Insurance Council of Australia

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The Productivity Commission
GPO Box 1428
Canberra City
ACT 2061
By email: productivity.inquiry@pc.gov.au

To whom it may concern

Australia's Productivity Performance

The Insurance Council of Australia (Insurance Council[1]) welcomes the opportunity to provide a submission to the Productivity Commission's Inquiry into Australia's productivity performance.

In providing this submission the ICA wishes to highlight some key areas where targeted collaboration, reform and public sector investment, will drive significant productivity improvements in Australia.

Specifically, the Insurance Council wishes to highlight the productivity benefits of:

- Regulatory reform and policy settings that encourages market competition, flexibility and innovation, particularly in the financial services sector.
- A more transparent and planned regulatory and policy reform and implementation framework.
- Greater public investment in infrastructure that build community and business resilience and protection against extreme weather events and climate change.
- Removal of external and artificial barriers to insurance availability (ie. taxes and levies on insurance products).
- Building a more robust policy framework for cyber security
- A review and evaluation of current civil liability settings.

A transparent and planned regulatory and policy reform and implementation framework

The general insurance industry has recently navigated a significant period of regulatory change stemming principally from recommendations of the Hayne Royal Commission. Insurers, their customers, and regulators need time to assess the impact of these far-reaching changes before any further regulatory changes are considered. An outline of these changes is outlined in Attachment A.

Given the pace and complexity of these reforms, it is crucial that post-implementation reviews are undertaken by government and regulators in a timely way, and that they are guided by clearly articulated principles for financial services regulation. This would provide an opportunity for policymakers to repeal outdated regulation or de-prioritise any policy that may have been superseded by recent reforms based on an agreed framework.

Clearly articulated expectations and a transparent policy framework for financial services regulation would result in greater efficiency, consistency and clarity for policymakers, regulators, insurers and other financial service providers.

[1] The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95% of private sector insurers. As a foundation component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $59.1 billion per annum and on average pays out $148.7 million in claims each working day ($38.8 billion per year).

For example, in the UK, the Financial Services Regulatory Initiatives Forum (FSRIF) is comprised of the UK's financial regulators and develops a regulatory pipeline with a 24-month horizon (published as a 'Regulatory Initiatives Grid') which provides financial services sectors and stakeholders with the ability to understand and plan initiatives. This is particularly beneficial to those reforms and initiatives that have a significant operational impact.

This more transparent policy framework with clearly articulated expectations would ultimately benefit consumers by targeting policy and regulatory resources to more clearly defined areas of consumer and economic benefit. More specifically, it would also assist insurers who operate in an increasingly volatile business environment due to more frequent extreme weather events.

A regulatory framework for financial services that supports competition and innovation.

Competitive markets and well-informed consumers offer the best prospects of the financial sector meeting community needs without government intervention. Therefore, the Insurance Council is of the view there needs to be greater emphasis on competition in driving better consumer outcomes. We note this is consistent with the Productivity Commission's finding as part of its 2018 Competition in the Australian Financial System inquiry.

Given the benefits of competition, as outlined in the ICA's 11 March 2022 submission to the ALRC's review of financial services regulation, the Insurance Council endorse the Productivity Commission's support for a designated competition champion within financial services. The Insurance Council also propose that the ACCC be included within the Council of Financial Regulators (given the CFR is the primary forum for cooperation and dialog between financial regulators).

Resilience investment

The Insurance Council endorses the Productivity Commission's recommendation that Commonwealth and state and territory governments need to increase their investment in extreme weather resilience measures.[2]

In line with the Productivity Commission's 2014 recommendation for annual investment of $200 million from the Commonwealth Government to be matched by the states and territories,[3] Finity Consulting has developed a five-year program of resilience measures requiring an investment of approximately $2 billion that is expected to reduce financial costs to Australian governments and households by more than $22.6 billion by 2050. Based on an extensive review of current research, the proposed resilience program is expected to provide a return on investment of 10 nationally.[4]

In addition to better protecting property and providing premium relief, there are wider benefits that come from greater investment in resilience measures, with significant evidence demonstrating the economic benefits of more resilient communities.[5] As an additional benefit, insurance premiums can decrease with appropriate mitigation infrastructure or household-level programs.

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[2] Productivity Commission, *Natural Disaster Funding Arrangements,* Inquiry Report Volume 1, No. 74, 17 December 2014, p. 9 at https://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume1.pdf; p. 9

[3] ibid. p. 22

[4] Reaping the Rewards of Resilience, Finity Consulting Report 2022 at https://insurancecouncil.com.au/wp-content/uploads/2022/02/R_ICA_Resilience_Final_220218.pdf

[5] Deloitte Access Economics, 2021, 'Special Report: Update on the economic costs of natural disasters in Australia' at https://www.iag.com.au/sites/default/files/Newsroom%20PDFs/Special%20report%20_Update%20to%20the%20economic%20costs%20of%20natural%20disasters%20in%20Australia.pdf

Insurance Council of Australia

Given the clear productivity benefits, and evidence that climate change will see greater frequency of extreme weather events, the Insurance Council is of the view that public resilience investment must proceed as a matter of urgency.

Specifically:

- The Commonwealth Government must increase investment to at least $200 million per year ($1 billion over the next 5 years)
- State and territory governments should match this Commonwealth funding.
- The Commonwealth Government direct the National Resilience and Recovery Agency to partner with state, territory and local governments, the insurance industry and other stakeholders to establish a fully funded, five-year program of resilience programs and projects across Australia, based on need.
- To ensure its effectiveness, the five-year program should be developed through a fully transparent, non-partisan process and be subject to a robust, post implementation review process.

Removal of barriers to insurance – taxes and levies on insurance products.

State and Territory taxes and levies on insurance products add significantly to the cost of insurance. A consistent theme coming out of multiple inquires and reviews, including the Productivity Commission's 2014 report findings, has been that State-based taxes on insurance products are inefficient and unfairly burden those who seek private insurance protection to the benefit of those who do not.

Depending on the state and territory government taxes and charges can add 20-40% on to the cost of insurance premium. This contributes to non-insurance or underinsurance, adversely affecting businesses and consumers ability to obtain the insurance they need to adequately financially protected. Further, it increases reliance on governments in the event of claims.

Given the inefficiency of these taxes and levies, it is not surprising that every inquiry and review of insurance costs and affordability over the last decade has recommended the abolition of these State government charges and some have also recommended the abolition of GST.

For example, we note the Productivity Commission report in 2014 concluded on this topic with -

"Replacing state insurance taxes and levies with more efficient revenue sources, such as broad-based payroll or land taxes, would improve the price signal to policyholders and the effectiveness of insurance as a risk management tool and reduce the price of insurance. Taxes could be phased out over time, as is being done in the ACT. The resulting price decrease could also encourage households and businesses to take up insurance or increase their coverage".[6]

Despite the inefficiencies of insurance taxes and levies, they continued to be applied by governments in Australia.

In 2015 Deloitte Access economics identified that the abolition of all state taxes on insurance and replacing these with broad based land taxes would lead to a $5.52 billion net increase in household spending capacity each year, which would both increase insurance affordability as well as add extra financial spending stimulus to the economy.[7]

The tax system should encourage not hinder insurance coverage. Therefore, state and territory taxes and levies on insurance products should be phased out as a matter of urgency and be replaced with less distortionary and efficient taxes.

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[6] Productivity Commission Inquiry Report 2014.

[7] Deloitte Access Economics, 2015, 'Impact of removing stamp duty on insurance'

Cyber security

Increasing digital interconnectivity continues to create new and innovative ways for businesses to interact with customers.

Exponential growth of digitisation is transforming how organisations of all sizes store and communicate information. Moreover, developing trends such as big data analytics and smart technologies are set to dramatically boost the volume and importance of digital assets.

Increasing digitisation and connectivity brings great benefits to consumers and productivity more broadly.

However, it also increases the potential for data breaches and cyber-crime such as digital theft, with potentially huge financial consequences, the nature of which presents a unique and extremely challenging underwriting risk for insurers.

In 2017 there was an estimated 4 billion individual data breaches globally.[8] In 2018 cyber crime was estimated to cost the world $600 billion, equivalent to 0.7 per cent of global GDP or 14 per cent of the worldwide internet economy.[9]Typically, only about one third of those losses were covered by insurance.[10] Ransomware attacks are now increasingly sophisticated and more invasive, with sensitive data targeted and operating systems disabled. Consequently, the cost to investigate, repair and recover has also increased.

Cyber insurance helps business meet the various first and third-party costs related to data breaches. These policies typically include costs related to forensic investigation, data restoration, customer notification and rectification, and indemnification of penalties imposed by regulators. Where the data breach is due to the malicious act of a foreign state actor or criminal gang coverage may include costs related to the services of a negotiator, legal advice to determine if any ransom payment is legal or reportable, and indemnification of the ransom if the business decides to pay the ransom.

Cyber insurance is a rapidly evolving product. There is a low awareness of the product amongst the business community and a small number of providers. This results in a relatively small pool size within which to transfer risk. Further, the nature of risk means it can rapidly multiply, or aggregate, as unlike other insurable risks it is not easily isolated to, and hence pooled against, a specific segment or geographic region, as is possible for something like cyclone risk.

These factors, together with the increasing sophistication and maliciousness of cyber-attacks, have put significant pressure on insurers and businesses alike. Insurers are finding it increasingly difficult to provide cyber insurance, or instead provide limited insurance cover, given the high cost and difficulty in pricing cyber risk due to its rapidly changing profile. Premiums are rising and at present there are no significant factors working to reduce loss costs or induce additional capacity into the market.

The ICA is of the view that to properly address the challenges and increasing cyber-crime threat requires greater collaboration between industry and government.

In particular, the ICA propose:

- The Commonwealth government establish a whole-of government forum for stakeholders across government, the insurance industry and technology to collaborate on the policy settings that manage system risk and support good cyber security health for business.

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[8] Lloyds of London, 2018, 'A world at risk: closing the insurance gap'

[9] Oxera Economics, 2020, 'The value of cyber insurance to the UK economy'.

[10] op cit. Lloyds of London, 2018.

Insurance Council of Australia

- Government agencies, notably the Department of Industry, Science, Energy and Resources, be directed to work with the technology sector to develop minimum security requirements and third-party certifications for software and hardware to reduce the vulnerability of business software and hardware to cyber-attacks, considering international best practice.

- There be collaborative development of real time two-way threat data sharing between government and industry to help reduce the incidence of cyber attacks and to assist insurers to more accurately quantify risk (which will, in turn, bring more capacity into the cyber insurance market and reduce pressure on cyber insurance premiums, which increased significantly in 2021).

- Governments collaborate with the insurance industry to facilitate improved cyber risk reporting by businesses, which would help insurers identify risk mitigation opportunities for their customers and providing the most effective way of reducing cyber premium costs over time.

Civil Liability settings

Australia, like most countries, is currently experiencing a 'hard' insurance market which is impacting insurance availability and affordability across some sectors, particularly in relation to public liability insurance.

Insurers have struggled to maintain profitability for public liability insurance over the past three years, often experiencing combined loss ratios (losses plus expenses divided by premium) above 100 per cent, peaking at 128 per cent in 2020.[11] The hard global insurance market, characterised by scarce capital, difficult to obtain reinsurance, and low risk appetites, as well as the open class action regime that exists in Australia, means insurers are sometimes unwilling to insure some business sectors where either the risk of litigation is higher (due to the nature of service provided by the business), and/or there is inadequate risk management practices.

Tort reform was previously undertaken in 2001-02 to address insurance availability problems experienced by small businesses at that time. Given it has been 20 years since these reforms, the development of case law over this time, emerging new industries and the current difficulties many businesses are experiencing obtaining public liability insurance, a further examination of tort reforms settings and whether they remain appropriate and fit for purpose should be undertaken.

One reform option that could be examined is the use of statutory defined benefits frameworks for certain classes of personal injury claims (similar to those used in CTP and Workers Compensation insurance schemes) to reduce claims costs and durations, improve health outcomes for injured people, and increase affordability and availability of public liability insurance for businesses.

Insurance affordability and availability is also driven by appropriate risk management processes and risk mitigation activity. The implementation of appropriate national risk mitigation standards play an important role in helping businesses and organisations implement necessary risk reduction measures that will not only reduce risk of injury to people, but also put downward pressure on the cost of insurance for businesses.

The ICA therefore supports a broad review of the current civil liability settings in Australia, including examining how current setting are impacting businesses' access to affordable insurance and whether they remain fit for purpose.

Given the direct correlation between insurance affordability and risk management the ICA are also of the view that consideration be given to development of national standards and training and education

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[11] Taylor Fry, 2021, Our class-by-class insights for insurers

programs across business sectors experiencing insurance availability difficulties due to a greater frequency of public liability insurance claims.

Harmonisation and competitive underwriting of statutory insurance classes.

Across Commonwealth, state and territory governments there are multiple workers compensation and motor vehicle third party injury insurance schemes. The role that the various governments play in these schemes varies from regulatory supervision to scheme administration and underwriting.

Each of the various statutory schemes provide different benefits structures. This not only results injured workers and motorists with the same or similar injuries receiving different levels of benefits and compensation depending on where they live, who they employed by, and the circumstance of their injury, but also leads to unnecessarily duplication, operational inefficiencies and ultimately reduced productivity.

Consolidation of these multiple insurance schemes, for example establishing a competitively underwritten national workers compensation scheme, would help address these inconsistencies in benefit entitlements and inefficiencies.

Competitive or private underwriting of statutory insurance schemes, within a framework of competitive neutrality, would also provide broader customer and productivity benefits. These include:

- Allowing for greater competition in pricing
- Providing greater opportunities for innovation in claims management
- Enabling regulators to focus on regulation rather than administration
- Reduced fiscal volatility for governments (and flow through implications for taxpayers)
- Improved capital management of schemes (enhanced further through APRA regulation), with less likelihood of schemes falling into deficit.

If you have any queries please contact, Aparna Reddy, General Manager, Policy Regulation Affairs

Kind regards

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Attachment A: Examples of changes over a two-year period between 2020-2022