QBE submission to the Financial System Inquiry

Interim Report

August 2014

Contents

Executive summary

QBE Insurance Group (*QBE*) is one of the few Australian-based financial institutions to be operating on a truly global landscape with operations in and revenue flowing from 43 countries around the globe.

QBE welcomes the Federal Government's Financial System Inquiry (*Inquiry*) as an important opportunity to consider how our financial system can position Australia to participate and compete in an increasingly converging and interdependent global market. QBE is pleased to provide this submission in response to the Inquiry's interim report and would like to emphasise the following matters for the Inquiry's consideration:

Underinsurance

A key factor for consideration in the debate about underinsurance is the impact of state taxes, levies and duties, that add significantly to the cost of insurance. Given the importance of affordability of insurance and the potential implications of non or underinsurance on the public purse, particularly in the aftermath of natural peril catastrophes, QBE believes it is time to act to remove these inefficient and counterproductive imposts on insurance, as has been recommended by numerous independent reviews.

Aggregators' access to information

QBE is strongly opposed to a mandated policy position requiring general insurers to provide information to aggregators. Aggregators are simply an alternative commercial distribution model for general insurance, driven by profit and not necessarily the customer's best interests. QBE believes this proposal to be fundamentally flawed with likely significant unintended consequences for consumers. This is particularly so for complex insurance products like home and contents and strata title insurance, given the exposure in Australia to natural peril risk and the need for consumers to be appropriately insured for such risk.

Competition in statutory schemes

QBE is supportive of introducing competition into the non-catastrophic statutory insurance schemes and believes it is timely to consider whether it is appropriate or necessary for governments to continue to underwrite such schemes. Insurance is not "core business" for government and opening up statutory compensation schemes to private capital underwriting has a range of benefits over the current arrangements. Governments at both state and federal level have significant exposure and fiscal liability for personal injury schemes. Additionally, unlike APRA prudentially regulated insurers, government monopoly schemes are not subject to consistent prudential or pricing oversight and can be subject to, and influenced by, conflicting social and political pressures. Our initial submission, outlines in detail, the potential benefits and improved value this would provide to consumers, business and governments.

Lenders mortgage insurance

QBE appreciates the consideration given to lenders mortgage insurance (*LMI)* in the interim report. LMI has been a critical component of the housing market since 1965, facilitating home ownership and accessibility to credit for millions of borrowers. Currently internal ratings based lenders receive no capital benefit for the use of LMI, despite the fact that the LMI providers are required to, and do hold, significant capital for the risk that is transferred. APRA's specific regulatory capital regime for LMI requires LMI providers to hold capital at multiples of that held for traditional property and casualty lines. This significant and independent layer of fungible capital provides support specifically for credit default risk on residential housing, which should be recognised.

QBE believes the Inquiry should consider the important role that LMI plays in the financial system and recommend that capital relief be provided to all lenders that utilise LMI.

Focusing forward

QBE welcomes this Inquiry as an opportunity for Government and market participants to take into active consideration the need for a more productive, innovative and competitive economy. The costs of doing business in Australia should be a paramount concern in this Inquiry, now and into the future. In our initial submission to the Inquiry, QBE submitted the following seven-point plan for the Panel's consideration. QBE looks forward to our continued participation in the Inquiry and supports continued dialogue and more effective collaboration between governments and industry.

QBE offers the following seven point plan for consideration by the Inquiry and looks forward to further discussions on these matters:

1. **Government initiate a regulatory harmonisation program aimed at removing all forms of duplication, overlap and reporting on the same activity with a view to ensuring our regulatory systems operate effectively, efficiently and productively and ease the compliance burden.**
2. **Additional or changing regulation on the financial services industry operating in and/or from Australia should be:**
   - **subject to a genuine and rigorous cost benefit analysis that should also include a cost impact analysis on consumers;**
   - **balanced, by also explicitly considering the proposed reform in the context of improving and sustaining Australia's competitiveness and productivity. Regulators' performance could be assessed against this same standard, which would give due weight to the need to promote productivity and competitiveness in a dynamic global economy and maintain affordability for consumers.**
3. **APRA's mandate should be reviewed to incorporate a formal objective that the regulator consider the impact of regulatory requirements and reforms on affordability for consumers and on competition, efficiency and innovation in the insurance industry, which operates in a global marketplace.**
4. **Given the impact on affordability and potential implications for the public purse, all specific taxes on insurance premiums should be removed and the states and territories should be encouraged to implement this reform within a three year time frame.**
5. **In recognition of the important role that lenders mortgage insurance plays in our economy, Government should ensure IRB banks receive appropriate capital incentive for the use of LMI.**
6. **Consideration should be given to a national framework that moves toward:**
   - **establishing national or nationally consistent compensation schemes that interface appropriately with the other compensation schemes (particularly for workers compensation);**
   - **rationalising or standardising the disparate state and territory based intervention in various classes of insurance;**
   - **recognition that insurance is not "core business" for Governments;**
   - **defining the boundaries or role of Government acceptance of certain risks, where market based acceptance of risk is not viable or not cost effective for consumers.**
7. **Continued and more effective communication and collaboration between governments and the industry and an in depth understanding of the complexities and societal impacts involved with issues such as accessibility and affordability of insurance is needed.**

1. About QBE

QBE Insurance Group (*QBE*) is one of the few Australian-based financial institutions to be operating on a truly global landscape with operations in and revenue flowing from 43 countries around the globe.

Listed on the ASX and headquartered in Sydney, QBE has, through stable organic growth and strategic acquisitions, become one of the world's top 20 insurers with a presence in all of the key global insurance markets. As a member of the QBE Insurance Group, QBE Australia operates in Australia primarily through an intermediated business model that provides all major lines of insurance cover for personal and commercial risk throughout Australia.

QBE has been an integral part of the Australian business landscape since its early beginnings in Queensland in 1886, providing peace of mind to Australians during normal business and times of crises.

QBE welcomes the Federal Government's Financial System Inquiry (*Inquiry*) as an important opportunity to consider how our financial system can position Australia to participate and compete in an increasingly converging and interdependent global market. Our global general insurance experience and expertise gives QBE insights across a broad range of financial systems and regulatory regimes that either enable or impede a competitive, innovative insurance sector.

2. Background

QBE is pleased to provide this submission in response to the Inquiry's interim report (*Interim Report)* issued on 15 August 2014.

QBE provided a substantive initial submission to the Inquiry in March 2014. QBE also provided a separate submission outlining the significant role that lenders mortgage insurance provides in the Australian housing market and the support it provides to stability of the financial system. These initial submissions detail our observations on the important role of insurance, the emerging opportunities and challenges for the industry and the need to review our regulatory framework that QBE considers is curbing Australia's economic growth.

QBE is supportive of the Australian Government's deregulation agenda and considers that the current cost of doing business in, and from, Australia should be of paramount concern to the government, now and in the future. In our initial submission, QBE provided a seven point plan for the Inquiry's consideration, a copy of which is included in the executive summary, for ease of reference.

QBE welcomes the Inquiry's clear recognition that insurers are less likely to generate or amplify systemic risk[1] within the financial system or economy, given the absence of liquidity risk and minimal risk of contagion for insurers. QBE notes however, that the Interim Report touches only briefly on the insurance sector and contains little commentary on the role of general insurance in the financial system. General insurance is a critical part of Australia's financial system and is fundamentally important for the economy and community in the management of risk. It provides confidence to individuals that assets are protected and for business to invest in new assets and ventures.

QBE suggests the Inquiry expand its consideration of this important sector. Particularly the benefits of developing a framework as to where risk should optimally reside in the context of insurable and uninsurable risks and the role of government and the private sector. A framework of this nature is important when considering issues such as non or under insurance; which has been noted by the Inquiry as a policy matter for debate.

QBE's response to the Interim Report focuses on the specific general insurance matters highlighted for further consideration. QBE also makes some additional comments, as a global insurer domiciled in Australia, on the impact of regulation in relation to international competitiveness.

For more detailed background and commentary on these matters, QBE refers the Inquiry to its initial FSI submissions.

[1]Financial System Inquiry - Interim Report, 15 August 2014, chapter 3-6.

3. Non insurance and underinsurance

The Interim Report has raised the question of underinsurance and queried whether Australia has an underinsurance problem that warrants some sort of policy response. For general insurance coverage, the Inquiry notes that it is difficult to measure the exact level of underinsurance, as underinsurance often only becomes apparent after a loss and particularly after a large scale natural disaster.

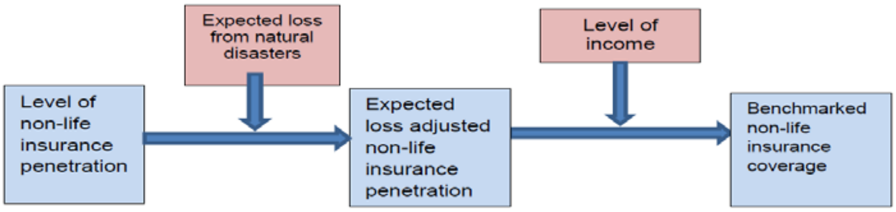
The Inquiry also notes that the information available on the extent of underinsurance is limited and that there is no agreed measure of what level of insurance is desirable. The Inquiry is seeking further information on this topic.

Underinsurance – an international perspective

General insurance is a fundamental foundation of a modern economy and touches all levels of the community and our individual human and corporate activities. A strong, stable and innovative insurance industry is critical to the smooth functioning of the economy.

QBE suggests for some international context on this topic, the Inquiry may find *Lloyd's Global Underinsurance Report, 2012* (*Lloyd's report*) useful. This report issued in 2012, contains an analysis of the penetration of non life insurance and a suggested methodology to assess the levels of underinsurance in 42 countries. The methodology applied to enable a determination of the potential level of underinsurance is described below[2]:

In order to evaluate the level of non-life insurance coverage across countries, the analysis uses a process of adjustment. The initial measures of non-life insurance penetration of each country are adjusted by the expected losses resulting from natural catastrophe and the income level of the country. This process can be represented as follows:



In terms of non life (or general) insurance penetration calculated on the basis of premiums as a percentage of GDP, the Lloyd's report notes Australia ranks seventh out of 42 countries in 2011. Once the methodology to determine a level of underinsurance is applied, Australia ranks as ninth out of the 42 countries, or within the top tier of better insured countries as detailed in the following table[3].

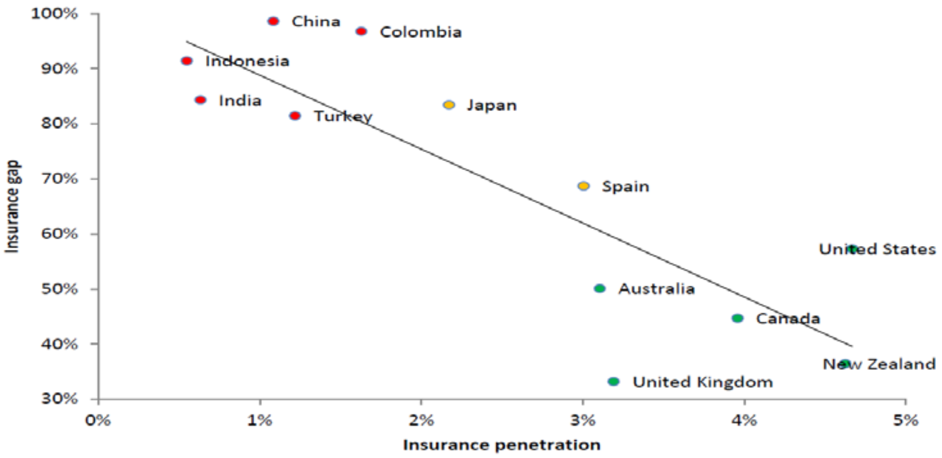
Rank	Country	Benchmarked insurance coverage	Underinsurance (US$ bn)	Rank	Country	Benchmarked insurance coverage	Underinsurance (US$ bn)
1	Netherlands	8.01	-	22	Norway	0.25	-
2	New Zealand	3.05	-	23	Malaysia	0.15	-
3	South Korea	2.55	-	24	United Arab Emirates	0.08	-
4	United States	2.53	-	25	Singapore	0.08	-
5	Canada	2.47	-	26	Hong Kong	-0.03	$0.08
6	Germany	2.11	-	27	Poland	-0.15	$0.78
7	Austria	1.67	-	28	Colombia	-0.17	$0.57
8	United Kingdom	1.60	-	29	Thailand	-0.41	$1.41
9	Australia	1.39	-	30	Brazil	-0.51	$12.68
10	Denmark	1.36	-	31	Mexico	-0.67	$7.78
11	Spain	1.05	-	32	Saudi Arabia	-0.93	$5.35
12	South Africa	1.02	-	33	Chile	-0.97	$2.40
13	Taiwan	0.97	-	34	China	-1.09	$79.57
14	Ireland	0.75	-	35	Nigeria	-1.11	$2.64
15	Italy	0.62	-	36	India	-1.18	$19.72
16	Argentina	0.44	-	37	Turkey	-1.31	$10.23
17	Israel	0.44	-	38	Egypt	-1.36	$3.20
18	Sweden	0.44	-	39	Philippines	-1.36	$2.90
19	Japan	0.43	-	40	Vietnam	-1.38	$1.69
20	France	0.39	-	41	Indonesia	-1.67	$14.12
21	Russia	0.34	-	42	Bangladesh	-2.64	$2.99
	Total underinsurance		-		***Total underinsurance***		***$168.11***

Source: "EM-DAT", World Bank, Sigma, CEBR analysis

[2] Lloyd's Global Underinsurance Report, October 2012, page 4.
[3] Ibid, page 11.

It is also helpful to consider the following diagram[4] from the Lloyd's report showing the relationship between insurance penetration and the insurance gap when considering the total damage associated with catastrophes in these countries during the period 2004 to 2011. This demonstrates that countries with a greater level of insurance penetration can be expected to incur lower uninsured losses as a proportion of the total loss.

Figure 8 - Insurance gap and insurance penetration



Source: "EM-DAT", World Bank, Sigma, CEBR analysis

The Lloyd's analysis would suggest that, having regard to international experience, Australia does not have a significant non or under insurance issue for general insurance, although we are lagging other similarly developed economies such as the United States, UK, Canada and New Zealand. Also, given that the Lloyd's report concludes a one percentage point increase in insurance penetration is associated with a reduced burden on the government and ultimately, the tax payer of one-fifth of estimated total damage this topic merits consideration by the Inquiry.

The Australian experience

The question of non or underinsurance in Australia needs however, to be considered in context.

As noted by the Inquiry, the general insurance market is competitive with a number of new insurers recently entering the Australian market. Insurance cover is generally available and affordable for the majority of consumers. The insurance industry is stable, well capitalised and functioning effectively – there is no market failure. As such, any policy intervention should focus on the specific issues or pockets of risk where underinsurance is problematic and address root causes. It should also be appropriate for and commensurate with the specific issue, rather than a broad brush approach which may distort an otherwise effectively functioning market.

Underinsurance and high natural peril risk

QBE suggests that, as identified by the Inquiry, non or underinsurance in Australia features as an issue primarily following catastrophe events or in relation to accessibility and the cost of coverage for pockets of high natural peril risk (like flood, earthquake, bushfire and cyclone risk).

This does not however, mean that there is no issue at other times. Each and every day people, communities and governments suffer the devastating consequences of non and under insurance. Rather, that awareness is more acute in the aftermath of a catastrophe event and the effects of non and underinsurance are often highlighted at these times.

There has been much written in Australia[5] on the topic of underinsurance and QBE also refers the Inquiry to the detailed findings of the Queensland Floods Commission of Inquiry 2012,

[4] Ibid, page 21.
[5] Some useful commentary is to be found in such studies as: Insurance Council of Australia, *Reponses to 2011 Natural Disaster Insurance Review,* July 2011; Institute of Actuaries of Australia, *Natural Disasters in Australia: Issues of funding and insurance,* 2010; Professor Deborah Ralston, *Underinsurance: a case of moral hazard,* Melbourne Centre for Financial Studies, 2013.

the 2009 Victorian Bushfires Royal Commission and associated reports on this topic. Also useful is the Insurance Council of Australia's research on this topic including Dr Richard Tooth and Dr George Barker's paper on *The Non-insured: Who, Why and Trends*.

From this commentary, it is clear there are a number of factors that contribute to non and underinsurance including:

- Determining the "sum insured" and estimating replacement costs can be difficult for people.
- People often do not increase the sum insured over time or to reflect increases in building costs or home improvements and renovations.
- People can choose to reduce their level of cover in order to reduce or maintain premiums at a lower level.
- Often after significant natural peril events, claims inflation, scarcity of building materials and services and also changes to improve building standards, can result in insurance coverage gaps.
- For certain types of high natural peril risk, there may be a limited or different appetite of insurers for this risk. An example is the current debate on the cost of insurance for properties in far north Queensland which has been the topic of a recent Federal Government discussion paper[6].
- Insurance may not be affordable for people, particularly those with low incomes, or for those living in areas considered as "high risk" and that are priced accordingly.
- People may choose not to purchase insurance, either considering it is not worth the benefit, or that the event is unlikely to happen and as such, concluding they do not need cover.
- People may choose not to purchase insurance on the basis that the government will step in and provide financial assistance in the event of a serious disaster creating "charity hazard", reinforcing a lack of individual accountability for managing risk.

QBE believes there are a number of important background and behavioural factors in Australia that need consideration in this debate.

- Research based on behavioural economics demonstrates that people tend to underestimate what the damage caused from a potential disaster would be, and therefore what coverage is required[7:]
- Consumers in Australia often see insurance as a "grudge" purchase. As the Insurance Council of Australia in its initial submission to the Inquiry states[8] insurance is often not perceived in rational terms. Rather, individuals consider paying premiums to insurance companies with no perceived "return" as unfair and insurance cover becomes a grudge purchase (except of course at times of claim). This perception is exacerbated during times of disasters when it is often expedient for media and governments to blame insurers, adding to reputational issues for the industry and increasing the reluctance of consumers to insure, further expanding the cycle of non and underinsurance.
- In recent times, there is a growing expectation by consumers that governments will intervene and provide support for individuals. Consumers using new platforms such as social media are relatively more powerful, demanding action and intervention by governments. This is often true for small minority groups as well. Concerns raised are often based on anecdotal evidence, rather than hard data that considers objectively the performance of such a large industry that manages and pays many millions of claims in any year. Extensive media and social backlash from such campaigns then leads to public policy responses that can be reactive and focused on quick "solutions" which may not adequately consider longer term impacts and distortions.

The importance of risk based pricing in insurance

Given the level of catastrophe peril in Australia, if people and communities are not insured or are not adequately insured for this risk, this will directly impact government budgets. Equally problematic and unpopular, are additional taxes or levies imposed by governments after catastrophic events to fund assistance.

[6] Federal Government, *Addressing the high cost of home and strata title insurance in North Queensland,* May 2014.
[7] PricewaterhouseCoopers-UK, *Behavioural economics: Driving better customer outcomes,* 2014, page 6.
[8] Insurance Council of Australia, *Submission to the Financial System Inquiry,* March 2014.

In its report on global underinsurance, Lloyds considers five natural catastrophe case studies occurring between 2004 and 2011 to examine the role of general insurance in reducing costs to the taxpayer and increasing the speed of recovery. The analysis undertaken by Lloyds concludes that a one percentage point increase in insurance penetration is associated with a reduced burden on the government, and ultimately the taxpayer of one-fifth of the estimated total damage[9].

Against this backdrop, is the increasing concern over the level of premiums being charged by insurers for those individuals who are located in areas of "high risk”. This is however, a very complex issue that requires considerable unpacking and debate by stakeholders prior to the implementation of policy measures by Government.

The progress in Australia over the last decade with industry and government initiatives like sharing of flood risk data, flood mitigation projects and studies into strata building risks from cyclonic weather in far north Queensland has increased our understanding and helped reduce uncertainty for insurers when considering and pricing these risks.

This benefits the majority of consumers in areas of low or medium to high risk, however, there are areas where legacy issues exist and the risk is relatively high, for example, some existing developments and strata in far north Queensland. Further, local council, state and territory governments continue to allow development in areas that are considered high risk flood or bushfire zones with limited risk mitigation strategies required of developers. This increased concentration of people, infrastructure and economic activity in areas exposed to significant natural peril risk, is a key driver of increasing loss, particularly when the urbanisation occurs without appropriate mitigation to reduce vulnerability.

As insurers on the one hand develop more sophisticated methodologies and data to understand risks at a more granular level, technical pricing and our current prudential regulatory regime requires that insurers in Australia hold capital for such risks with consequent flow through effects on pricing. Similarly, regulators are requiring insurers to purchase more reinsurance than ever before. On the other hand, this inevitably means that those individuals or consumers who are considered to constitute a high risk will have that risk reflected in the higher insurance premium required to be paid to the insurer to cover that risk.

This has exacerbated the debate around non insurance, under insurance and the issue of accessibility and affordability of insurance for natural peril risk, which is currently under the spotlight at an Australian political level.

Insurance pricing plays a critical role for society by alerting individuals, communities and government to important information about the existence and nature of specific risks. In pricing risks, insurance companies give a signal to the market as to how they see that risk. In an efficient market, this is desirable, with price providing an appropriate signal to individuals, society and governments about the increased level of risk and encouraging risk mitigation. Optimally, this would lead to action being taken to stop allowing development in inappropriate areas or by ensuring that new dwellings and construction in "high risk" areas meet building standards that would significantly reduce the potential damage of a significant weather event.

Conversely, if pricing signals of risk are lost or distorted in any way (for example by cross-subsidising or by Government subsidisation and/or regulation), market information is lost, and risk is likely to increase. When individuals believe that governments will step in and provide a safety net there is significant risk of “charity” hazard as communities and individuals have less incentive to mitigate or insure their risk and take personal responsibility.

Recent increases in insurance premiums for areas of high natural peril risk in Australia are providing an important and clear signal of risk of which individuals, communities and all levels of Government need to be cognisant. The higher cost of insurance is obviously a concern for those living in areas that are assessed as “high risk”. From an insurance perspective however, there is an issue when differentiated premiums are viewed by society and politics as unjust and discriminatory and public policy measures are introduced to address the perceived inequity. With the recent debates on the affordability and accessibility of insurance and the potential implications of non or underinsurance on the public purse, finding workable solutions to mitigate risk and build more resilient communities is an important sustainable longer term solution.

[9] Op.cit, Lloyds, page 38.

Where should risk lie?

Clearly not all risks are insurable. Where risk should lie is becoming increasingly complex as risk is rapidly aggregated and accumulated with increased urbanisation and the economic losses caused by natural and other hazards, continue to rise.

QBE considers it is critical that further engagement and collaboration with consumers and all levels of Government continues to:

- increase understanding and awareness of how insurance operates and enhance the reputation of the industry; and
- ensure the insurance industry understands and operates to meet the needs of its customers and consumers.

Insurance is socially valuable and an effective tool for transferring and mitigating risk however, the expectation that insurers alone can bear this risk is not realistic. Increasing natural peril risk and loss feeds directly into an increasing requirement for recovery funding with direct impact on the fiscal spend for Government. According to a study by Deloitte Access Economics in 2013, the economy wide cost of natural disasters in Australia was over $6 billion in 2012 alone. Disregarding the effects of possible climate change, this was estimated to double by 2030 and to increase to a yearly average of $23 billion by 2050[10].

Government clearly has a role to play, particularly in ensuring that appropriate incentives are in place for reducing and mitigating risk. Cohesive action needs to be taken to stop allowing development in inappropriate areas and by ensuring that new dwellings and construction in “high risk” areas meet building standards that would considerably reduce the potential damage of a significant weather event. High risk legacy issues need to be identified, prioritised and mitigated. Often there can be conflicting objectives which creates considerable tension between government, developers’ and consumers' expectations and insurers’ appetite for risk and regulatory obligations.

The insurance industry and QBE accepts our vital role in protecting the financial well-being of individuals, households and communities. The insurance industry manages and prices risk and provides insights and advice on mitigating against natural catastrophes. QBE welcomes recent efforts to improve disaster coordination between Government agencies and insurers, and steps taken to improve risk mitigation.

Increasing consumer understanding and awareness

The insurance industry has responded to community concerns in various ways to alert and educate consumers of the risks of non and underinsurance. There have been extensive efforts[11] from insurers, industry and governments to increase consumers’ understanding of insurance and the importance of being adequately insured.

QBE believes that consumer reforms in the past decade have generally benefited both consumers and the insurance industry, assisting to increase consumer understanding of insurance and insurance products. For QBE's further comments on disclosure, please see section 7.

Increased transparency and disclosure to purchasers of property by local governments in high natural peril risk areas should also be considered in this debate. Although there are clear legacy issues to consider, looking forward, local government disclosure of natural peril risk to consumers - at time of purchase or occupation - would enable better informed choices to be made by individuals enabling them to take more personal accountability and responsibility.

There is a significant risk of moral and charity hazard when individuals are not held accountable for their actions and believe that governments will step in and provide a safety net. Without personal accountability, individuals have less incentive to mitigate or insure their own risk.

[10] Deloitte Access Economics, *Building our nation’s resilience to natural disasters – Prepared for the Australian Business Roundtable for Disaster Resilience and Safer Communities*, 2013.
[11]Some of these initiatives include the recent launch of the industry's *Understanding Insurance website*, the availability of uplift cover, indexation and estimation tools provided by insurers to assist consumers appropriately estimate the sum insured.

Removing state taxes and levies – increasing affordability

Numerous reviews, including the recent Henry Tax Review, have unanimously found that state taxes, duties and levies on insurance are very inefficient and in fact counterproductive. One major concern, is that the level of taxes applied to general insurance policies impacts the affordability of insurance in the community and in all probability, decreases the level of insurance in Australia.

Given the importance of affordability of insurance and the potential implications of non or underinsurance on the public purse, QBE believes it is time to act to remove all these specific imposts on insurance, as has previously been recommended. Further, state and territory governments should be actively encouraged by the Australian Government to implement this reform within three years.

The Inquiry should affirm the previous recommendations by numerous reviews that all specific state and territory taxes, stamp duties and levies on insurance premiums should be removed and that the states and territories should be encouraged to ensure this occur within a three year time frame.

The need for a collaborative approach

QBE appreciates that these considerations are complex and it is unlikely that there will be a simple solution to the issue of underinsurance and high natural peril risk that can be adopted holistically. There has been considerable progress in increasing transparency around the operation of insurance and disclosure of insurance products in recent years. QBE considers the debate may be enriched with further behavioural economic studies into consumer behaviour, to better identify the drivers of consumers' reluctance to adequately insure.

QBE believes the question of underinsurance needs to be put in context. It is important that:

- **any public policy intervention in insurance markets be carefully considered and tailored to address the root causes of underinsurance, rather than a broad brush and reactive response that could operate to undermine the broader market insurance offering;**
- **there is an increased understanding of the economic aspects of consumers behaviour that drive underinsurance; and**
- **individually, and as an industry, we continue to work collaboratively with all levels of Government to promote risk awareness, develop better risk data, build resilient infrastructure and embed appropriate incentives to achieve these aims.**

4. Aggregator access to information

Interim report policy option for consultation

The Interim Report states that despite the high level of concentration in the general insurance sector, few submissions have raised concerns about competition. Where concerns were raised, the main issue was aggregator access to general insurance information. The Inquiry has sought views on the policy option of enhancing aggregator access to this information.

Market intervention is not appropriate

Aggregators or comparison websites are, in effect, an alternative commercial distribution model for insurance products and are driven by profit.

QBE believes the case for market intervention in this situation has not been made and is inconsistent with the Federal Government's current de-regulation agenda. Additionally, as noted in the Interim Report[12]

> *The Inquiry emphasises the importance of market forces and competition in any cost-benefit analysis. The financial system has the ability to evolve successfully in*

[12]Op.cit, Interim Report, chapter 1-6.

response to market signals without government intervention in many situations. In many cases, the best outcomes may be for the Government to allow market forces to operate...

The insurance sector is highly regulated, with prudential oversight by APRA and with market conduct of the provision of financial services, supervised by ASIC. There has been no market failure or significant consumer detriment that would indicate policy intervention mandating the provision of information to aggregators by general insurers is required.

Government intervention that distorts or destabilises a functioning market runs the risk of thinning or undermining the availability of private insurance. If private insurance cover becomes scarce, it is simply a question of time before the Government will be required to fund losses, which will have significant implications for budget expenditure.

Overseas experience of aggregators

Insurance aggregators have been embedded as a mature distribution model in certain markets overseas for some time with greatest penetration in simple insurance products, such as motor insurance. Overseas experience of insurance aggregator or comparison website models has demonstrated in such markets as the United Kingdom (*UK)* and Europe, that there can be significant issues with the operation of these models.

In this respect, QBE refers the Inquiry to two recent reports[13] on the operation and practice of aggregators or comparison websites from the Financial Conduct Authority (*FCA*) (July 2014) and the European Insurance and Occupational Pensions Authority (*EIOPA)* (January 2014). These reports illuminate some of the issues and concerns for consumers with this distribution model, which are touched on briefly below.

Aggregator and comparison websites - focus on price

Numerous studies and reports have found that the primary focus of insurance aggregator or comparison websites inevitably revolves around comparison of price.

A report by Accenture[14] on the evolution of aggregators in the UK notes that price is widely regarded as the single most important factor for the majority of UK consumers when choosing an insurance provider and price sensitivity of aggregator business is between two and three times higher than comparable direct on line books. EIOPA[15] notes in its recent report that consumers using a price comparison website (*PCW*), tend to over-rely on the price of products rather than the underlying terms and conditions.

Similarly, the FCA's consumer research found that consumers were price focused when using a PCW, which was corroborated for the FCA by the aggregators' own data on consumers using their services. The FCA also found that aggregators present the price of the core product more prominently than other information which, combined with the shortcomings in information provision, leads to a large number of consumers buying the cheapest product (even where this may not be the most appropriate).

A recent paper by released by PricewaterhouseCoopers[16] in the United Kingdom on behavioural economics and driving better customer outcomes, provides some insight as to the attraction for consumers in this respect. The paper states that financial products are inherently complex for most people. Faced with complexity, customers may simplify decisions in ways that lead to errors, such as focusing only on headline rates[17].

PricewaterhouseCoopers goes on to say that, as financial products usually have a substantial effect on the long term wellbeing of customers, a poor decision made can have a highly significant effect on the consumer.

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[13] Financial Conduct Authority *Price comparison websites in the general insurance sector,* 2014; European Insurance and Occupational Pensions Authority, *Report on Good Practices on Comparison Websites,* January 2014.
[14] Accenture, *The Evolution of Aggregators: Impacts and Future Challenges for Insurers*, 2010, page 4.
[15] Op.cit, EIOPA, page 7.
[16] PricewaterhouseCoopers, Behavioural economics: *Driving better customer outcomes*, February 2014, page 3.
[17] Ibid, page 3.

Commoditisation of product and risks of inadequate cover

The predominant focus and sensitivity to price that is reinforced by the aggregator distribution model has led to product offerings overseas that have become increasingly commoditised, with a primary emphasis on price, over value. A useful example is the provision of motor insurance in the United Kingdom. The aggregator experience in this market over recent years has profoundly changed the provision of motor insurance, fuelling what has become a low value commodity market, with insurers forced to compete mainly on price.

The outcome has seen insurers reduce or strip product offerings to a “core” product so that pricing of their product can feature in the top rankings of comparison sites. The risk is that this reduced offering can leave the consumer with inadequate or inappropriate cover, and a product that may not suit their needs.

While some types of insurance, such as motor insurance, may arguably lend themselves more readily to commoditisation, it has been recognised that this distribution model may not be appropriate for other more complex insurance products[18]. Particularly for products where more information is required than usually can be obtained by a short set of questions and where customer engagement on the specific insurance requirements is important, such as home and contents insurance.

Consumer outcomes

In terms of consumer outcomes, the FCA in its recent thematic review of insurance aggregators found that:

- Aggregators did not present sufficient product information in a clear and consistent way to ensure consumers were given appropriate information to allow them to make informed decisions.
- While aggregators may provide choice in the number of providers and products available, they had not always taken reasonable steps to ensure consumers had the appropriate information to allow them to make informed choices for both core policy and add-on products. This increases the risk that consumers may not always achieve fair outcomes, as they may buy products without understanding key features such as level of cover, excess levels, main exclusions and limitations.
- Some consumers believed erroneously that the aggregator had provided them with advice or guidance with quotes on the best policy for their needs. Also, that they had assessed the suitability of the policy for them or gave assurance regarding the security of the provider.

There has also been quite extensive evidence[19] in Australia in relation to concerns over the quality and accuracy of data and information on aggregator sites, with both the Australian Prudential Regulatory Authority (*APRA*) and the Australian Securities and Investments Commission (*ASIC*) noting concerns about the operation of such websites.

In December 2012, ASIC released a warning to operators of insurance and credit comparison websites of the need to ensure compliance with consumer protection laws. ASIC advised it was focused on ensuring they were providing accurate information and not misleading consumers. ASIC identified a number of concerns, including that some of the websites:

- compared only a limited number of brands/products from a limited number of providers. This may not be clearly disclosed which creates the impression that the extent of comparison is much broader than it actually is;
- used ‘ratings’ and ‘rankings’ for products without a clear explanation of the basis for those ratings and rankings;
- referred to ‘special offers’ and ‘featured products’ without properly explaining the basis of selection of certain products;
- provided insufficient disclosure relating to website operators who were related to the issuer of the insurance brands being compared;
- provided comparisons on the basis of price without any warning that different products may have different features and levels of coverage, and
- were not appropriately licensed or authorised to provide financial services.

[18] Op.cit, EIOPA page 7.
[19] APRA *Insight Issue 3,* 2013, ASIC 12-304 *ASIC warns on comparison websites,* 2012.

ASIC also reminded operators that websites that allow consumers to obtain and/or compare insurance quotes, will generally be providing financial services, and will need to be licensed or be an authorised representative of a licensee. Subsequently, ASIC has moved to take specific action against individual operators, as has the Australian Competition and Consumer Commission (*ACCC*)[20].

Disclosure of aggregator remuneration and conflicts of interest

As noted above, aggregators or comparison websites are in effect an alternative commercial distribution model for insurance products and are driven by profit. Overseas regulators have expressed reservations and concerns that aggregators often do not make it clear what role they were performing when providing quotes "with 'less sophisticated buyers' misunderstanding the role played by aggregators".

Also noted as a concern, is a lack of transparency or misleading information provided to consumers around the remuneration structures of aggregators[21].Similarly, regulators have highlighted a lack of transparency and the potential for conflicts of interest, which could stem from close commercial links between insurers or brokers and aggregator operators, with many aggregators owned by, or affiliated with, particular insurers or insurance brokers.

Aggregator business models typically depend on high volumes in order to maximise revenue, which can be fee based on pay per new business conversion, or pay per click or advertisement, or a combination of these arrangements. As such, aggregator's marketing strategy and business models are dependent on and encourage churn[22] regardless of consumers' needs and requirements. As the aggregator model in essence precludes customer loyalty, aggregators have to renew their existing market share on an ongoing basis.

This has seen a heavy investment by aggregators (and consequently insurance companies) in marketing, with a significant spend on advertising in order to attract new business which adds, possibly unnecessarily, to transactional costs.

Aggregators overseas are now facing pressure for profitability with margins squeezed. The combined impact of social networking, content search and other online consumer analytics services (eg Google) entering this space, means aggregators are clearly looking to other markets to maintain profitability. This trend is seen in overseas markets where aggregators are shifting from a "growth" to a "share stealing" strategy as the market has matured[23], however this is not without consequent risk for consumers.

Impact on insurers

It is clear that the advent of aggregators in the United Kingdom motor insurance market significantly impacted the profitability of insurers and distributors, with unsustainable outcomes. As a result, many insurers have left or are planning to leave the market to seek better returns on their capital and investment[24]. Profit in the UK motor market is largely dependent on investment income and ancillary sales to create a return on invested capital.

The UK general insurance market is substantially deeper than the Australian market and a similar experience resulting in reduced product offerings, worsening deals for consumers, reduced competition and market exits, is obviously not the result either the Australian Government or the general insurance industry wants, and is certainly not in the interests of consumers and communities.

There are other implications for insurers that have been demonstrated by the UK experience with aggregators:

- The focus on price as a decision factor for consumers and the increased commoditisation of insurance products brought about by the aggregator business model means there is less ability or opportunity for insurers to differentiate themselves with service, claims

[20] ACCC, most recently issuing an infringement notice for an alleged false or misleading representation in its health insurance advertising to Compare the Market Pty Limited.
[21] Op.cit, EIOPA, page 7, FCA, pages 12, 13.
[22] Op.cit, Accenture, page 7.
[23] Data Monitor, *UK Insurance Aggregators 2012, As growth in channel volume plateaus, the marketing war continues,* 2012.
[24] Ernst & Young, UK, *Bringing profitability back from the brink of extinction – a report on the UK retail motor insurance market,* 2011, page 36.

handling experience and expertise or strength of insurer brand, as factors to attract consumers, when acquiring insurance. All insurers are not equal and consumers who have made decisions based primarily on price will only experience this differentiation at the time of claim, which can lead to reputational issues for the industry.
- The rise of online sales is compromising data quality and increasing application fraud, with inaccurate information potentially undermining the quality and value of insurers' databases, with consequent impacts on risk and pricing decisions[25].
- Overseas experience has demonstrated that aggregator models ruthlessly expose any price weakness, with a number of insurers suffering significant losses accordingly.
- Aggregators are increasing their expenditure over time at a considerable rate with TV advertising accounting for the majority of spend, contributing greatly to the cost of acquiring customers.

QBE's position

QBE submits that developing an aggregator for the comparison of home and property insurance (rather than motor) is far more complex and that this type of insurance will not translate effectively into an aggregator model. Property insurance is complex. It is important for consumers to understand the relevant offerings and choose cover that is suitable for their individual needs. A distribution model that inevitably leads to a "dumbing" down of cover with a focus purely on price has a strong likelihood of resulting in inappropriate or insufficient insurance cover for individuals. The efforts of the industry to increase education about insurance and the importance of suitable cover will be negated, if not reversed.

Unlike motor insurance, where people can make do without a car, making do without a place to live, creates the risk of personal ruin. A home is often an individual's greatest investment and its loss can be a life changing event. The importance of obtaining appropriate insurance to protect against this risk is critical. This is the likely reason why an aggregator model for home and building insurance has not achieved similar penetration to motor insurance in the UK (and Australia).

Additionally, QBE considers the set up and ongoing compliance costs of participating in a live quote aggregator model, together with the increasing advertising and marketing costs, to be prohibitive which would place further pressure on insurer profitability. This ultimately may see capital currently invested in the sector seek more stable and less volatile returns, with consequent longer term impacts for consumers and for the economy.

QBE is strongly opposed to a mandated policy position requiring general insurers to provide information to aggregators. As previously indicated, aggregators are simply an alternative commercial distribution model for general insurance, driven by profit and not necessarily the customer's best interests. We believe this proposal to be fundamentally flawed with likely significant unintended consequences for consumers. This is particularly so for complex insurance products like home and contents and strata title insurance, given the exposure in Australia to natural peril risk and the need for consumers to be appropriately insured for such risk, as outlined in our earlier comments in section 3.

QBE does recognise and support the Government's aim to increase general consumer information about the availability of insurance and the different product offerings, particularly in far North Queensland. QBE is supportive of a consumer information website that facilitates awareness of the insurers that offer insurance products, particularly in areas of high natural peril risk, as outlined in QBE's response to Treasury's recent discussion paper[26]. QBE believes this would be a cost effective and efficient method of increasing transparency for consumers, without significantly increasing red tape and ongoing compliance costs that would ultimately end up being passed on to consumers.

Also as noted in section 7, QBE supports the development of a short form product disclosure statement that can be delivered in a technology neutral manner which would assist consumers to compare insurance products and key features of cover (and not drive a predominant focus on price at the expense of appropriate coverage).

[25] ibid, page 24.
[26] QBE Submission to the Australian Government's discussion paper – *Addressing the high cost of home and strata insurance in North Queensland*.

QBE strongly advocates there should be no change to the current position and the provision of general insurance information to aggregators should not be mandated Aggregators or comparison websites are an alternative commercial distribution model for insurance products and are driven by profit. The aggregator market should be allowed to develop in accordance with market forces and policy intervention should not dictate participation.

5. Competition in statutory schemes

The Interim Report notes submissions have argued that some state and territory-based statutory insurance schemes are not open to private sector competition and that consumer value could be improved by introducing competition. The Inquiry is seeking further information on the improved value to consumers of opening up state and territory based insurance schemes.

Statutory compensation schemes – government participation

The historical and political dimensions influencing the development of Australia's compensation schemes have tended to obscure the true role and function of the scheme arrangements. These schemes have developed in an incremental fashion often with little regard to the origins or long term rationale for particular developments and there has been very little articulation of the interfaces of the compensation schemes and the wider political and social system. Similarly, the interaction and interface with the operation of the proposed National Disability Insurance Scheme *(NDIS)* and National Injury Insurance Scheme (*NIIS*) is currently extremely unclear.

State and territory governments have been fiscally challenged by managed fund schemes with unfunded deficits at different times, which drive political responses that invariably lead to increased premiums or reduced benefits.

Australia has 10 separate workers compensation systems and eight separate compulsory third party insurance systems. The role that governments play in these schemes ranges from regulatory supervision to total scheme administration and underwriting, depending on the class of insurance and jurisdiction.

Various governments have embarked on scheme reviews and reform programs in recent years, leading to overhauls of scheme administration arrangements focused on addressing rising scheme costs, substantial funding deficits and slower injury recovery and return to work rates. Further reform remains on the agenda. To date, however, there has been limited consideration of the benefits of opening up the injury compensation schemes to private capital underwriting.

Governments at both state and federal level have significant exposure and fiscal liability for personal injury schemes. Additionally, unlike APRA prudentially regulated insurers, government monopoly schemes are not subject to consistent prudential or pricing oversight and can be subject to and influenced by conflicting social and political pressures.

Benefits of private capital underwriting

Insurance is not "core business" for government. Opening up statutory compensation schemes to private capital underwriting has a range of benefits over the current arrangements including:

- Greater competition and certainty in pricing with less potential for volatility driven by underlying political objectives;
- Greater innovation in claims management with more incentive for private insurers to invest in systems and practices to ensure the best community and financial outcomes are achieved for all parties;
- With greater focus on risk pricing, incentives can be embedded to drive better safety practices and reduce accidents;
- Increased focus on effective return to work programs will benefit all stakeholders and has been shown to have significantly better longer term outcomes for the well being of injured workers;

- Less potential for conflict with the regulator able to focus on scheme design principles and regulating the scheme, rather than underwriting, managing and administration of the scheme;
- Increased clarity and delineation of roles between scheme regulators and the prudential regulator (APRA). Put simply, APRA can focus on the prudential and capital adequacy aspects of the scheme insurer and the scheme regulator can focus on the delivery of the scheme legislative and regulatory intent, avoiding duplication of effort or conversely, avoiding gaps in regulation;
- Improved capital management of the schemes, with prudential oversight by APRA, reducing the probability of schemes falling into deficit;
- Reduced fiscal volatility for governments (and flow through implications for taxpayers) through removal of the potential for ratings agencies to consider scheme deficits when assessing state credit ratings.

Harmonising regulation

QBE also refers the Inquiry to our initial submission where we provided detailed observations on the operation of Australia's varied compensation schemes and the need for harmonisation. In essence, one of the key objectives for an effective personal injury scheme, is that the amounts paid to injured parties should constitute the vast majority of the costs which are met by an insurance company. Australia's varied compensation schemes mean that there is a significant cost burden for the economy which impedes productivity, innovation and competition. Benefit arbitrage, the layers of regulatory responsibility and overlapping regulatory requirements and objectives between the various regulators and schemes creates complexity, rework, inconsistencies and additional costs and operational issues for insurers and business.

QBE believes Australia's federated approach to the management of injury compensation arrangements creates a range of efficiency, affordability and equity issues that impact on productivity and competition. Although unquestionably challenging and complex to address establishing national (or nationally consistent compensation schemes) that interface appropriately with the other compensation schemes will enhance Australia's standing as an attractive place to do business, increase competition and have a positive effect on productivity.

QBE is supportive of introducing competition into the non-catastrophic statutory insurance schemes and believes it is timely to consider whether it is appropriate or necessary for governments to continue to underwrite such schemes. Our initial submission outlines in detail the potential benefits and improved value this would provide to consumers, business and governments.

QBE believes Australia's federated approach to the management of injury compensation arrangements creates a range of efficiency, affordability and equity issues that impact on productivity and competition.

6. Lenders mortgage insurance and system stability

The Interim Report notes submissions have proposed policy changes to re-establish the place of lenders mortgage insurance (*LMI*) including changes to capital standards for insured loans.

The Interim Report notes submissions have indicated LMI has the potential to improve the competitive position of smaller ADIs and non bank lenders, maintain broad access to mortgage loans and assist with system stability by the provision of more capital by LMI in the system. The Inquiry also notes however that there could be trade-offs with stability implications and factors that may affect the competitive position between IRB banks and smaller lenders.

The Inquiry has requested views on the costs, benefits and trade-offs of the following policy option or other alternatives:
- No change to current arrangements
- Decrease the risk weights for insured loans.

QBE's position

LMI has been a critical component of the Australian housing market since 1965, facilitating home ownership and accessibility to credit for millions of borrowers. LMI enables those who would otherwise have difficulty obtaining a home loan (particularly borrowers with low incomes or low levels of equity) to satisfy responsible lending criteria and purchase a home. Currently, Internal Ratings Based (*IRB*) lenders receive no capital benefit for the use of LMI, despite the fact that the LMI providers are required to, and do hold, significant capital for the risk that is transferred.

LMI has contributed significantly in ensuring a stable and competitive residential mortgage market during the last 45 years. QBE believes the Inquiry should consider the important role that LMI plays in the financial system and recommends that capital relief be provided to IRB lenders that utilise LMI. This would ensure that LMI continues to benefit the housing industry and its customers and continues to facilitate increased competition between lenders. LMI does and should continue to bolster financial and economic stability and importantly, improve access to affordable home ownership.

APRA's specific regulatory capital regime in relation to LMI providers requires very high levels of capital (due to APRA's view of potential losses arising from mortgage defaults in a severe economic downturn). The largest component/driver of LMI premium rates is therefore the high level of regulatory capital that LMI providers must hold. From a financial system stability perspective, the significant additional independent layer of capital assists in diversifying risk across lenders, across time and across geography.

There is currently little capital incentive for the home lending market to use LMI because of the increasing dominance of IRB banks, together with a lack of regulatory recognition for IRB banks use of LMI when modelling reduction in credit losses.

QBE believes in the absence of any regulatory or structural recognition for IRB banks use of LMI, the important role that LMI has and currently plays in the Australian home lending market may be impacted. This in turn will place at risk both the accessibility to home ownership and affordability of homes within the Australian housing market.

QBE considers this an important consideration for the Inquiry and has provided a separate detailed submission to the Inquiry on LMI together with further follow up information on the role LMI plays in improving market discipline.

QBE has contributed to and also supports the Insurance Council of Australia's more detailed response on this matter.

QBE believes the Inquiry should consider the important role that LMI plays in the financial system and recommends that capital relief be provided for insured loans for all lenders that utilise LMI.

This would ensure that LMI continues to benefit the housing industry and its customers and continues to facilitate increased competition between lenders. It would bolster financial and economic stability and importantly improve access to affordable home ownership.

7. International competitiveness and regulation

As one of the few Australian-based financial institutions with extensive global operations, QBE would like to emphasise comments made in our initial submission on the need to consider international competitiveness when reviewing our financial systems and regulatory regimes.

QBE recognises the need and importance of engaging on consistent international regulation, but believes early adoption should not be regarded as an outcome in itself. Leading the way could mean that Australia risks creating an unlevel playing field for businesses operating in and from Australia. It is not in Australia's best interests if Australia's leading edge regulatory regime is more onerous than those found elsewhere in the globe and which impacts on our international competitiveness.

QBE refers the Inquiry to sections 6 and 7 of our initial submission and provides the following additional information reinforcing the position that regulatory settings in Australia add considerably to the cost, and reduce the ease, of doing business.

Capital and reinsurance

QBE's initial submission provided high level examples of the impact of funding terms on the cost of capital for Australian based insurers, compared to their peers based overseas. QBE also provide some insights on the treatment of reinsurance in Australia, the need for access to alternative forms of reinsurance widely used overseas and the non-economic treatment of reinsurance recoveries from well rated, but non APRA regulated reinsurers.

Expanding on these initial observations, it should be noted that Australia remains one of a very limited number of countries that currently imposes detailed group based prudential capital standards. Under the auspices of the International Association of Insurance Supervisors (*IAIS*), work is underway to produce a capital standard for internationally active insurance groups for an implementation currently scheduled to take place in 2019.

APRA in contrast, developed and implemented a standard for Australian groups in 2013, at least six years before there is likely to be a similar regime more broadly applicable internationally. At the same time, APRA implemented requirements for the types of allowable capital, adopting Basel III conditions for non-viability, not only for Australian banks ahead of the rest of the world, but uniquely, as far as QBE is aware, for insurers.

APRA's prudential standards for groups have had three key impacts:

- The introduction of a completely new regime at Level 2, which imposes requirements both locally and overseas, with further new requirements flowing from the conglomerate (Level 3) standards released on 15 August 2014, which will further adjust expectations at Level 2;
- Australian groups have less flexibility with respect to their Australian based entities, when compared to overseas groups with businesses in Australia; and
- Australian groups operating overseas are required to meet standards that negatively impact their overseas entities when compared to local competition. For example with regard to the holding of foreign currency capital to support overseas operations and the types of reinsurance arrangements required/allowed for overseas businesses.

When operating in global markets, QBE contends that Australian companies need to be able to utilise similar capital and reinsurance structures to their overseas competitors.

Reinsurance structures, such as catastrophe bonds, give access to a broader range of sources of capital and are widely used to provide protection from major events. It is important that such instruments are available to Australian companies. This is so that they are not disadvantaged against competitors who can access more innovative reinsurance through parent companies based internationally and outside of APRA's regulations.

Similarly, the imposition of security arrangements when using overseas reinsurers increases the costs for all Australian companies. The United States, which has until recently had similar arrangements to those now introduced in Australia around reinsurance recoveries, has begun reducing the level of security required, which is reducing the cost of doing business for companies providing reinsurance and making the market more attractive.

As outlined in our initial submission, requirements for non-viability clauses in capital instruments of Australian insurers, are estimated to cost around 35 basis points. These requirements, together with the level of tailoring required for local capital admissibility, increase the costs and time taken to raise capital in Australia.

Development of international standards

We support the Insurance Council of Australia's submission that Australia's financial services regulators should be required to undertake meaningful and timely consultation with industry when they are participating in the negotiation of international regulation. APRA has been heavily involved in the development of international standards, but has rarely consulted the general insurance industry before taking positions in international discussions. International standards agreed by organisations such as the Financial Stability Board, even if only advocated as best practice, are then held as important for local adoption and, as illustrated above, are often put in place in Australia much earlier than elsewhere.

Consistency with international regulation will remain important to Australia's reputation as a politically and financially stable location for investment. QBE believes, however, Australia's recent record as an early adopter of the new wave of regulation requires rethinking in the context of its impact on financial institutions' international competitiveness.

Corporate governance and the roles of boards and management

Corporate governance continues to be a key issue for prudentially regulated institutions and QBE welcomes the discussion on this topic in the Interim Report.

The continually escalating requirements imposed by APRA on boards and directors demonstrate the need to revisit and establish a clear delineation of roles for a regulated entity's board and management. QBE notes APRA has recently foreshadowed changes in response to feedback on this area arising from the updated risk management standard. This is, however, a broader issue requiring clarity as there are a number of areas in other current prudential standards that also need to be addressed to delineate the appropriate roles of boards and management.

QBE considers that the degree of oversight and verification expected of boards over management's handling of day to day operational matters unduly diverts the boards' attention from broader strategic issues. The additional obligations and ad hoc requests made to boards by APRA are often incremental, but over time have resulted in a significant unchecked increase in compliance. It is important to take stock and re-weight the time boards are spending on compliance and day to day operational matters, at the expense of more strategic considerations.

QBE supports the Interim Report's proposition that there be a thorough independent review of prudential requirements to clearly delineate the roles of management and boards.

Disclosure

QBE notes that the current disclosure regime has been raised for consideration by the Inquiry with suggestions raised in submissions that the current arrangements have reached their useful limits.

QBE agrees with the Insurance Council of Australia's comments on this topic and that without an overarching philosophical framework that would replace the current disclosure settings, the Inquiry should be cautious of action that is likely to lead to further fragmentation increasing regulatory cost and system wide inefficiencies.

QBE does however support a review of the length and complexity of product disclosure statements (*PDS*) and would be supportive of the development of short form PDS documents that can be delivered in a technology neutral manner, to increase transparency for consumers.

Regulatory mandates

QBE recognises the need for operational independence of regulators however considers that regulators should be subject to Ministerial direction in relation to questions of policy and issues of priorities. QBE does not support any changes to current legislative provisions in this respect.

While recognising the commitments made by ASIC and APRA in their recent Statements of Intent, all regulation creates and imposes costs. In the general insurance industry, these additional costs will ultimately result in higher prices to customers and affect shareholder returns. In the competitive global market for investment capital, the insurance industry must continue to be an attractive destination that provides adequate commercial returns to its shareholders. To do this, the insurance industry must keep its costs competitive and operate as efficiently as possible in an environment that recognises and supports this goal, so we are not put at a disadvantage to other industries competing for investment. In turn, this will enable us to provide suitable and more affordable products for customers.

As outlined in QBE's initial submission to the Inquiry, APRA's continually expanding regulatory ambit over time has led to commensurate increases in costs, and consequently, increases in levies for financial institutions that have been significantly higher than inflation. QBE believes this levy funding design and methodology requires review.

QBE believes additional or changing regulation on the financial services industry operating in and/or from Australia should be:

- **subject to a genuine and rigorous cost benefit analysis that should also include a cost impact analysis on consumers;**
- **balanced, by also explicitly considering the proposed reform in the context of improving and sustaining Australia's competitiveness and productivity. Regulators' performance could be assessed against this same standard, which would give due weight to the need to promote productivity and competitiveness in a dynamic global economy and maintain affordability for consumers.**

Additionally, APRA's mandate should be reviewed to incorporate a formal objective that the regulator must consider the impact of regulatory requirements and reforms on competition, efficiency and innovation in the insurance industry, which operates in a global marketplace.

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