increased public and private mitigation;
- Improved building quality and standards; and

[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 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. December 2019 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of $50.2 billion per annum and has total assets of $129.7 billion. The industry employs approximately 60,000 people and on average pays out about $152.3 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).

- Improved land use planning.

To make effective and lasting improvements to Australia's disaster resilience, the level of Federal and State Government funding should be significantly increased to a level equal to or greater than that recommended in the Productivity Commission Natural Disaster Funding Arrangements Inquiry in 2014.

Furthermore, Annex Five looks at the need to overhaul the manner in which some States source the funding for their emergency services. It is well recognised that the manner in which NSW in particular chooses to fund its emergency services via a levy on policyholders results in higher rates of non-insurance and under-insurance in that State, as compared to other States and Territories. This approach exacerbates the loss suffered by individuals, small businesses and communities when they are afflicted by natural disasters.

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 telephone: 02 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director & CEO

ANNEX ONE

THE BLACK SUMMER FIRES

Insurance industry actions and observations

Helping Australian communities respond and recover to disasters is at the core of the insurance industry. Since 2011, the insurance industry has maintained a Catastrophe Taskforce, coordinated by the Insurance Council, dedicated to managing the industry response to disasters and to ensuring that policyholders can access the benefits of their insurance policy as quickly as possible.

In the lead-up to the Black Summer Fires, insurers had been preparing for a particularly catastrophic fire season based on the advice of Emergency Agencies and the Bureau of Meteorology. The Insurance Council, on behalf of industry, also maintained during this period regular discussions with State Emergency Management offices to ensure industry was up-to-date with information.

From September 2019, when the first of the large fires caused property loss, the Insurance Council and representatives from the insurers quickly deployed to impacted communities to expedite claims processing. As the number of fires grew throughout November and into December, industry commenced regular crisis meetings to ensure insurers maintained the best possible situational awareness and to ensure a coordinated response.

Insurance Council disaster experts, insurance claims staff and assessors were constantly deploying to impacted communities, briefing Local Governments on industry's response and speaking with residents at community meetings. The Insurance Council also set up numerous Insurance Hubs as a point for residents to access assistance in addition to a roving presence in more remote communities that had been impacted.

Throughout the Black Summer Fires, the Insurance Council was continually liaising with State Government to ensure industry was able to provide the best possible assistance to impacted residents and communities. This also ensured that industry and Government were able to coordinated and sufficient resources to benefit impacted communities. Two specific examples are given:

1. **The Mallacoota evacuation**: following the fire that impacted Mallacoota on 31 December 2019, Emergency Management Victoria (EMV) liaised with the Insurance Council to support the evacuation of Mallacoota. When evacuees arrived at the Melbourne Reception Centre, the Insurance Council and a large contingent of insurers were present and ready to assist residents with emergency accommodation. For tourists, insurers were able to assist with travel arrangements home.
2. **Rapid damage inspection of Mallacoota**: As a result of Mallacoota remaining inaccessible for many weeks following the fire, the Insurance Council liaised with EMV for insurance assessors to gain access to the town. Doing so, would allow insurers to ensure residents could access the benefits of their insurance as quickly as possible. To support this, EMV arranged for industry representatives to access Mallacoota via a RAAF C-27. This early access greatly benefited residents by helping them access funds available under their insurance policies earlier than otherwise.

The Insurance Council and insurers have worked closely with each of the State Governments to coordinate debris removal programs to ensure affected residents have a greater ability to recover. In particular, industry has committed to pass on to policyholders any savings arising from Government contractors cleaning up their properties. This ensures residents who have lost their homes will have more funds available from which to finance the rebuilding of their homes.

The Insurance Council has also held regular meetings with elected members of parliament to brief them on the industry response and to hear any concerns or issues raised from their constituents. These were then escalated to the relevant insurer for resolution. The Insurance Council also maintained a 24 hour a day hotline to assist affected residents with any insurance questions or concerns.

As at 23 March 2020, the industry had received 31,079 claims relating to the Black Summer Bushfires; 72% of these claims relate to domestic products and 28% are commercial claims. Of the domestic claims, 8,045 are for damaged or destroyed property with an average value of $150,632; 12,153 are for damaged or destroyed contents with an average value of $13,873. Industry presently estimates the total insured loss from the fires is over $2.2 billion, although that is likely to be an under-estimate of the total eventual loss. This figure does not include damage or loss of Government infrastructure or uninsured property.

Insurance Council's recommendation

An important operational learning from the Black Summer Fires is that there needs to be greater sharing and coordination of data by and from State Governments. In our experience each State Government collects impact assessment data following disasters. However, due to real, or misplaced, concerns regarding the *Privacy Act 1988 (Commonwealth)* State Governments frequently demur in making that data available to insurers. This hesitation is detrimental to impacted residents.

There is a tremendous community benefit in providing impact assessment data to insurers as it allows for funds and other benefits (such as emergency accommodation) to be made available to residents without the insurer having to wait until the property is accessible (which can take many weeks if a disaster is prolonged).

The Insurance Council recommends that the Commonwealth and State governments establish an effective data sharing framework. This will involve work with the Office of the Australian Information Commission and other relevant stakeholders such as the Insurance Council, to identify impediments in the *Privacy Act 1988 (Commonwealth)* to the development of an effective data sharing framework and amendment of that Act to remove those impediments.

INSURANCE COUNCIL OF AUSTRALIA

ANNEX TWO

DISASTER MITIGATION

The insurance industry's role in disaster mitigation
The insurance industry plays a critical role in Australia's disaster preparedness and recovery efforts. Australia benefits from very high rates of insurance coverage with an estimated 95% of homes at least partially insured for loss or damage, albeit with some variation as between the States and Territories.

Each year, the industry pays out billions of dollars towards funding the rebuilding of communities following disasters. For instance, between November 2019 and April 2020, the industry received over 252,000 insurance claims from natural disasters in Australia at an estimated total loss of over $4.6 billion. This money not only allows local residents and businesses to recover, but also stimulates local economies by supporting local builders, trades and suppliers.

Beyond the direct benefit of rebuilding communities following disasters, insurance also provides the clearest financial indication of a building's hazard exposure via risk-based insurance premiums. In effect, risk-based pricing means a poorly constructed home in a location with high hazard exposure will attract a higher insurance premium than a well-constructed home with a lower hazard exposure. Risk-based pricing also means that when a building's exposure to a hazard is quantifiably reduced, so too will be the cost of insuring the property.

The financial incentive of insurance in promoting the benefits of mitigation should not be underestimated as a motivating force for investment in disaster risk reduction. When the risk of a disaster is quantifiably reduced in a community, the insurance premiums paid by residents will reduce which can act as financial stimulus for a local economy by decreasing homeowner expenses and increasing disposable income.

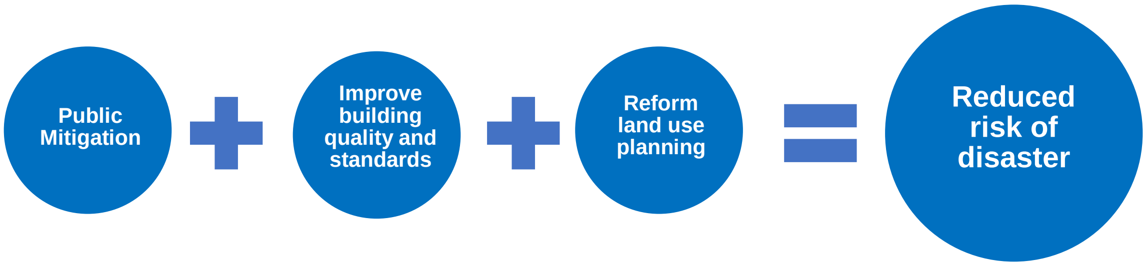
Unfortunately, Australia is highly exposed to natural hazards. Moreover, that exposure is only increasing due to climate change and the increasing incidence of extreme weather events. However, this high exposure to extreme weather incidents does not in itself mean that Australia must also accept a high and increasing incidence of life and property loss – not to mention the heavy emotional, social and financial toll on residents. Catastrophic losses due to natural disasters arise more frequently where the built environment has not been designed and constructed to withstand the likely environmental hazards particular to that location.

If Australia's increasing disaster risk remains unmitigated, one consequence will be increasing insurance premiums, which will further add to cost-of-living pressures already experienced by many in our community. If risk mitigation measure are not taken then it is probable in the long-term that some highly exposed communities will practically be unable to buy insurance cover for particular risks. This will be due to the high cost of purchasing cover due to the high likelihood of disasters occurring, or cover ceasing to be available for the same reason. If this were to occur, these communities would likely falter as banks would be unwilling to provide mortgages to homeowners or financing to local businesses. Therefore, it is imperative that Australia acts now to reduce our current and future exposure to disasters.

Insurance Council's recommendations

The Insurance Council has long called for improvements to Australia's disaster mitigation framework. In this respect, we maintain the only means to effect lasting improvements to hazard exposure in Australia is by adopting a systematic approach to disaster risk reduction in which the measures interact to improve the resilience of communities, reduce the residual risk of disaster and ultimately improve insurance affordability. This position focuses on three key measures:

1. Improving building quality and standards so both new and old homes and strata buildings are stronger, more resilient and better maintained.
2. Reforming land use planning to more effectively mitigate against increasing hazard exposure.
3. Investment in mitigation to better defend Australian communities from natural hazards.



Crucially, solutions need to be framed as the responsibility of not just governments or industry, but of all stakeholders including residents. Each stakeholder must understand their responsibility for improving the resilience of Australia.

- **Residents**: maintaining their property in good condition, repairing wear and tear, understanding their own vulnerability and investing in private mitigation.
- **Governments**: large scale mitigation investment, land use planning, education.
- **Insurance Industry**: reducing premiums where risk is quantifiably reduced, advising government on quantifiable mitigation, educating residents.
- **Building industry**: supporting improved building resilience, building to or above code, educating consumers.

Disaster mitigation funding

In many instances the only effective means at reducing a community's risk is by mitigating the natural hazard through infrastructure – such as a dam, levee or sea wall. However, despite having the ability to make broad-scale improvements to resilience; investment in large mitigation projects is infrequent in Australia due to the lack of investment, cost of the proposed mitigation or difficulty in valuing the proposal.

Despite the high cost, mitigation projects should be treated as nation-building infrastructure initiatives, on par with highways, rail and national broadband networks. When mitigation is in place it protects communities, has a substantial impact on the economy and productivity, and helps prevent loss of life.

Public mitigation – funding issues

With respect to funding, the Insurance Council has long advocated for a substantial increase in Federal Government funding. In order to effectively reduce disaster risk in Australia, funding must be increased. As a nation we are all too experienced at responding to natural disasters and rebuilding communities. Between 2009-10 and 2012-13, over $8.3 billion was spent on disaster response and recovery in Australia. Yet, our investment in preventing these disasters from occurring in the first place remains low and inefficiently managed. Over the same 2009-10 to 2012-13 period, only $170 million was spent on disaster mitigation.

This disparity in spending continues today, despite many inquiries and organisations calling for increased mitigation funding. Most notably, the Productivity Commission in its 2014 Natural Disaster Funding Arrangements Inquiry recommended that the Federal Government allocate $200 million annually to disaster mitigation, with a further $200 million to be provided by the States and Territories. This investment outlay would be offset by the reduced cost of post-disaster response and recovery.

In 2013, the Australian Business Roundtable for Disaster Resilience and Safer Communities White Paper demonstrated that carefully targeted resilience investments of $250 million per annum would generate potential budget savings of $12.2 billion for all levels of government and would reduce natural disaster costs by more than 50% by 2050. In a more recent report, the Australian Business Roundtable estimated the total economic cost of disasters in 2015 to be in excess of $9 billion, that this cost would double by 2030 and would average $39 billion a year by 2050 without substantial investment in mitigation.

Additionally, the 2016 Northern Australia Insurance Premiums Taskforce found the only means to reduce high insurance premiums in Northern Australia was to invest in mitigation to reduce the region's high exposure to natural hazards. Similarly, the Australian Institute of Actuaries estimates the annual cost of disasters as between $11-12 billion, only 40% of which is insured. In its pre-budget submission in February 2019, the institute repeated its calls for government to adopt the productivity commission's recommendations.

Without a commitment from Federal and State Governments to invest in mitigation, many communities in Australia will remain highly exposed to disaster and insurance premiums will remain commensurate to the high risk.

Disaster mitigation valuation issues

Aside from funding, another key reason for lack of investment in disaster mitigation infrastructure is the difficulty in accurately valuing a mitigation proposal. It is acknowledged that valuing mitigation is complex and not always tangible. In essence, it requires placing a price on the prevention of an occurrence that may not happen at all. Further, many consequences of disasters are so remote that they can be difficult to accurately value.

Commonly, the value of a mitigation proposal is assessed through formal economic modelling of cost-benefit analysis. This known and accepted method for investment consideration and, in respect to disaster mitigation, analysis consists of a risk assessment before mitigation, assessment of mitigation options and the costs, and a risk assessment after mitigation. The economic effectiveness of the mitigation is evaluated by comparing the benefits of the projects against its costs (Benefit-Cost Ratio).

That said, applying traditional cost benefit analysis to disaster mitigation has significant limitations. For example, traditional means of measuring investment have a limited capacity to assess qualitative benefits and estimate climate change impacts. Additionally, traditional economic analysis has difficulty quantifying systemic mitigation. For example, it may be effective in assessing the effectiveness of a flood levee, but this model is less effective in assessing a system of mitigation initiatives such as a flood levee combined with a household resilience program and the restoration of a mangrove forest.

The result of these limitations in using cost-benefit analysis means this approach frequently underestimates the cost-effectiveness of mitigation investment or generates a conclusion to support a mitigation option which is more cost-effective in the short-term but which is less effective at improving long-term resilience.

Conversely, more recent mitigation valuation models which do incorporate more qualitative aspects risk, can end up being too complex and subjective.

Difficulty also arises in valuing mitigation when a discount rate is applied. A discount rate is a means of recognizing that money held today has a higher value than money realised in the future. Use of a discount factor means that the longer it takes to realise a return on investment, the lesser the value of that return. This has a useful application when the goal of investment is to generate a financial return. However, this is less relevant where the goal is community resilience to disasters.

In Australia, the Federal Government typically applies a discount rate of 5%-7% to investment considerations. However, elsewhere in the world, a discount rate of 3% is commonly considered more appropriate for mitigation investment and to account for intangible benefits and the impact of climate change.

Example: Launceston Flood Mitigation

The Launceston flood levee is an example of both the benefits of mitigation and the limitations of utilising cost-benefit analysis to prioritise mitigation. In 2014, the old Launceston flood levee was upgraded and raised. The initial cost estimate for the upgrade was $27.9 million. However, the final cost increased to $58 million. Maintenance costs for the new levee were estimated to be $181,000 per annum, with an additional $250,000 every five years.

In 2018, the Bushfire and Natural Hazards CRC conducted a study to evaluate the cost effectiveness of the Launceston levee. Based on the initial estimated cost of the levee of $27.9 million, the study found the benefit to cost ratio (when applying a discount rate of 7%) was 1.48. When the actual cost of $58.4 million was used the benefit-to-cost ratio fell to 0.71. These calculations suggested it was an unsound investment. However, if a lower discount rate of 4% were to be applied, the study would have found the benefit-to-cost ratio for the initial estimated cost to be 2.49, and if actual cost were used then the BCR rose to 1.19, indicating a cost effective investment.

In June 2016, the city experienced a 1/50 year flood. In its report into the flood, the BNHCRC found that the reconstruction of the Launceston flood levee resulted in avoiding losses of approximately $216 million had the pre-existing levee failed. In other words, the losses (from this single event) would have been four times greater than the investment in the new flood levee, had the old levee failed.

Insurance Council recommendation

It follows that mitigation investment should be viewed as nation-building infrastructure and projects and projects should be selected based on their quantitative and qualitative benefits to the community rather than projected investment return. Further, Governments must adopt a different mindset and approach to mitigation investment compared to other forms of infrastructure where a financial return is expected. Finally, if discount rates are applied to mitigation investment decisions, a lower rate of 3-4% should be adopted to account for climate change and qualitative benefits.

The Insurance Council has publicly produced a list of the most highly exposed electorates in Australia which are also those that would benefit most from public mitigation. The insurance industry remains committed to assisting Governments in implementing mitigation via lower insurance premiums commensurate to reduced hazard exposure.

Disaster mitigation private actions

The Insurance Council considers one of the most effective measures to improve the resilience of older homes is through programs which retrofit critical components of an older property to present-day standards. Importantly, measures that quantifiably improve the resilience of existing buildings have demonstrated success in lowering insurance premiums.

Older homes are disproportionately represented in disaster damage assessments due to their lower resilience. From an insurance industry perspective, this is clearly observed in claims lodged and, therefore, a higher insurance premium is charged. As an example, 66 per cent of premiums above the median in Northern Australia related to homes built before the introduction of windspeed designs in the construction code. Further, 89 per cent of premiums above $5,000 relate to pre-1980 homes with both a cyclone and flood exposure.

The recently completed Household Resilience Program, operated by the Queensland Department of Housing and Public Works (HPW) provided eligible households with up to $11,250 to fund risk mitigation measures such as roof replacement and strengthening of windows and doors. The insurance industry supported the program and the benefits for participants was an immediate improvement to insurance affordability. According to HPW, the average insurance premium reduction, once program participants had completed the works, was 7.8%. The highest identified premium reduction as a result of the program was 25%. Unfortunately, despite the clear success of this program, no further funding has been allocated for its continuation.

The success of these types of programs at reducing insurance premiums is two-fold. First, the retrofitting of older, more vulnerable homes reduces the residual risk of damage being passed on to the insurer. Secondly, when retrofitting a building occurs as part of a program, insurers have greater confidence in the nature and quality of the work undertaken without the need to independently verify each property.

Insurance Council recommendation

The Insurance Council supports further programs aimed at retrofitting older homes to meet today's more stringent building codes. The Insurance Council recommends that these programs not be means-tested, or at the least have a broader eligibility than the Household Resilience Program. The means-testing of the Household Resilience Program resulted in many residents being excluded from participation. The difficulty with this approach is that the residents excluded are very unlikely to then retrofit their home on their own accord. The reality is, most residents do not appreciate that their homes are vulnerable to hazards and require incentivisation to improve undertake improvements to their home.

It follows that the Insurance Council supports initiatives which aim to retrofit older, more vulnerable homes to current standards but consider a broad eligibility would have greater success at improving insurance affordability.

Summary of Insurance Council mitigation recommendations:

- **Funding for disaster mitigation be increased to the amount proposed by the Productivity Commission Natural Disaster Funding Arrangements Inquiry – i.e. $200m annually from Federal Government matched by a further $200m from State Governments.**
- **Public mitigation to be viewed as a 'nation building' exercise similar to investment in large road, rail or broadband network projects.**
- **Government subsidisation of private mitigation to incentivise residents to understand, take responsibility for and invest in improving the disaster resilience of their own assets.**

ANNEX THREE

IMPROVING BUILDING QUALITY AND STANDARDS

Improving the quality of both new and existing buildings in Australia is a critical component to improving Australian communities' resilience to extreme weather incidents.

While newer buildings remain vulnerable to extreme weather, older buildings are more susceptible to damage due to being constructed to a standard lower than that required by the present day building code, or becoming vulnerable as a result of wear and tear, pre-existing damage or general degradation. Therefore, measures targeting the quality of older buildings should focus on addressing these vulnerabilities.

New buildings – improved construction code

Improving the building standards of new homes and strata buildings is also critical to long-term insurance affordability in Australia. As evidenced by high insurance premiums in regions exposed to multiple natural hazards (such as North Queensland), even new buildings remain too vulnerable to damage from extreme weather and this risk is passed on to homeowners. That said, reforms to building standards are not only needed to ensure homes can withstand the hazards present today, but they should also take account of future hazards arising as a result of the changing climate.

There are two main aspects to improving building standards for new constructions. First, the National Construction Code (NCC) needs to be amended with a greater focus on protecting the building assets from extreme weather. Second, greater monitoring and enforcement is required to ensure compliance. If effective improvements can be made to new building standards and compliance in Australia, the long-term resilience of the built environment will be gradually improved. Specific changes to the NCC require a more technical assessment than provided for in this submission. The Insurance Council considers the governance of the NCC must be reformed to place a greater focus on protecting buildings from damage arising from extreme weather events.

As it stands, the Australian Building Codes Board (ABCB) predominately focuses on the preservation of life through ensuring buildings provide a safe refuge to occupants. However, though the NCC ensures buildings should not collapse under high wind loads, the NCC has not been designed with the aim of otherwise preventing damage to the building itself during extreme weather. For example, strata buildings are designed to withstand high windspeeds to ensure they don't collapse. However, window and door flashings are not designed to withstand water ingress under high windspeed. As a result, strata buildings in Australia are highly vulnerable to extensive water damage during storms. It follows, the ABCB's focus on preserving life rather than also protecting the building itself has contributed to the poor disaster resilience of Australia's built environment.

Without detracting from the need to protect life, the Insurance Council considers a focus on protecting both buildings and life in equal measure would result in a more positive outcome for the residents of Australia. Ensuring a building is more resilient to extreme weather (fire, wind or water inundation) will naturally provide greater protection to its occupants.

The cost of improving building standards will vary depending upon the measures adopted. Higher standards within the NCC will ultimately be incorporated into construction costs. Although these costs are likely to flow through to home and unit owners, the benefit to the homeowner of living in a more resilient home cannot be overstated. Despite marginally higher construction costs, the homeowner will likely benefit from lower insurance premiums reflecting the improved resilience. Additionally, a property's value will likely reflect its higher quality and improved resilience.

In addition, improvements to the NCC can only be effective with increased compliance monitoring and enforceability to prevent new constructions being built below NCC requirements. Unfortunately, the CTS's technical reports following recent cyclone events highlighted numerous instances of new buildings suffering damage as a result of being constructed below the standards required in the present NCC. Therefore, for a building code to effectively mitigate hazard exposure, it must be complied with and breaches must be adequately rectified through enforcement.

Older buildings - periodic building inspections in high risk areas

As well as being built to a lower construction standard, older buildings often have a greater vulnerability to extreme weather due to pre-existing damage or building degradation through wear and tear. Too often these vulnerabilities are not addressed leaving these buildings highly susceptible to damage.

Pre-existing damage or significant wear and tear is often easily detected by obtaining an inspection by a qualified builder. However, despite the house often being the home owner's largest asset, few homeowners arrange for their home to be inspected for wear and tear, unless the consequences of damage are obvious, such as, a leaking roof. Even then many homeowners will simply use a bucket to mitigate damage from a leak without investigating the cause of the leak or whether their roof has been compromised. This approach to home maintenance can be contrasted to the maintenance many carry out on their cars. Residents are likely to service their car at least once a year, yet not do the same on their house, notwithstanding that the value of their car is significantly less than that of their home. In addition, cars more than a few years old are required by State laws to have an annual safety inspection before their registration can be renewed.

Insurance Council recommendation

It follows that a community's resilience could be substantially improved if buildings in high-risk regions were periodically inspected for vulnerabilities such as pre-existing damage or general degradation affecting the building's resilience. Such a measure would be most effectively delivered through a Government program so as to effect behavioural change amongst homeowners and provide a level of fidelity for insurers.

The cost of an individual building inspection can range from $200 to $500 per building depending on the size of the house and the extent of the inspection. However, a regional program would likely see reduced per-building inspection costs due to economies of scale. Costs could also be reduced by limiting the scope of the inspection to the highest vulnerabilities, such as the roof, doors and windows. Inspections could focus on the quality of the roof, ensuring screws and tie-downs are secure, that battens have not rotted or corroded, that doors have been installed to code and window flashings and seals have not deteriorated.

The cost of the building inspection could be borne by individual homeowners. That said, the program may suffer from low engagement without cost subsidisation or a quantifiable benefit for the homeowner to justify the cost. Therefore, some form of subsidisation by State Governments is most likely required in order to deliver a successful outcome.

Any inspection program could be voluntary or mandatory depending on the risk profile of an area or variable depending on the age of a home. For example, inspections could be mandated for homes over a particular age. Likewise, inspections could be mandated following an extreme weather event in which a building may have sustained damage which is not easily visible.

Summary of Insurance Council building code and standards recommendations:

- **The NCC be reviewed and amended to ensure greater resilience to extreme weather is incorporated into building design and construction, including increasing risk posed by climate change.**
- **Improving inspection and compliance enforcement to ensure buildings are constructed to code.**
- **Periodic inspections of existing buildings in high risk areas to ensure they are maintained.**
- **Representation from the insurance industry on the ABCB to advise on unnecessary risks and exposures emerging in the built environment.**

REFORMATION OF LAND USE PLANNING

In many parts of Australia, the built environment has developed in locations highly exposed to natural hazards. Notably, homes and strata buildings have been constructed in close proximity to the ocean with very little accommodation for rising sea levels or storm surge. Entire suburbs have been developed on flood prone land provided the floor has been constructed above the Q100 flood. In essence, poor land use planning has allowed for homes and businesses to be impacted by natural hazards.

Understandably, Local Governments have, at times, been under pressure to utilise land that is close to city centres. Further, flood mapping in the past may not have been performed as accurately as it can be done now. Similarly, the effects of climate change were not previously understood and are only now being effectively modelled by more progressive Local Governments. Notwithstanding, poor land use and urban planning has significantly contributed to high (and increasing) insurance premiums in regions with high exposure to disasters.

Although land use planning has improved in respect to reducing disaster risk reduction, there is still clear evidence of recent planning decisions placing communities at a known and obvious risk of disaster. For example, development in the suburb of Idalia in Townsville is only partially completed, yet it was significantly inundated by flood in February 2019. Many of these new homes have been constructed on stumps or concrete slabs despite the known flood risk in the suburb. Although these homes meet the minimum design standard above the predicted Q100 flood level, the houses still remains at significant risk of flood damage during the expected lifetime of these buildings. As a result, despite these newly constructed homes being built to the latest standards, they will attract a high insurance premium due to land use planning that exposes these homes to unnecessary risk.

Conversely, many older homes 'Queenslander 'style homes were constructed to be elevated well above the known flood risk and undoubtedly higher than any Local Government requirements. This suggests, at least in the present day, when a land use planning system sets a minimum standard, many developers will design only to that minimum.

It follows that, to improve Australia's resilience to disasters, land use and urban planning need to be reformed to ensure new developments are not constructed in locations that pose a significant risk now or which are likely to in the future. Where land has a high exposure to hazard, building development simply should not occur and the land should be purposed for its natural hazard mitigation qualities. If, however development does occur, then significant action should be taken to ensure the hazard exposure is mitigated and buildings are not simply built to the minimum standard.

Developing more effective land use planning requires action from both local and State Governments. While Local Governments dictate the planning of their community, support is required from State Governments to ensure consistency and enforceability of the planning system. Additionally, State Governments must ensure State legislation does not allow the judiciary to overturn planning determinations which would adversely affect the resilience of the existing community or unnecessarily exposes the proposed development to risk. There have been numerous instances in which State Planning and Environment Courts have overturned Local Government decisions thereby enabling buildings to be developed on highly exposed flood-prone land without adequate disaster mitigation.

Finally, where developed land is - or is likely to be - highly exposed to natural hazards as a result of poor land use planning, Governments should consider creative solutions to capturing and repurposing the land for hazard mitigation. For example, if a home built on highly-exposed flood prone land is destroyed in a flood, Governments should consider a land swap for that resident to a nearby location outside of the flood risk. The flooded land parcel could then be returned to its natural state and potentially reduce the flood risk for other properties. Similarly, highly exposed coastal properties which are at risk of rising sea levels or storm surge could be repurposed as natural sea barriers. Such measures would require significant further investigation and investment by Federal and State Governments.

ANNEX FIVE

UNDER-INSURANCE

Maintaining adequate insurance cover against natural disaster risks enables individuals and businesses to recover faster from natural disasters. Insurance payouts enable policy holders to get on with the task of rebuilding their lives or businesses. The smaller the insurance payout relative to the cost of the replacing, repairing or rebuilding the destroyed or damaged asset the longer the time it will take for them to rebuild their lives or business. Thus, there is a direct correlation between the level of non-insurance and under-insurance and the speed with which affected individuals and businesses can rebuild after a natural disaster, subject to a decision by government to fill, wholly or partially, the resultant funding gap by grants out of the taxpayer funds.

Insurance contracts are voluntary agreements under-which a policyholder transfers the financial loss which will arise should a specified adverse event(s) occur in the future to the insurer for a price known as the premium. Insurers set the premium commensurate to the level of risk they are willing to accept. Insurance operates in an optimal manner where the policyholder purchases an insurance which covers the entirety, or 100%, of the financial loss which will arise should that adverse event occur. This is a situation of full-insurance.

The problem in Australia is that governments layer State and Commonwealth taxes on top of the premium risk-transfer payment. Policyholders also need to pay: in NSW and Tasmania, a State levy to fund emergency services; Commonwealth GST; and then for all States and the Northern Territory, stamp duty. This layering also includes an element of triple taxation.

As a result, the total cost paid by policyholders to acquire insurance is significantly greater than the premium paid to transfer the risk to an insurer. The quantum of the additional tax cost imposed on policyholders ranges from 10% in the ACT to more than 50% for a household policy and up to 70% to a business policy in NSW: please see the attached White Paper on the *"Impact of Government Duties on Household Insurance"* prepared by the Insurance Council in November 2019.

These additional government imposts distort the operation of the insurance market in Australia. They introduce a bias towards under-insurance by making the total cost of full-insurance disproportionately high compared to the proportion of the premium which insures against the actual risk. Therefore, many individuals and businesses will consciously choose to under-insure because the cost of fully insuring against that risk has become too expensive, given their personal circumstances.

In April 2016, Quantum Market Research conducted a survey on behalf of the Insurance Council. It found that more than 80 per cent of Australian homeowners and renters are likely to be under-insured for their home and contents and 63 per cent of renters do not have contents insurance.

The sum insured calculators are now commonplace to help people determine the amount of cover they require. However, the problem of policyholders not understanding the extent of the loss they potentially face is exacerbated because insurers are constrained in the conversations they can have with their customers. This is due to the lack of clarity as to how the financial product advice definitions in the Corporations Act 2001 (Cth) operate. Without certainty that they are not inadvertently giving personal financial product advice, most insurers limit their interaction customers to the provision of information.

The difficulties caused by the personal and general financial product advice definitions led the Financial Systems Inquiry to recommend reform. We understand that the review which ASIC will undertake in 2021 into the effectiveness of the advice regime (a recommendation of the Hayne Financial Services Royal Commission) will consider how reform could be undertaken. The Insurance Council hopes that a solution can be found to the current disincentive for general insurers and other financial services providers to have useful conversations with their customers. The Insurance Council urges the Commonwealth Government to expeditiously enact the outcomes of the ASIC review.

From a systemic point of view this results in a situation where:

- Individuals and businesses choose the certainty of saving some money in the short-term by under-insuring, but run the risk of losing more money in the longer-term if an adverse event occurs.
- Governments choose the certainty of raising revenue in the short-term by imposing taxes and levies on policyholders, but run the risk of having to pay out significant grants to support those under-insuring policy holders in the longer-term if an adverse event occurs.

Such a trade-off, may have been appropriate in a world of where national natural disasters were infrequent. However, in a world of increasingly extreme weather events and in which natural disasters are becoming more and more commonplace that policy trade-off is no longer rational.

In 2015, research commissioned by the Insurance Council examined the impact of removing State and Territory insurance duties (and the ESL in NSW) on the take-up of house or contents insurance. It found that the removal of all insurance taxes and charges would result in a $643 million (or 13 per cent) increase in household expenditure each year on pre-tax insurance premium on house or contents insurance across Australia.

Insurance Council recommendations to address under insurance:

- **The Commonwealth should expeditiously enact reforms to the Corporations Act advice definitions to facilitate useful conversations between insurers and policyholders about the amount of insurance cover they require.**
- **NSW should abolish its emergency services levy and replace it with a broad property-based levy and introduce concessions for low-income earners, as occurred in Victoria.**
- **All Australian States and the Northern Territory abolish stamp duties on insurance premiums.**

INSURANCE COUNCIL OF AUSTRALIA

THE IMPACT OF GOVERNMENT DUTIES ON HOUSEHOLD INSURANCE

Insurance Council of Australia

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Contents

1. Introduction

The Insurance Council of Australia (the Insurance Council) is the representative body of the general insurance industry in Australia. Its members are responsible for more than 95 per cent 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. They provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, professional indemnity, commercial property, and directors and officers insurance).

The industry employs about 60,000 people and on average pays out about $151.4 million in claims each working day. June 2019 Australian Prudential Regulation Authority statistics show that the private sector general insurance industry generates gross written premium of $48.4 billion a year and has total assets of $128.4 billion.

Through the efficient management of risk, the general insurance industry plays an essential role in supporting the everyday activities of individual Australians, communities and the broader operation of the Australian economy. In particular, the industry plays a critical role in protecting the financial wellbeing of individuals, households, businesses and communities by restoring their standard of living and helping them recover following natural catastrophes and other insured events.

The role of the general insurance industry in community recovery is significant not only in terms of the billions of dollars of claims paid each year, but also because of the evolving risk mitigation and emergency management initiatives that make for more resilient Australian communities.

The Insurance Council has been a key participant in the tax reform debate. The economic case for the abolition of insurance-based taxes (here referring to stamp duties and levies to fund emergency services) is widely accepted, having been canvassed in numerous federal, state and territory government reviews and inquiries including:

- Australian Competition and Consumer Commission's Northern Australia Insurance Inquiry 2018
- Australian Government's Review of Australia's Future Tax System (the Henry Tax Review) 2010
- NSW Independent Pricing & Regulatory Tribunal (IPART) Review into State Taxation 2008
- 2009 Victorian Bushfires Royal Commission
- NSW Government 2012 review: *Funding our Emergency Services*
- ACT Review of Taxation 2012
- GST Distribution Review[1]
- Various Productivity Commission reports.[2]

[1] See GST Distribution Review, Final Report. October 2012.
[2] Multiple Productivity Commission reports have recommended the abolishment of insurance-based taxes including Rec 4.8 – *Natural Disaster Funding Inquiry* (December 2014); Rec 4.8 – *Shifting the Dial: 5 Year Productivity Review* (October 2017) and; Rec 14.3 – *Inquiry Report; Competition in the Australian Financial System* (August 2018).

The consensus is that the states and territories would be materially better off if they reformed their tax regimes so that they were more or wholly reliant on broad-based taxes with minimal exemptions at the same time as they reduced their reliance on transaction-type taxes, including insurance duties.

The interests of all states and territories would be best served by abolishing their insurance duties. The successful shift in states (including Victoria, South Australia and Western Australia) from funding their emergency services through an insurance levy to a broad-based property levy shows that reform is feasible and would bring significant social and fiscal benefits.

Unfortunately, high taxes are a significant disincentive for households to insure. The take-up of home and contents insurance is consistently lowest in NSW, the jurisdiction with the highest rate of insurance duties and levies and the only state or territory to still fund emergency services via a levy on retail insurance premiums.

The ACT's experience in phasing out its stamp duties on insurance products between 2012 and 2016 shows governments can smoothly transition to other, more efficient and fairer revenue sources.

A broad-based property levy, subject to safeguards as to its impact, is a more economically effective and equitable method to fund Australia's state and territory governments when compared with transactional insurance duties.

This type of levy would encourage the adequate take-up of insurance and be a more efficient and certain way of collecting revenue compared with insurance duties, which in essence penalises policyholders for effectively managing their risks.

State and territory governments have the opportunity, through the reform of their insurance tax regimes, to strengthen the long-term integrity of their own revenue bases.[3]

[3] For example, the Productivity Commission's October 2017 Draft Report on its Inquiry into Australia's system of horizontal fiscal equalisation (HFE) underpinning the distribution of GST revenue to the states and territories.

2. The impact of taxing home and contents policies

Table A below demonstrates in each state and territory the significant increase in premium from layering of insurance duty on premium before the Goods and Services Tax (GST) is applied, from 19.9 per cent on a Queensland home insurance policy premium to a substantial 45 per cent in New South Wales (NSW is the only state to retain an additional Emergency Services Levy or ESL on home insurance).[4] Having phased out insurance duties in 2016, consumers in the ACT are in a markedly better off position with only the GST charged on premiums. Commercial premiums are typically significantly higher than for consumer policies, so the impact of these charges often hits small-to-medium businesses hardest.

Table A: Comparison of insurance duties by states and territories

Tax	General insurance (GI) taxes (GST of 10% applies to all GI products)	Impact of levies, GST and stamp duties on final price paid by consumer[5]
NSW	**Stamp duty*:** 9% of the premium. Concessional 5% of premium payable on aviation, disability, hospital and ancillary health benefits, motor vehicle, occupational indemnity. Concessional 2.5% of premium paid on crop and livestock. **ESL:** Historically adds 21% to home and contents premiums and up to 40% to business premiums. **Note:** NSW is increasing its ESL requirements by $230 million between 2018-19 and 2021-22 to fund presumptive workers' compensation liabilities for firefighters.	The addition of ESL, GST and stamp duties is projected to add in 2020-21 **more than 50%** to the base premium for a household policy and up to 70% to a business policy.
VIC	**Stamp duty*:** 10% of previous month's gross premiums. **Note:** Victoria abolished its Fire Services Levy on insurance premiums in 2013.	The addition of GST and stamp duties adds **21%** to the base premium for a household policy.
QLD	**Stamp duty***: 9% of the premium for most GI contracts; 5% of net premiums for workers compensation. 10c flat for CTP. **Note:** The Queensland Government increased its stamp duties on GI products by 1.5 percentage points in 2013.	The addition of GST and stamp duties adds **19.9%** to the base premium for a household policy.
WA	**Stamp duty*:** 10% of gross premiums; 10% of premiums on CTP.	The addition of GST and stamp duties adds **21%** to the base premium for a household policy.
SA	**Stamp duty*:** 11% of premium.	The addition of GST and stamp duties adds **22%** to the base premium for a household policy.
TAS	**Stamp duty*:** 10% of premium. There is also a fire levy of 2% on marine cargo insurance; 14% aviation hull insurance and 28% on certain other prescribed classes of commercial insurance. **Note:** The Tasmanian Government increased the stamp duty on GI products by 2 percentage points in 2012.	The addition of GST and stamp duties adds **21%** to the base premium for a household policy.
NT	**Stamp duty*:** 10% of premiums.	The addition of GST and stamp duties adds **21%** to the base premium for a household policy.
ACT	**Stamp duty*:** Nil. **Note:** The ACT completed the phasing out of its stamp duties on insurance products in 2016.	The addition of GST adds **10%** to the base premium for a household policy.

Source: States and territories' general insurance duty rates retrieved from NSW Treasury, *TRP18-01 Interstate Comparison of Taxes 2017-18*, page 22. April 2018. States and territories' impact of general insurance duties on price (percentage) calculated by the Insurance Council. NSW Budget papers and ministerial statements.

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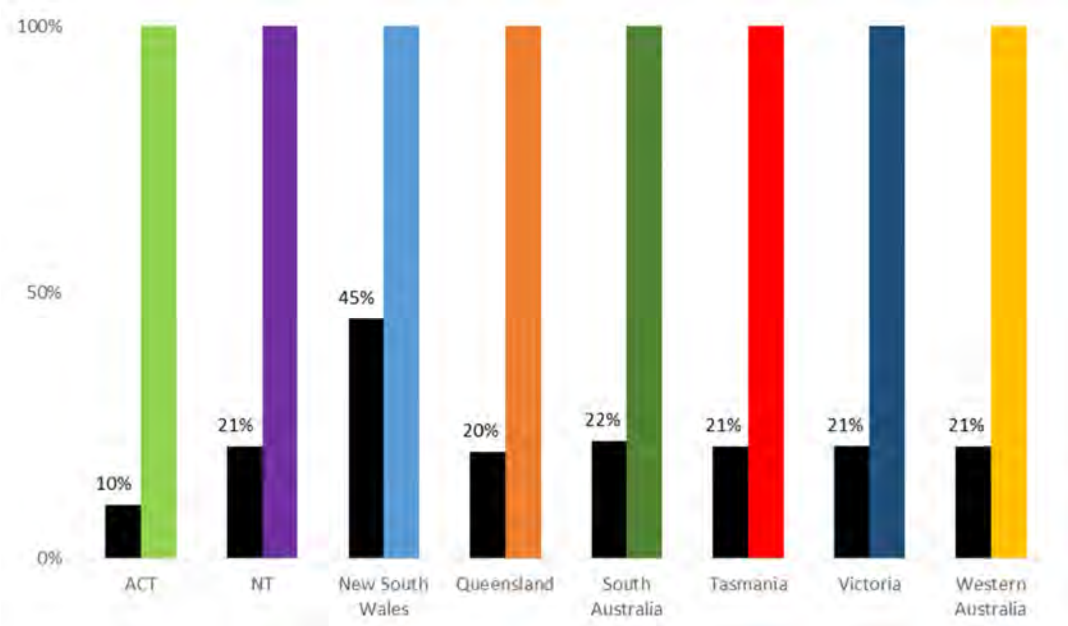
[4] Under the Australian Accounting Standards, the ESL is considered a component of the insurance premium, alongside the GST and state duty applied.

[5] Percentages are a calculation of the final effect of all state and territory government charges as a percentage of the insurer's base premium.

The significant impact of levies, GST and stamp duties on final price paid by consumers for household policies is represented in **Chart 1** below.[5]

Chart 1: Interstate comparison of insurance duties as a percentage of base premium



The Insurance Council recently conducted an analysis, using the taxation rates in Table A and drawing data from the past three Australian Bureau of Statistics (ABS) Household Expenditure Surveys to examine changes in the affordability of and decision to purchase (take-up) household home and contents insurance in each state and territory from 2003-2016.[6]

Chart 2 shows the percentage of total household income (all sources) spent on home and contents insurance.[7] **Chart 3** selects food (including takeaway and restaurant) and non-alcoholic beverages, as a comparative measure of an expenditure class that is relatively inelastic in demand.[8]

Separately, **Chart 4**[7] observes home and contents insurance take-up over these three survey years, to show how price growth affects some states more than others.

The survey data shows that the cost of home and contents insurance relative to income increased significantly, with a notable sharp escalation in the 2015-16 period, for most states and territories. Household expenditure on food and beverages is shown alongside these figures to provide some context.

The take-up of home and contents insurance is consistently lowest in NSW, the jurisdiction with the highest rate of insurance duties and levies and the only state or territory to still fund

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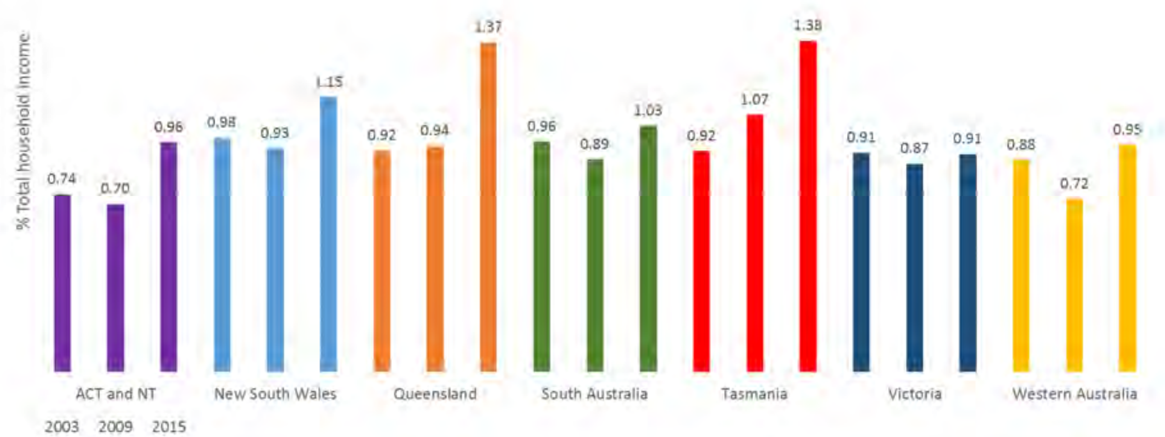
[6] Insurance Council conducted this analysis using data extracted from the past three ABS Household Expenditure Surveys: 2003-04, 2009-10 and 2015-16. The analysis is limited to households residing in a detached or semi-detached dwelling owned by the occupants outright or by mortgage.
[7] Charts 2 and 4 include households purchasing a combined home and contents policy; home policy; and contents policy. (Exclude each household that purchased a home or contents policy in isolation).
[8] Household expenditure represented in Charts 2 and 3 is tax inclusive.

emergency services via the ESL on insurance premiums (see **Chart 4** on page 8).

In 2016, the NSW Government announced it would abolish its ESL from 1 July 2017. The insurance industry spent more than $40 million to help ensure a smooth transition from the ESL to a property-based tax.[9] However, in late May 2017 the NSW Government announced the postponement of this essential reform, with no date given for resumption of the process.

Insurers were therefore required to continue the collection of ESL on household, small business and some motor vehicle policies in NSW. The NSW Government's policy reversal has led to confusion among insurance customers and fluctuations in premiums, particularly for commercial insureds, as the ESL was reinstated upon renewals. Furthermore, the NSW Government committed in 2018 to funding an increase in NSW firefighters workers' compensation benefits through the ESL. While not questioning the policy reason for the increase, the Insurance Council regrets that this decision will further reduce the affordability of premiums in NSW.

Chart 2: Percentage of total household income spent on home and contents insurance



[9] Household expenditure represented in Charts 2 and 3 is tax inclusive

Chart 3: Percentage of total household income spent on food and drink (exc alcohol)

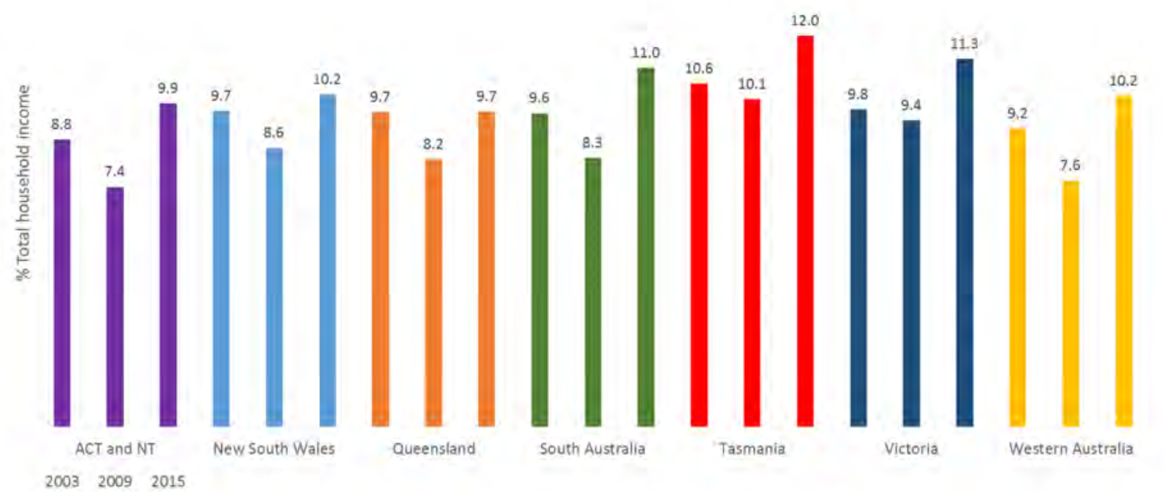
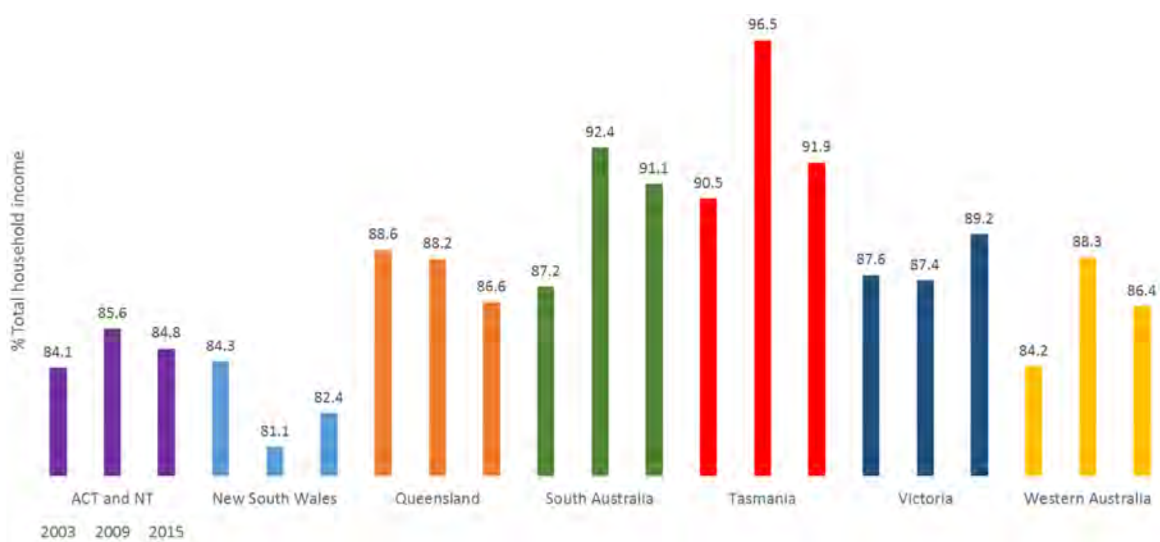


Chart 4: Percentage of households covered by home and contents insurance policies



3. Decreased affordability contributes to underinsurance and non-insurance

According to data from the 2015-16 ABS Household Expenditure Survey, it is estimated that of the nine million households that could potentially purchase contents insurance, 30 per cent (about 2.7 million) did not have a contents policy. Of the 5.8 million potential buyers of home insurance[10], 5.7 per cent do not have a building insurance policy. The ABS data estimates are substantiated in **Table B**, with similar median percentages of non-insured households determined from the Insurance Council's policy-in-force (PIF) dataset.[11]

Table B[12]: Rates (percentage) of non-insured households in Australian suburbs from PIF dataset

1. State	2. Median suburb rate	3. Highest suburb rate	4. Lowest suburb rate
QLD North	5.68%	8.57%	3.61%
QLD South	5.87%	7.84%	3.34%
NSW	6.38%	9.37%	4.21%
VIC	6.12%	8.89%	2.44%
SA	6.23%	6.92%	3.53%
TAS	6.09%	9.09%	2.38%
WA	6.31%	7.93%	3.38%
ACT; NT	Not assessed		

The Insurance Council also recently conducted a national survey[13] that found more than 80 per cent of Australian homeowners and renters are likely to be underinsured for their home and contents and 63 per cent of renters do not have contents insurance.

Insurance duty increases the cost of insurance and may deter many householders and small business owners from taking up the appropriate level of insurance. The current insurance duty regime imposes a tax on people who protect their property, businesses, motor vehicles and personal possessions by insuring them.

The non-insured do not pay the insurance duty, while the owners of underinsured assets and businesses pay less than those fully insured. Apart from operating as a disincentive for owners of assets to purchase adequate insurance, when duties on the insurance industry are one of government's main own-source revenue mechanisms, this raises significant equity concerns.

The disincentive to appropriately insure is exacerbated by the combined effect of GST charged on insurance premiums and the ESL in NSW, which significantly reduces insurance affordability and increases the risk that a household or business will underinsure or not purchase insurance.

[10] Potential buyers of home insurance are represented by households residing in a detached or semi-detached dwelling owned by the occupants outright or by mortgage.
[11] The PIF is an ICA collated dataset that contains policy records for approximately 10 million building insurance policies in Australia that were in-force as at 1 November 2017. This dataset is useful as it represents actual consumer behaviours, rather than anecdotal information and speculation. The PIF shows, for each address, what the policy holder purchased, including; the sum - insured, the premium paid, the age of the property and the excess payment preferred for making a claim.
[12] Columns 3 and 4 show the percentage of non-insurance in suburbs with highest and lowest rates of non-insurance per state, respectively.
[13] Quantum Market Research for Understand Insurance (the Insurance Council's financial literacy initiative). April 2016.

The diminished affordability arising from the imposition of state and territory government stamp duties on insurance premiums reduces community resilience to insurable catastrophic events.

Exacerbation of non- and underinsurance by insurance duties ultimately increases the Australian and state and territory governments' own financial exposure to catastrophic events through strong political pressure to meet community expectations of recovery assistance.

It has been recently calculated that over the past decade the total economic cost of natural disasters in Australia averaged $18.2 billion a year and that the total economic cost of natural disasters will reach $39 billion a year by 2050, a growth rate of 3.4 per cent a year.[14]

Research from the Insurance Council in 2015[15] examined the impact of removing state and territory insurance duties (and the Emergency Services Levy in NSW) on the take-up of house or contents insurance.

It was found that the removal of all insurance taxes and charges would result in a $643 million (or 13 per cent) increase in household expenditure each year on pre-tax insurance premium on house or contents insurance across Australia.

Also in 2015, the Insurance Council commissioned research[16] using computable general equilibrium modelling of the Australian economy[17] to determine the economic impact of removing all insurance-based taxes in all states and territories and replacing them with commensurate increases in municipal land rates/property taxes. The research found that this would lead to:

- A net increase in real private consumption across Australia of $5.52 billion
- A net increase in tax revenue collected by state, territory and local governments of $575 million after five years if this reform were implemented Australia-wide.

[14] Australian Business Roundtable for Disaster Resilience and Safer Communities, Media Release. 21 November 2017.
[15] Tooth, R, Sapere Research Group, (research commissioned by the Insurance Council), Analysis of demand for home and contents insurance, pages 24-30. August 2015.
[16] Insurance Council and Deloitte Access Economics. Impact of removing stamp duties on insurance. October 2015.
[17] Comparative static computable general equilibrium model of the Australian economy with a representative household to model the impact of these changes on private consumption (as a proxy for welfare) and government budgets is recent best practice of modelling the impact of taxes in Australia, according to Cao, L. et al. *Understanding the economy-wide efficiency and incidence of major Australian taxes*. The Treasury, Australian Government. 2015; KPMG, *CGE analysis of the Current Australian Tax System*. Canberra. 2010; and Deloitte Access Economics, *Analysis of state tax reform: Report for Insurance Council of Australia*. 2011.

4. Designing an efficient tax system

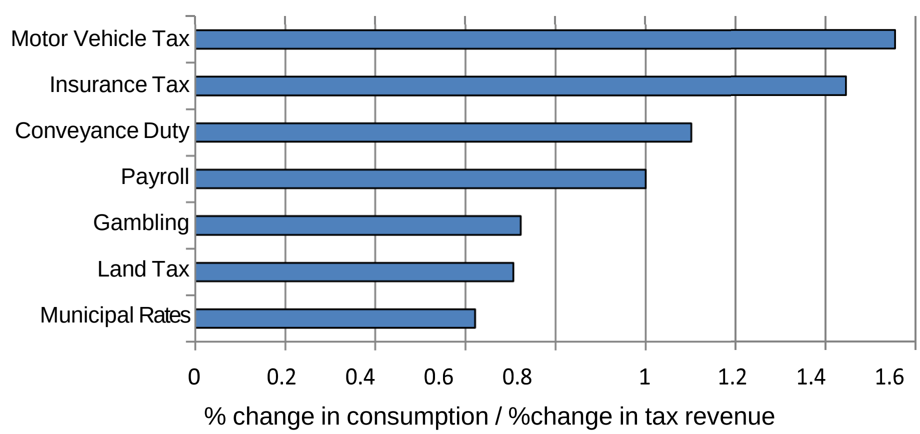
The effectiveness of a tax in achieving its purpose can be assessed against certain criteria, firstly by being equitable in terms of both horizontal and vertical equity (meaning that taxpayers with greater ability to pay, pay more tax). Furthermore, the effective tax should be:

- Transparent and simple to understand
- Unaffected by the imposition of separate taxes and levies
- Structured to minimise non-compliance
- Able to provide government/s with sufficient funding to adequately provide the services expected by the community.

Insurance duties imposed on general insurance policies do not satisfy these characteristics. Nor do they uphold the effective tax criteria of efficiency, in that the imposition of insurance duties raises premiums and as a consequence can affect consumers' choices to purchase insurance, increasing the likelihood of non-insurance and underinsurance (as discussed in earlier sections). The Insurance Council conducted an analysis[18] of the economic efficiency of state and territory government taxes to produce the rankings summarised in the chart below.

Chart 5 shows that the change in consumption reduces as tax becomes more efficient. The efficiency rankings are based on the ratio of the percentage change in real consumption to the percentage change in tax revenue and then indexed to payroll tax, which is assigned a value of 1. Accordingly, the higher the ranking the less efficient is the tax.

Chart 5: Australia-wide efficiency rankings of state and territory taxes



The analysis shows that of the primary sources of taxes and duties collected by state and territory governments, motor vehicle taxes, insurance taxes and conveyance duty are the least efficient when compared with the more efficient municipal rates, land taxes, gambling and payroll taxes.

[18] Analysis conducted in 2009 by Deloitte Access Economics in conjunction with the Insurance Council using the Access Economics General Equilibrium model to assess the efficiency of state government taxes as part of project examining stamp duty reform. The efficiency of an individual tax in the model is measured by the change in household consumption that comes from raising an extra dollar of revenue via the tax while at the same time decreasing lump sum taxes by a dollar (equivalent to raising Government transfers by a dollar). The consumption response is dependent on the size of the demand and supply elasticities incorporated into the model.

4.1 Stamp duty is a regressive tax

In 2015, the Insurance Council sourced data on average premiums, average sums insured and the number of policies at the post code level from members and combined this data with Australian Taxation Office postcode-level income data to determine the average stamp duty burden[19] at the postcode level[20].

Analysis of the data demonstrated that as incomes increase, the stamp duty burden tends to decrease. This reflects the fact that households on higher incomes have a greater propensity to reduce premiums (for a given sum insured) by adopting self-insurance strategies such as increased deductibles or implementing household mitigation strategies.

The regressive nature of insurance stamp duties should be an important equity issue for policy makers.

4.2 Stamp duty reforms

In the past two years the NSW and Victorian governments announced stamp duty exemptions for several forms of insurance covers.

In NSW, a stamp duty exemption for lenders' mortgage insurance took effect from 1 July 2017 while exemptions for certain small business and crop and livestock insurance covers took effect from 1 January 2018.[21] In Victoria, stamp duty exemptions for certain crop, livestock and agricultural machinery insurance covers took effect from 1 July 2017.[22]

While only a start on reform, the Insurance Council strongly supports the policy goals underpinning these important exemptions, chiefly as they collectively contribute to helping address the issue of underinsurance and non-insurance in Australia, which can have a devastating financial impact on people's lives.

The Insurance Council's members have invested significant resources in complying with the NSW and Victorian stamp duty exemptions. Insurers have been required to implement extensive changes and needed considerable time to develop, test and implement new systems, largely reflecting the complexity of the insurance covers that fall within scope of the exemptions. For example, many crop and livestock risks can be insured under generic commercial product lines (such as grouped or blanket commercial property covers), rather than specific, stand-alone agricultural lines. Because of this, insurers have typically needed to significantly alter systems to apply the exemptions in accordance with the new laws.

Implementing the exemptions has been a challenging experience for industry, particularly in light of the relatively short timeframes provided by governments and the complex nature of many of the insurance covers. The Insurance Council believes that more thorough industry consultation would have helped to facilitate a smoother transition process for all parties involved. For example, earlier consultation would have provided Insurance Council members with a better opportunity to identify potential technical challenges and work with governments on possible solutions. Given these experiences, the Insurance Council encourages all State

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[19] Stamp duty burden is defined as total stamp duty paid divided by income for each Australian post code.
[20] Aggregated member data from Insurance Statistics Australia database for the Insurance Council's submission in response to the Australian Government's Tax Discussion Paper. June 2015.
[21] See Revenue NSW website.
[22] See Victorian State Revenue Office website.

and territory governments, in developing any insurance stamp duty exemptions, to consult early on any proposed changes and provide a sufficient time frame for industry implementation.

4.3 Government reliance on insurance taxation revenue

The Insurance Council examined the total insurance taxation revenue collected by each state and territory government over the past 12 financial years (2007-08 to 2018-19) and the forecasted collections from financial year (FY) 2019-20 to FY2022-2023.

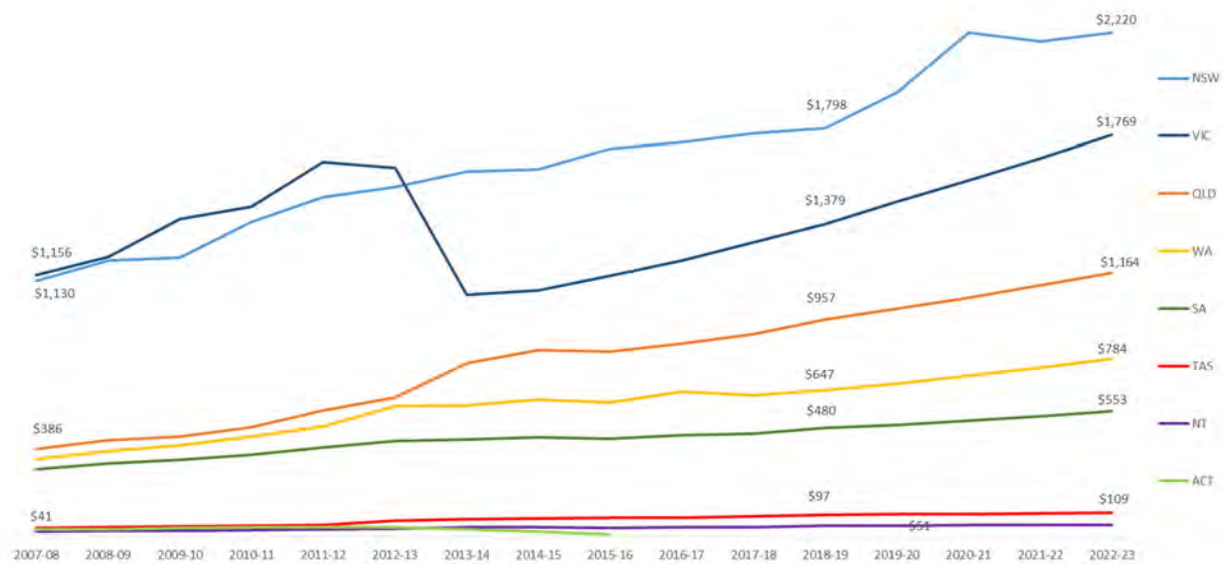
Over the past 12 years, state and territory governments together collected $54.7 billion. NSW collected the most revenue at $18.2 billion, followed by Victoria ($15.7 billion), reflecting the higher number of dwellings in each state and the growth in population and new housing developments. The ACT collected the least ($314 million). This is broken down in **Chart 7** (on page 15).

As illustrated in **Chart 6** below, over the past 12 years, each state and territory governments' insurance taxation revenue has steadily increased. The total insurance taxation revenue collected in FY2007-08 was $3.41 billion and $5.41 billion in FY2018-19, an increase of 58.6 per cent. This is projected to increase another 22.0 per cent in forecasts to FY2022-23.[23] The only state or territory that experienced any notable decline in collections over these periods is Victoria in FY2013-14. This occurred due to the abolition of the insurance-based Fire Services Levy.

[23] Estimated percentage increase in total forecasted insurance taxation revenue from FY2018-19 to FY2022-23 for the states and territories that published forecasted insurance revenue figures (NSW, Victoria, Queensland, WA and SA. ACT abolished stamp duties in FY2016-17).

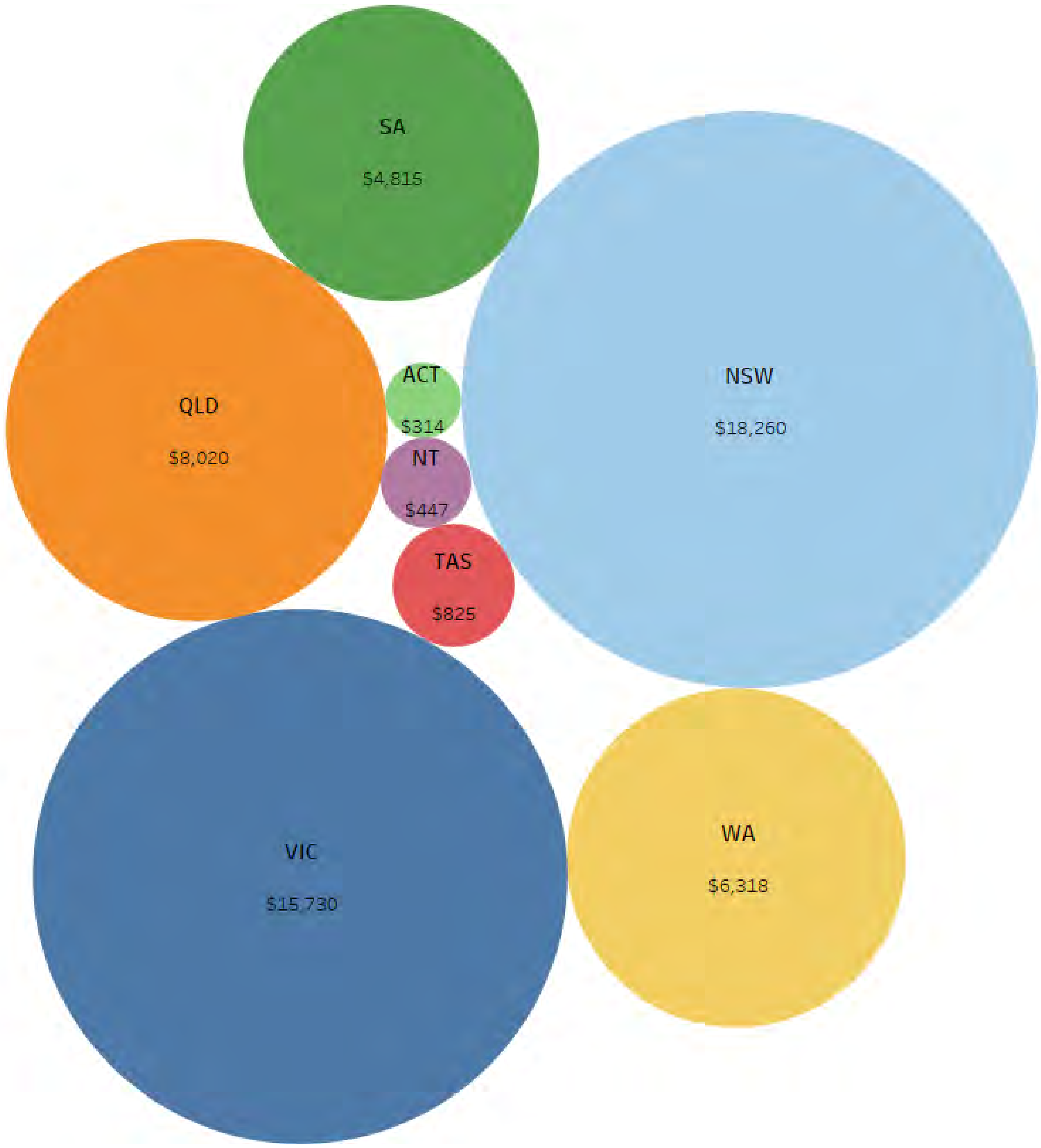
INSURANCE COUNCIL OF AUSTRALIA

Chart 6: State and territory government insurance duties and levies collected and forecasted between financial years 2007-2008 and 2022-23 ($ million)



Source: Budget and forecast figures retrieved by the Insurance Council from each respective state and territory's budget papers, for all financial years inclusive of 2007-08 to 2018-19 (current).

Chart 7: State and territory government insurance duties and levies collected between financial years 2007-2008 and 2018-19 ($ million)



Source: The Insurance Council retrieved budget and forecast dollar amounts from each respective state and territory's budget papers, for all financial years inclusive of 2007-08 to 2018-19 (current).

5. Alternative model for revenue collection

Proposals to abolish insurance duties and levies, inevitably raise the question of alternative sources of revenue. A decision to reform an inefficient tax which is diminishing community welfare would be justifiable on its economic merits alone.

However, given the practical considerations in forgoing such a significant source of revenue, an alternative is to replace insurance duties with a commensurate increase in a broad-based property levy subject to safeguards as to its impact.

The Insurance Council's research presented earlier found that this would result in an increase in real private consumption and a net increase in revenue collected by each state and territory overall. As shown earlier in **Chart 5**, a broad-based municipal or land tax is highly efficient when compared with other possible sources of taxation revenue, including taxes on insurance. The efficiency rankings highlight the scope for economic gain if state and territory governments were to shift the composition of their taxation revenue away from transaction taxes on insurance to taxes of a more fixed nature, such as municipal rates and land taxes.[24]

The Insurance Council respectfully submits that state and territory governments should implement a tax reform strategy designed to shift their reliance from inefficient, narrow-based transaction taxes to broad-based, more efficient taxes.

Provided there is adequate consideration of each jurisdiction's specific characteristics, the Insurance Council is confident that governments will be able to implement an effective broad-based property levy in the same manner most had transitioned away from insurance-based emergency services levies.

For example, in Queensland, the emergency services levy incorporates stipulated risk factors depending on the activity carried out on the property; in Western Australia, the levy is a function of service levels with minimum payments and maximum caps in place; South Australia employs a land-use factor for its emergency service calculation. The fire services property levy in Victoria is made up of a residential or commercial fixed charge and a variable charge component. The variable charge is calculated by applying the appropriate land use classification rate[25] to the capital improved value of the land.

[24] This is consistent with the understanding in the Henry Tax Review and the IPART State Tax Review. The policy objective of shifting state taxes away from transactional taxes to taxes on immobile bases was also discussed at the Commonwealth Taxation Forum in October 2011.

[25] The State Revenue Office of Victoria uses 12 variable levy rates; a metropolitan and regional rate for 6 property classifications.

6. Conclusion

Many federal, state and territory government reviews and inquiries have recommended to abolish insurance-based taxes across Australia. In recent years these have included the Australian Government's Review of Australia's Future Tax System (the Henry Tax Review), the NSW Independent Pricing & Regulatory Tribunal Review into State Taxation, the 2009 Victorian Bushfires Royal Commission, the NSW Government 2012 review: *Funding our Emergency Services*, ACT Review of Taxation, the GST Distribution Review[26] and Productivity Commission reports.[27]

A strong body of economic analysis consistently demonstrates the inequities and economic inefficiencies of taxation on insurance, including emergency services levies.

There are numerous examples across the states and territories that exhibit the successful reform of insurance-based taxes for potential social and fiscal benefit.

Broad-based taxation remains the most economically effective, equitable and efficient method to fund Australia's state and territory governments. Transaction-based insurance duties are distortionary to pricing and reduce the affordability and take-up of insurance.

Insurance taxes create an incentive for the policy holder *not* to insure by penalising them for effectively managing their risks. Accordingly, the imposition of insurance-based taxes exacerbates the serious problem of non-insurance and underinsurance. This ultimately increases the financial exposure to all levels of government when providing recovery assistance during catastrophic events

The Insurance Council urges state and territory governments to commit to and prioritise the abolition of insurance-based taxes. This would immediately improve insurance affordability and increase the take-up of insurance. Furthermore, it would reduce the need for government funding in the aftermath of natural disasters, thereby shifting the burden of disaster recovery from the public to private sector.

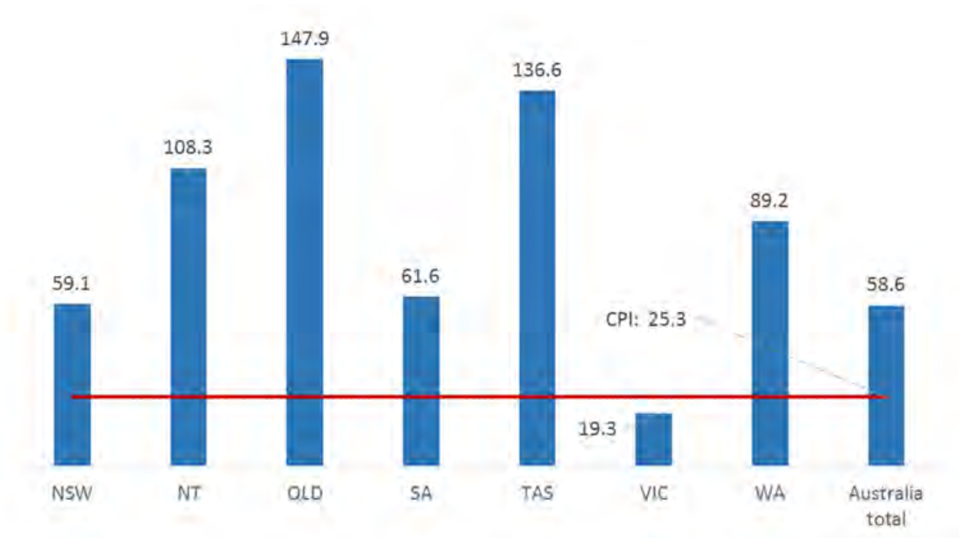
State and territory governments have the opportunity, through the removal of insurance taxes, to strengthen the long-term integrity of their revenue bases.[28]

[26] See GST Distribution Review, Final Report. October 2012.
[27] Multiple Productivity Commission (PC) reports have recommended the abolishment of insurance-based taxes including Rec 4.8 – *Natural Disaster Funding Inquiry* (December 2014); Rec 4.8 – *Shifting the Dial: 5 Year Productivity Review* (October 2017) and; Rec 14.3 – *Inquiry Report; Competition in the Australian Financial System* (August 2018).
[28] For example, the PC's October 2017 Draft Report on its Inquiry into Australia's system of horizontal fiscal equalisation underpinning the distribution of GST revenue to the states and territories.

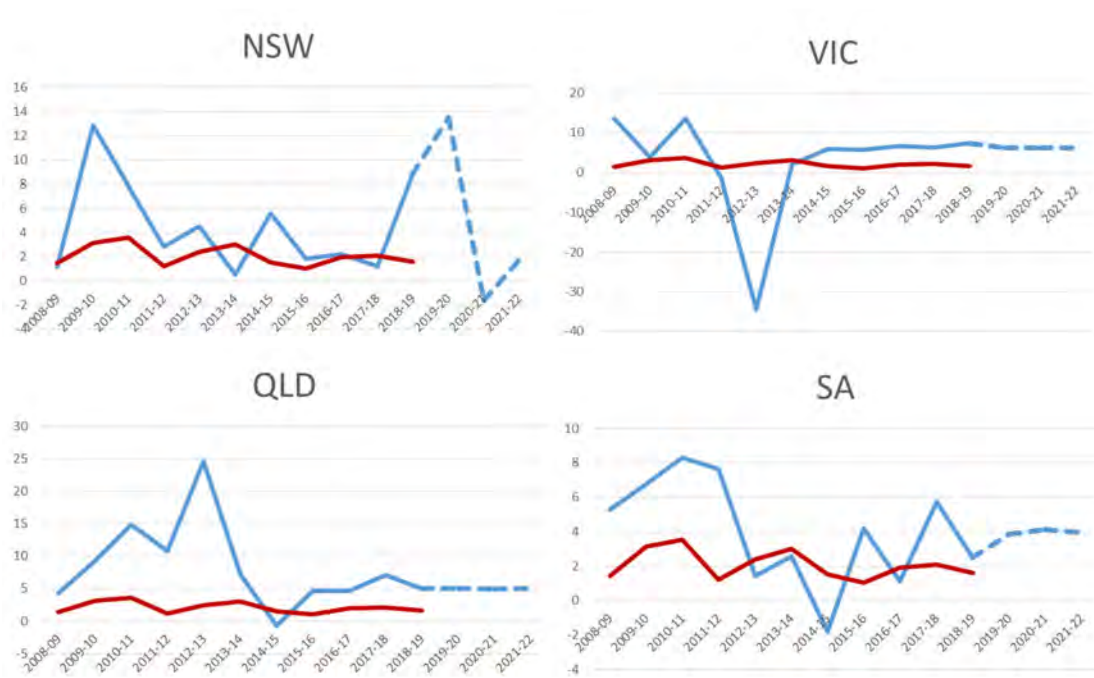
7. Appendix

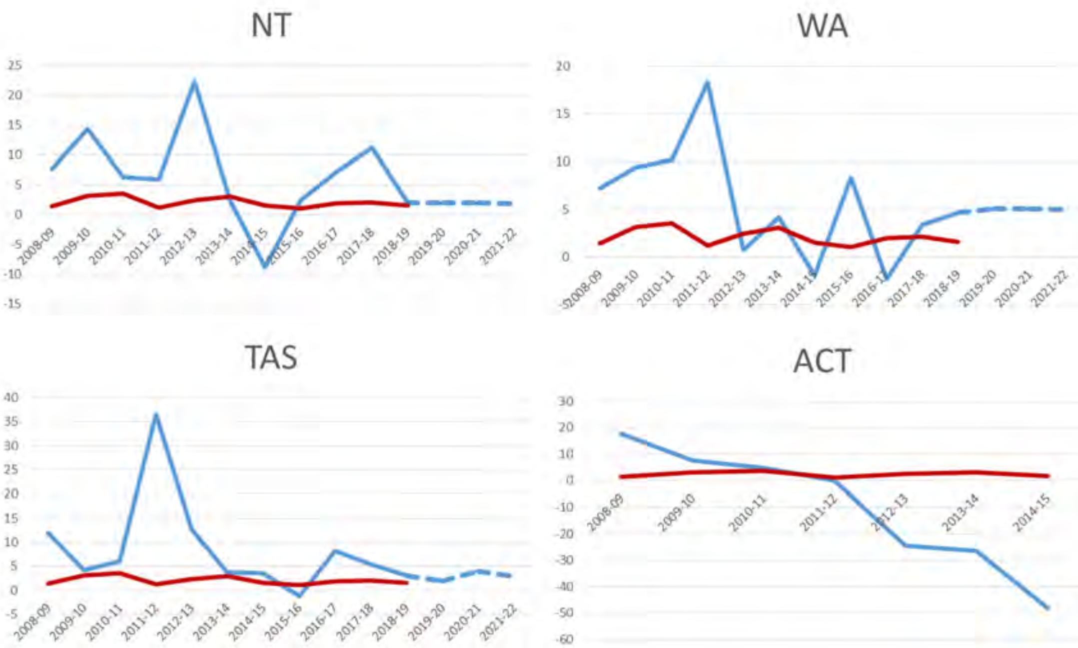
Total general insurance taxes and levies collected ($ million) – Actual and Projected

Change (%) in insurance tax collected (blue) Vs Change (%) in CPI, 200-08 to 2018-19 (red)



Year-on-year change (%) in insurance tax collected (blue) vs CPI (red) – Actual and Projected (dotted)

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