IAG SUBMISSION TO FINANCIAL SYSTEM INQUIRY INTERIM REPORT

August 2014

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INTRODUCTION

Insurance Australia Group (IAG) welcomes the opportunity to make a submission to the Financial System Inquiry *Interim Report*.

IAG particularly welcomes the *Interim Report* observations that:

- insurers are less likely to generate or amplify systemic risk within the financial system or in the economy;
- the Australian general insurance industry while concentrated is competitive;
- there is inconsistency in prudential setting in Australia with supporting international expansion such as the way equity investment in offshore financial services businesses are treated for capital purposes;
- there is a cost burden of regulation on business; and
- risk based pricing is an important risk signal.

IAG endorse the content and sentiment of the submissions made by the Insurance Council of Australia to the Financial System Inquiry.

COMPETITION - STATUTORY INSURANCE SCHEMES

FSI Interim Report:

> *"Submissions from insurers and insurance brokers note that some state- and territory-based statutory insurance schemes are not open to private sector competition. The two main types of statutory schemes are workers compensation and personal injury motor accidents schemes. Submissions argue that some schemes operate like government monopolies and that consumer value could be improved by introducing competition from the private sector. The Inquiry notes that stakeholders have also raised these concerns with the Competition Policy Review. The Inquiry would welcome stakeholder views on this matter."*

IAG is a leading insurer in New South Wales for compulsory third party insurance (through NRMA Insurance) and is one of the largest private sector workers' compensation providers in Australia, (as a competitive underwriter and claims service provider) through CGU Insurance.

IAG believes workers compensation and compulsory third party insurance are key drivers of economic prosperity and international competitiveness. There are significant benefits to adopting private competitive underwriting as the model for insuring statutory injury schemes.

Private competitive underwriting enables efficient allocation of resources. Private insurers reward improved safety and care of injured workers and motorists with affordable premiums. This also capitalises on the opportunities for reduced risk and accident prevention for injured workers and motorists in Australia.

The existing privately underwritten workers compensation markets in Western Australia, Tasmania, the Australian Capital Territory and the Northern Territory demonstrate an effective balance of efficient market participants and stable regulatory environments with high value outcomes for employers and their workers.

FSI Interim Report:

> *The inquiry seeks further information on: "Would opening up state and territory based statutory insurance schemes to competition improve value for consumers?"*

Privately underwritten workers compensation schemes have a number of distinctive consumer benefits including providing a competitive market for employers to locate the most favourable price, product and service to suit their individual needs. In turn the competitive market provides an incentive for insurers to invest in order to maximise efficiency and service innovation ultimately contributing to lower business costs and better safety and return to work outcomes for employers and their injured workers;. As scheme underwriters insurers also have a financial interest in providing efficient and effective claims services which support the return to work of injured workers. Further, the requirement to comply with the Australian Prudential Regulation Authority (APRA) regulatory framework provides a high level of governance around the financial sustainability of the scheme.

For compulsory third party insurance the key benefits for consumers, and small businesses include the ability to 'bundle' insurance products with the effect of reduced premiums (often, overall). In addition, if there is a risk-based underwriting, this creates some opportunity for consumers who are safer drivers to pay less for their CTP.

COMPETITION - STATUTORY INSURANCE SCHEMES (CONTINUED)

Full funding of Claims Liabilities

The Australian Prudential Regulation Authority (APRA) regulatory framework requires insurers to fully fund the cost of claims arising from workers compensation and CTP policies underwritten in any specific year. This means that premiums must be set to meet the expected cost of claims based on prudential standards which govern the estimation of claims liabilities. Full funding is a generally accepted goal of all workers compensation schemes.

The Commonwealth *Insurance Act (1973)* specifically excludes State monopoly schemes from having to comply with APRA's requirements. As a result, most publicly underwritten schemes do not comply with APRA's prudential requirements and have been underfunded on numerous occasions.

Under funding can have detrimental social and economic consequences. For example, this can happen where schemes respond to underfunding by applying a 'catch up' premium surcharge whereby today's employers pay the cost of an earlier generation's claims. Alternatively, sharp and significant reductions in injured worker benefits have been the solution.

Partial funding and inter-generational transfers have a further problem of distorting the price signal which rewards or penalises large employers for safety and return to work performance. Additionally, underfunded schemes place pressure on State Government budgets and credit ratings.

Premium Rating

Insurers in privately underwritten schemes where there is some flexibility to risk-rate, set premium rates that allow consumers and small business to lower the cost of statutory insurances based on their risk profile, or the size of their business. For example, in workers compensation, smaller employers share the risk and cost of their industry claims experience, while larger employer premiums are based on their own claims experience. In NSW CTP, lower risk consumers are charged a lower premium. The application of 'experience rating' provides an important incentive for large employers to give greater priority to safety and return to work performance.

Our experience is that employers generally perceive the link between claims experience and premium rates to be more transparent and responsive in privately underwritten schemes compared to the more complex premium formulas adopted in most State monopoly schemes. As such the financial reward or penalty in a privately underwritten scheme can profoundly impact the behaviour of large employers.

Private insurers typically offer a number of premium solutions to very large employers including conventional policies (a single annual premium rate) and burning cost policies. While the former provides a high level of cash flow certainty, the latter is a form of partial self-insurance where employers pay an administration fee plus the direct cost of their claims up to an agreed limit. Under a burning cost policy, large employers who manage safety and return to work effectively, get an immediate financial return.

Adaptable Premium Solutions

Private insurers have the expertise to adapt to different pricing models commensurate with the specific needs and characteristics of different schemes. For example, private insurers deliver to 'file and write' systems such as under the New South Wales Motor Accident scheme, the Western

COMPETITION - STATUTORY INSURANCE SCHEMES (CONTINUED)

Australia WorkCover system or the competitive market models in Tasmania, Northern Territory and the Australian Capital Territory.

Underwriting

Underwriting is a function unique to a privately underwritten environment which derives a more accurate price particularly for larger employers or for consumers who seek to lower their risk on the road.

Typically, the underwriter derives the policy premium by considering the actuarial (technical) price combined with information about the driver, or the employers own claims experience, safety and return to work capability and other information relevant to risk assessment. Underwriting enhances the risk rating accuracy of employers' premium rates. It is not adopted under State monopoly funds which adopt complex premium formulas.

Services to Injured Workers

In a privately underwritten scheme the onus is on insurers to manage their funds effectively to fully fund the cost of claims, This translates to private insurers delivering highly responsive, efficient outcome based claims management with a strong focus on worker and employer communication and effective interaction with medical and other health service providers to ensure the worker receives optimum treatment and close liaison with employers to return the worker to productive work.

Investment in Continuous Improvement and Innovation

In a privately underwritten workers compensation model, continuous improvement and innovation which enhances value for those injured in a motor accident, employers and injured workers, is compelled by market competition.

An underwritten scheme gives insurers the financial scale required to invest in high cost, high benefit continuous improvement. This is particularly relevant for information technology investment which is critical for enhancing the efficiency and quality of service outcomes.

Opening up markets to private underwriting within competitive insurance markets enhances not only the motivation for participants to invest in innovation but more diverse strategic and operational approaches to improve safety and return to work solutions. Additionally, it will attract talent to the industry as a result of broader career opportunities and reward for excellence.

Governance

Insurers in privately underwritten workers compensation schemes are governed by APRA requirements. This means insurers must maintain an extremely high risk and assurance capability covering service delivery, human resource management, operations support, compliance and fund management.

Additionally, the need to service private capital creates a natural commercial discipline to optimise efficient delivery of entitlements, quite apart from the APRA prudential and other regulatory requirements which private underwriters must observe, unlike their public counterparts.

COMPETITION - STATUTORY INSURANCE SCHEMES (CONTINUED)

Insurers operate effectively in a broad range of workers compensation regulatory environments designed to control claims, underwriting and financial performance to suit the needs of different scheme requirements. The insurance industry's demonstrated ability to perform in these different contexts is evidence of our capability to deliver effective governance under different regimes.

AGGREGATOR ACCESS TO INFORMATION

Consumer Concerns

The *Interim Report* states that aggregators or price comparison websites (PCWs) have been successful in assisting consumers to compare products in the life insurance, travel insurance and private health insurance markets. However both in Australia and in the UK there is evidence that PCWs are not as valuable or useful to consumers as presumed in the context of general insurance.

Insurance is a multi-faceted product and seemingly similar policies may have variations – such as additional covers or exclusions – that may not be obvious to a retail consumer. A consumers' decision to choose a product such as a home building policy based on a misunderstanding of that policy's features can have significant financial implications.

IAG believes our customers should receive guidance to choose the most appropriate cover for their individual needs. Comparison websites do not facilitate effective and informed decision making. Types of cover (for example. opt out flood), applicable exclusions, excesses and discounts all need to be considered to ensure the consumer purchases an appropriate product. The lowest price, on which comparison websites focus attention, does not always mean a good deal for the consumer. Consumers may be left exposed to significant financial risk and underinsurance. As noted in the *Interim Report*, underinsurance can create financial hardship for consumers as well as having a broader negative economic effect by way of costs being passed on the government particularly in the event of natural disasters.

IAG has chosen not to participate in comparison websites because we believe they are not in the best interests of our customers. IAG believes customers should receive guidance to choose the most appropriate cover for their individual needs. Insurance brokers play an important role in reviewing products across a range of insurers and assisting consumers to obtain the most suitable coverage for their needs. Our direct sales approach involves questions to help guide customer decisions and minimise underinsurance.

Importantly, underwriting and pricing questions are not consistent across the Australian insurance industry. Each insurer has its own underwriting appetite of acceptable risks and relies on a unique set of underwriting and pricing questions that enable it to confirm the availability and the terms of the cover it provides. This is particularly relevant for building insurance. Even if a set of questions could be provided to capture some of this information, insurers could not rely solely on the responses to obtain a comprehensive view of the building's risk attributes because a) the list of questions that we would need to ask would be extremely lengthy and cumbersome for an insured to complete; and b) many questions that are intended to act as an indicator of potential risk issues that then require further analysis by an underwriter.

Due to variations in business models, cover and pricing, it is difficult for aggregators to accurately and fairly make "like with like" product comparisons. Aggregators tend to provide a limited number of policy coverage comparison points. Providing simplistic comparisons means consumers are less inclined to research the different products available to them that suit their personal circumstances. As a consequence, consumers can miss out on coverage options that suit their personal needs. Consumers also risk missing out on relevant discounts available to them, along with the ability to choose the level of excess suitable to their personal circumstances which could reduce premiums.

AGGREGATOR ACCESS TO INFORMATION (CONTINUED)

In July 2014, the United Kingdom's Financial Conduct Authority (FCA) released the "Review of price comparison websites in the general insurance sector" - its second Review of general insurance PCW in three years due to concerns that customers were being treated unfairly. The Review focused on motor, home and travel insurance because they are the general insurance products most commonly purchased through a PCW. The July 2014 Review found that:

- PCWs did not always ensure that consumers were given the appropriate information to help them make informed decisions;
- PCWs did not make clear their role in the distribution of the product or the nature of service they provided;
- Where a PCW were a part of a larger group of an insurer or broker, they did not disclose this potential conflict of interest; and
- While PCWs had taken steps to comply with their regulatory obligations; they had failed to fully implement Guidance published in 2011.

In December 2013 the UK Competition and Markets Authority published provisional findings on its investigation into the private motor insurance market and related markets to see if there are any features of these markets which have an adverse effect on competition. The Report noted "In the PCW market, we found that some of the contracts between insurers and PCWs contained conditions that limited price competition, reduced innovation and restricted entry. We also identified that PCWs have a degree of market power by virtue of the number of single homing consumers (that is, consumers who do not shop around between PCWs). These wide 'most-favoured nation' (MFN) clauses, and practices having an equivalent effect where a PCW takes advantage of single homing, are a feature of the PCW market. The result is that consumers pay higher motor insurance premiums." *(UK Competition and Markets Authority 'Private Motor Insurance Investigation' Provisional Findings Report December 2013 p 2).*

Existing insurance comparison websites in Australia have also attracted the scrutiny of regulators and consumer groups, indicating that a proliferation of these sites could lead to issues similar to those faced in the UK. The Australian Competition and Consumer Commission (ACCC) Chairman, Rod Sims has recognised that comparison websites can 'mislead consumers in significant ways'[1] and the Australian Securities and Investment Commission Commissioner, Peter Kell has expressed concerns about comparator websites failure to disclose which insurers are being compared for quotes, how rankings are compiled and the use of special offers and "featured products"[2]. Additionally, Choice CEO, Alan Kirkland described aggregator sites as 'potentially misleading'[3] and the Choice 2013 Review of Insurance Comparison sites was critical of aggregators in general.

The *Interim Report* raised the option of enabling aggregators to use automated processes to seek quotes from general insurance websites. We believe any regulatory intervention to facilitate such measures would provide PCWs with an unjustified advantage over other

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1 "Empowering Consumers in the Digital Age"; Address to National Consumer Congress, 13 March 2014.

2 See "ASIC Warns Comparison Websites" , 5 December 2012 http://www.asic.gov.au/asic/asic.nsf/byheadline/12-304MR+ASIC+warns+comparison+websites?openDocument

3 "Watchdog to crack down on 'comparison' sites" 13 March 2014 http://www.smh.com.au/digital-life/digital-life-news/watchdog-to-crack-down-on-comparison-sites-20140313-34od9.html

AGGREGATOR ACCESS TO INFORMATION (CONTINUED)

intermediaries and indeed other insurers. Comparison websites are commercial entities which often distribute their own products. For example, Compare the Market, Auto & General Insurance Company Ltd and Auto and General Services Pty Ltd (AGS) are related entities and all of the participating home and contents insurance brands on the Compare the Market website are arranged by AGS and underwritten by Auto & General Insurance. Often the competition is illusory – iSelect similarly offer 12 different brands for ‘comparison’ on its website, however eight of these are underwritten by Auto & General Insurance Company Ltd. Understandably, mandatory participation in these schemes is anticompetitive and raises concerns about inadequate disclosure of financial relationships, conflicts of interest and unclear representation to consumers.

Further, regulatory intervention compelling insurers to participate in PCWs would impose a substantial cost to industry particularly if insurers were required to update their information systems to enable access by live-pricing aggregators.

Based on both domestic and international experience PCWs are accompanied by a number of consumer risks that will most likely require increased consumer protections, regulation and monitoring. We endorse the ICA’s submission that PCWs should not be viewed as a panacea to particular general insurance market conditions with respect to pricing and access.

UNDERINSURANCE AND NON-INSURANCE

As outlined in IAG's initial submission to the Inquiry, general insurance products are largely available and affordable to the majority of the Australian community (with the average home insurance premium in Australia costing $11.33 per week[4]). We refer the Inquiry to the information and arguments outlined in that submission.

However, the *Interim Report* also highlights the issue of affordability and underinsurance in areas at high risk of natural hazards and extreme weather such as flood or cyclone, and with low income earners. We note the *Interim Report* specifically requested feedback and data on the underinsurance, in particular the extent of underinsurance in Australia.

Research on Underinsurance

The *Interim Report* references Quantum Market Research (the Quantum Report) undertaken by the Insurance Council of Australia in 2013. In relation to home and contents this data indicated that 4% of home owners do not have building insurance while 7% do not have contents insurance. This data also revealed that 63% of renters don't have contents insurance.

In February 2012 IAG retained Sapere Research Group and Roy Morgan Research to undertake research into household insurance. The report (*Australian Household Insurance: Understanding and Affordability – February 2012)* looked at the level of understanding of insurance and affordability.

The research involved a survey of 1200 households in order to understand their attitudes to insurance, their decisions around how they insure in response to affordability and price issues and how this affects associated outcomes of under and non-insurance.

Levels of Non-insurance

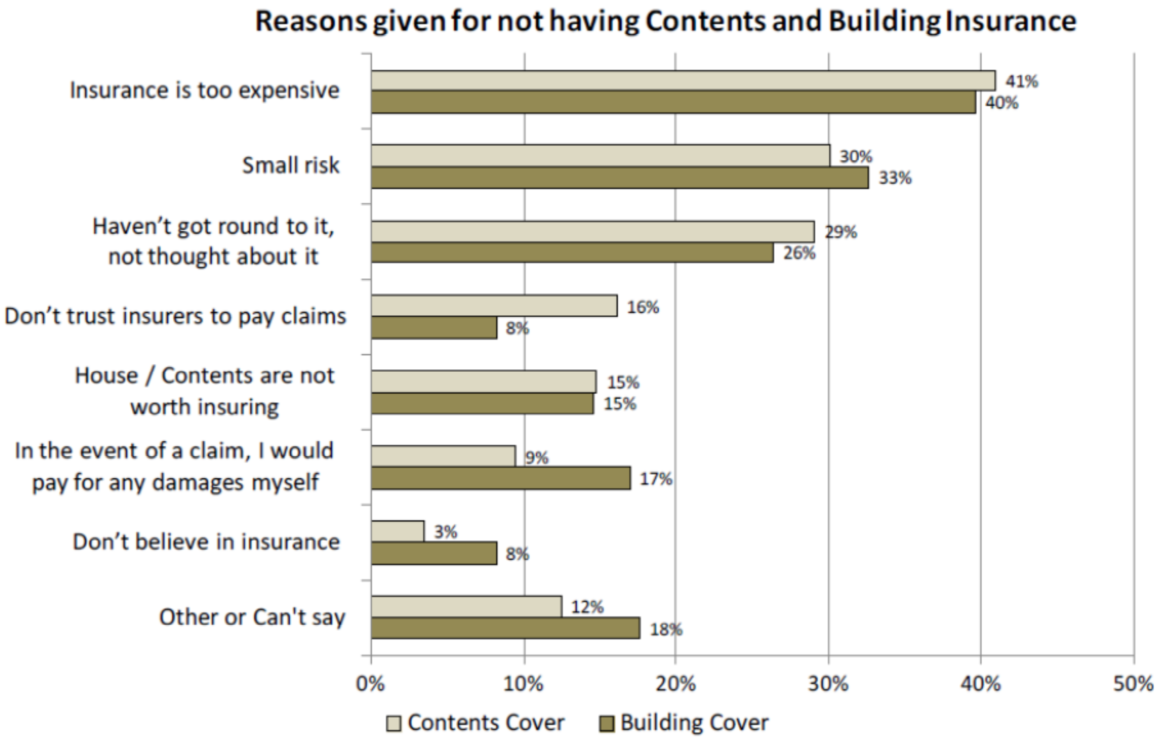
Levels of Insurance

The report had many similar findings to those identified in the Quantum Market Research illustrating that well over 90% of home owners had either home building and contents insurance or at least building insurance. It identified that 5% of homeowners only had building insurance and 2% had neither home or contents insurance. It also found that 39% of non-home owners (renters) did not have contents insurance.

Those respondents who did not have either home or contents insurance were also surveyed on the reasons why the chose to not take out this insurance. These responses are outlined in the graph below.

[4] See p 38 IAG Submission to the FSI

UNDERINSURANCE AND NON-INSURANCE (CONTINUED)



Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (2012).

The data indicates that cost/expense was the most frequently cited reason for not taking out home or contents insurance. However many respondents gave other reasons such as 'small risk' and having 'just not got around to it'. The different responses reflect the complexity of people's decision making process in determining their risk and insurance needs.

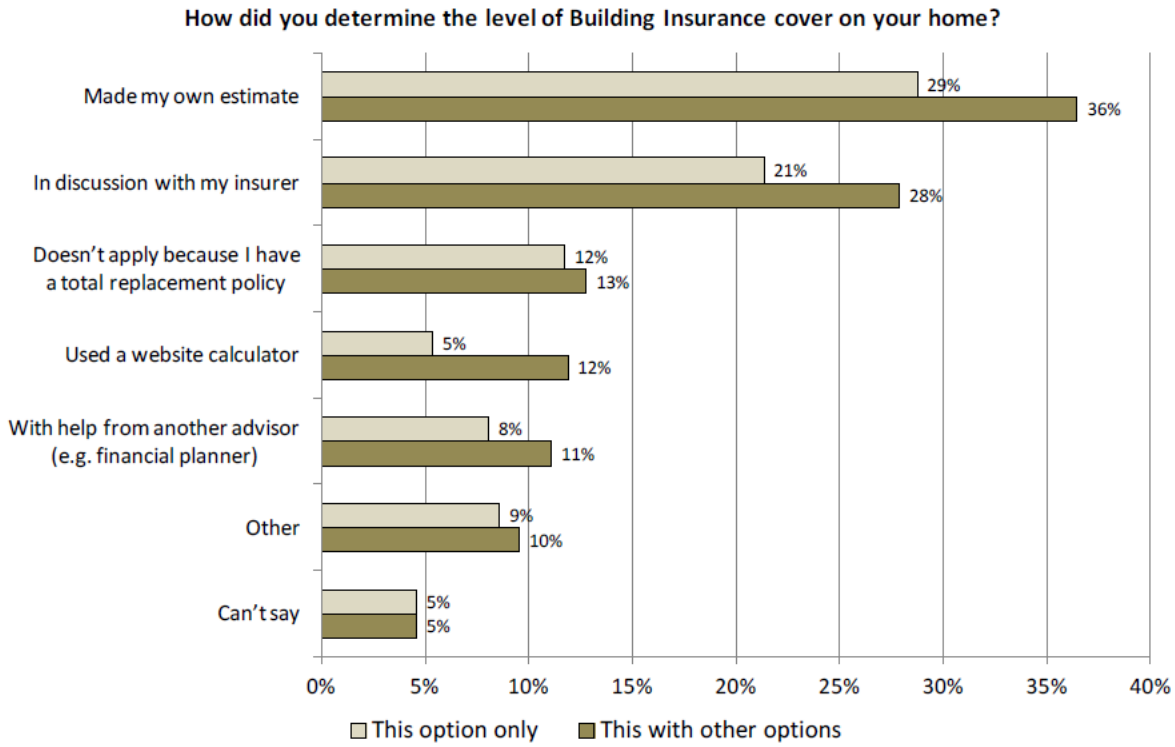
Adequacy of Cover

As outlined in the *Interim Report* underinsurance has serious ramifications for households and the wider economy. There is evidence that consumers adjust their level of contents cover to lower premium.

However the Sapere Report found that this is unlikely to occur with building/home insurance cover. Instead underinsurance in regard to building cover is the result of people underestimating the level of cover required. Within this context the method by which consumers determine the level (amount) of cover they should take out for home building insurance is important.

As part of the research, respondents with building insurance were asked 'How do you determine the level of building insurance cover for your home?'. The responses are summarised below.

UNDERINSURANCE AND NON-INSURANCE (CONTINUED)



Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (2012).

Both the findings in the Quantum Market Research Paper and Sapere Report indicate that consumer's own estimates most frequently determined the level of building insurance they took out. About 30% of households made their own estimate without any other support. Of note, the second most common method was 'discussion with my insurer'. Website calculators were only used in 12% of cases.

In Australia, home and contents insurers generally encourage their customers to take out sufficient cover to meet replacement costs. In most cases, this approach serves the customer well as a general desire to be able to replace and rebuild a home and contents. However, as the data in the table indicates, where there is a high reliance on insured's own assessment, it becomes very important that consumers have adequate information available to them in order to make an accurate assessment.

To ensure people are not unexpectedly caught out with a level of cover that is not enough to meet their replacement needs, IAG and the Insurance Council Australia have invested considerable time in developing appropriate information and estimate tools to ensure they are equipped to take out a level of cover that accurately reflects the replacement cost.

Replacement cost calculators are now a standard and easy to access part of the policy initiation process, and IAG encourages its customers to its calculators when taking out or renewing a policy. The suggested rebuilding cost is provided as a guide or indication only. There are also automatic constraints on the permissible extent of downward variation from the replacement cost values generated by these calculators.

UNDERINSURANCE AND NON-INSURANCE (CONTINUED)

However, these self assessment tools even if used by all consumers, cannot alone provide a complete solution to inadequate insurance cover. Further information and education must be provided.

Building Codes and Regulations - Consumers Need more Information from Government

A significant factor in home building underinsurance is lack of knowledge of new building laws and regulations implemented by state and local government.

In the event that a home is destroyed in a natural disaster such as a bushfire or a flood, any replacement building must also comply with codes and regulations. This adds significant additional cost to rebuilding, particularly in areas vulnerable to natural hazards and extreme weather. This was a contributor to some home owners in the Blue Mountains finding they were underinsured after their homes were damaged or destroyed in the October 2013 fires.

These laws and regulations differ depending on state and geographic location. As such, for homeowners, it is often a difficult and complex process determining what building laws and regulations apply to their house and property. Furthermore, there is often no clear information available to residents about the cost of compliance with these codes and regulations.

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For example, under current NSW regulations property owners are not required to assess a property's Bushfire Attack Level (BAL) - which then determines the building construction requirements they must comply with - unless they are seeking to build or redevelop a property.

In many cases this will only happen after a bushfire event which has destroyed or severely damaged their home – obviously this is too late to take out additional insurance to cover these extra costs. While homeowners may voluntarily undertake a BAL assessment this is infrequent given the cost involved. Further, completed BAL ratings are not published by state or local government nor are they disclosed to future purchasers.

These factors make it difficult not only for home owners but stakeholders such as insurers to understand the potential risk. IAG understands the benefits, in terms of safer and more resilient buildings, that building codes and regulations bring. Insurers have a role in assisting consumers to understand the cover they need and educating consumers about risk, and IAG is continually exploring new and more effective ways of doing this. State and local governments are responsible for implementing and enforcing rebuilding codes and regulations. Therefore government must also take greater responsibility for publicising and educating communities and residents about them and how these regulations may create additional rebuilding costs. This will help address underinsurance by giving consumers the knowledge they require to make appropriate adjustments to their insurance coverage.

Problems with Total Replacement Policies

The use of total replacement value policies has been identified by consumer advocates as a potential solution to underinsurance, particularly in relation to home and contents insurance.

Total replacement policies effectively shift the onus of estimating the rebuilding and replacement cost from the consumer taking out an insurance policy to the insurer. However, there are a number of practical difficulties with the introduction and expansion of total replacement policies in Australia.

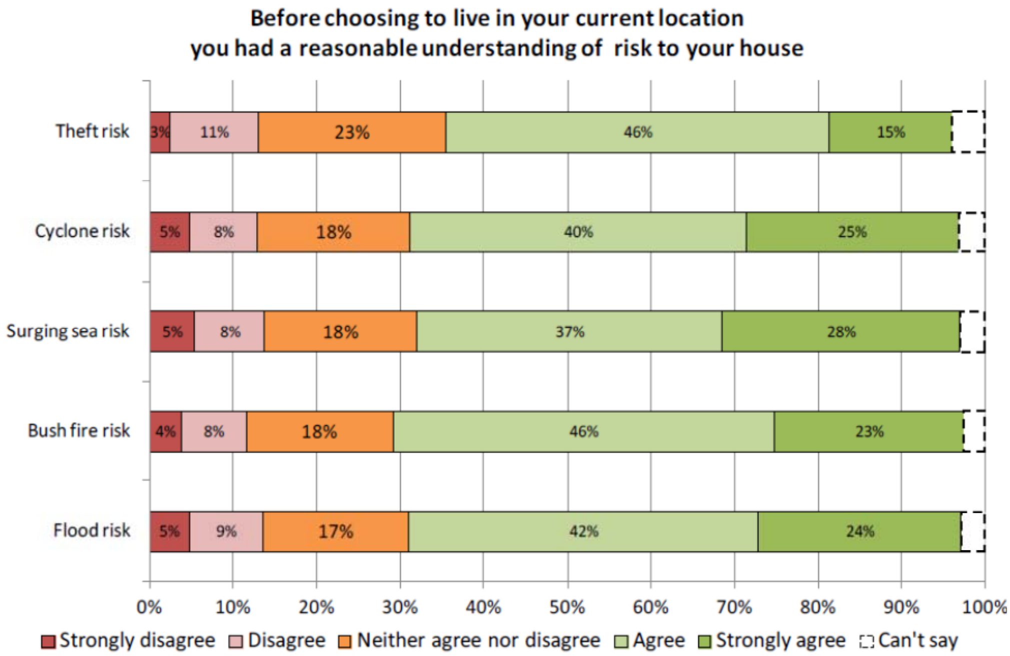
UNDERINSURANCE AND NON-INSURANCE (CONTINUED)

As acknowledged by ASIC in their 2005 report 'Getting Home Insurance Right', one problem with total replacement policies is the difficulty insurers have in obtaining accurate information about rebuilding costs. For example, different building regulations exist across the country, all of which have an impact on rebuilding costs. Insurers are often unable to obtain accurate information on all these different regulations, how they affect individual properties and how they impact on rebuilding costs.

In recent years, there has also been a movement away from total replacement policies by reinsurers. This reduction in support for total replacement policies in the reinsurance industry subsequently restricts general insurers' ability to provide total replacement cover to consumers at a reasonable price. For instance, the ICA's response to the Natural Disaster Insurance Review noted that several insurers had attempted to calculate the average impact on premiums that would occur in the event of a move to total replacement policies – the range of potential increases offered by insurers was 15% to 40%[5], Therefore, while in theory total replacement cover may be desirable, there are substantial practical barriers to insurers providing this coverage, as well as the associated affordability issues that arise.

Lack of Understanding of Cover Required and Natural Hazard Risk

The research undertaken by Sapere identified that many home owners are unaware of the risks to their home and the associated financial consequences should they decide not to insure or underinsure. Respondents were asked about their level of understanding of their risks prior to choosing to live in their current location. The findings of this part of the survey are outlined below.



Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (2012).

[5] March 2012 see page 4

UNDERINSURANCE AND NON-INSURANCE (CONTINUED)

For all risks, between 12% and 14% of respondents disagreed or strongly disagreed that they had an understanding of the risks before choosing to live in their current location. Of concern, the lack of understanding of risk with regard to flood and storm surge was greater among the sample of respondents who lived in areas at high risk for these natural hazards. For example, for those respondents who are relatively highly exposed to flood risk, over 20% of those surveyed said they did not understand their risk prior to choosing to live in that location.

These findings indicate that many consumers had little understanding of their homes' exposure to natural hazards at the time they made a decision to move into a high risk area. Clearly there is a case for more community education and provision of information on natural hazard risk to consumers, especially in light of the interim report's findings in regard the importance of price signals in encouraging consumers to manage their risk and the problem of affordability and availability of insurance to consumers in high risk areas which are likely to increase with the use or risk based granular pricing.

Lower income earners

Products providing more restricted benefits but at a reduced price could bring insurance within the reach of some lower-income households who may be currently excluded from the market. Intermediate covers (partial covers) may allow those currently without insurance due to income constraints to obtain some insurance protection to help minimise disruption to their lives when a disaster or loss occurs. Further, it might also reduce the default insurance role of governments and charitable organisations and the costs that come with this support.

The number of people that fit within this category is significant and growing. According to the Measuring Financial Exclusion Report 2014 [Centre of Social Impact for National Australia Bank], there are approximately 3 million people in Australia that are currently financially excluded. Affordable and accessible insurance products that provide for partial cover of losses appear to be a positive way to reduce this financial exclusion.

It is also expected that the underlying cost pressures in the insurance market are set to intensify rather than reduce in the future. Hence, without greater opportunities for some customers to option down existing insurance covers, price-driven exclusion and affordability stress will almost certainly increase; further compromising the benefits that insurance delivers for individuals and the wider community.

It is of course very important that customers purchasing intermediate covers are properly informed about what protection they will receive, and that the limits on the protection provided are clearly spelt out. This in turn highlights the need for robust, plain English, product disclosure requirements and appropriate investment by insurers in staff training. As part of their market oversighting role, regulators should be monitoring developments in relation to intermediate covers and highlighting any problems that arise.

However, it is equally important that such oversight and any particular regulatory requirements governing the provision of intermediate covers are suitably permissive. Put simply, moving too far down the protective path is likely to stifle product innovation that would benefit more consumers than it would disadvantage.

UNDERINSURANCE AND NON-INSURANCE (CONTINUED)

Multiple Actions required to address underinsurance

The *Interim Report*, as well as IAG's and the ICA's research, indicate that underinsurance and noninsurance remains a problem in areas at high risk of natural hazards and extreme weather.

The report has correctly identified non-insurance and underinsurance as being related to four issues being:

1. Lack of understanding of cover required;
2. Deliberate self-insuring (as opposed to unintended self-insuring);
3. Lack of affordability or suitable cover; and
4. Behaviour factors.

There is no simple 'quick fix' measure that can be implemented to solve the underinsurance problem. Instead a multifaceted approach must be taken by consumers, insurers and governments to firstly increase consumers awareness and understanding of their risk and the financial consequences of non-insurance or underinsurance, and to then arm consumers with the level of information they require for them to make a decisions about their appropriate type and level of insurance that best suits their needs.

Any policy response to address underinsurance must be proportionate to the problem identified. As the *Interim Report* identified, affordable insurance is available to 96% of Australians but a level of underinsurance will always exist. Underinsurance is a problem in areas of high natural hazard risk. This should be the focus of any policy response.

High vulnerability to natural hazard risk (insurance risk) is the biggest single factor driving insurance affordability issues and underinsurance in areas of high natural hazard risk. IAG is of the view that investment in risk mitigation and resilience measures, particularly given the increases in population density, is the most effective long term way of reducing insurance premiums in these areas and should be central to any policy response. This is currently being explored by the Productivity Commission Inquiry into Natural Disaster Funding Arrangements.

DISCLOSURE

As IAG outlined in its initial submission to the Inquiry, the general insurance industry in Australia is well regulated and there may be little cost-benefit in the short-term to overhaul the current disclosure based consumer protection regime if reforms lead to further compliance costs. However we would welcome an opportunity to contribute to work within the existing framework to streamline its operation if it would better meet consumer needs. For example by:

- facilitating insurer's use of shorter and more tailored disclosure documents;
- reducing regulation and compliance costs around providing advice for less complex products (for example motor and home insurance);
- enhancing the role of, and investment, in financial literacy and insurance education;
- ensuring policy responses take account of technological advances and consumer preferences; and
- more clearly tailor the regime to meet the type of product offering in question.

As IAG highlighted in its initial submission to the Inquiry the post-Wallis FSR regime placed an additional layer of generic product disclosure and financial advice requirements over the top of the *Insurance Contracts Act* with little accommodation of the unique nature of insurance contracts or the framework already in place.

However, amendments to the *Corporations Act* and its Regulations have facilitated more streamlined product disclosure and scaled advice. For example, reform in 2005 identified distinct classes of financial products (including general insurance) and recognized that disclosure laws should differ between these classes of products.[6]. Further, general insurance products do not have the same degree of risk nor require the same level of consumer protection as investment based products such as managed investments, margin lending or superannuation, all of which carry a much higher level of risk for a retail investor.

IAG recognises that there is potential to improve the current disclosure and advice regime in the general insurance context with the aim of helping consumers better understand products. We refer the Inquiry to the Insurance Council's submissions on this issue. IAG would support a recommendation that the general insurance sector, in partnership with government and consumer stakeholders, develop proposals for modernising disclosure and advice in a way that is tailored for general insurance context and is based around key principles such as those we have identified directly above.

[6] See Corporations Amendment Regulations 2005 (No 5) Regulation 7.9.15D, 7.9.15E and 7.9.15F