

**FIRE
SERVICES
LEVY
MONITOR**

**Report to the
Minister for Consumer Affairs**

June Quarter 2013

Letter to Minister

26 July 2013

Hon Heidi Victoria
Minister for Consumer Affairs
Level 6, 2 Kavanagh Street
SOUTH BANK VIC 3006

Dear Minister

I am pleased to present the second quarterly report by the Fire Services Levy Monitor on the performance of the functions of the Monitor in accordance with section 110(1) of the *Fire Services Levy Monitor Act 2012* (the Act). The Act came into effect on 19 December 2012. As required by section 110(4) of the Act, this report relates to the period ending 30 June 2013.

Yours sincerely



Professor Allan Fels AO
Fire Services Levy Monitor

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1. Background

1.1 Introduction

This is the Fire Services Levy Monitor's second quarterly report to the Minister for Consumer Affairs under Section 110 of the *Fire Services Levy Monitor Act 2012* (the Act). Section 110 requires the Fire Services Levy Monitor (the Monitor) to report to the Minister within 28 days after the end of each quarter on the operation of the Monitor under the Act.

The Act came into effect on 19 December 2012 and the Office of the Fire Services Levy Monitor (the OFSLM) commenced its public-facing operations on 30 January 2013. This report covers the period from 1 April 2013 to 30 June 2013.

The Monitor's role is to ensure that the interests of consumers of insurance are protected during the abolition of the insurance-based fire services levy (FSL) from 1 July 2013 and the transition to the new Fire Services Property Levy (FSPL).

Under section 6 of the Act, the main functions of the Monitor are to:

- Provide information, advice and guidance to consumers and insurance companies in relation to the abolition of the FSL
- Monitor insurance premiums, including the FSL component of premiums
- Monitor the compliance of the insurance industry with the legislative prohibitions on price exploitation and false representations or misleading or deceptive conduct
- Investigate potential contraventions of the law and take appropriate action
- Promote effective dispute resolution mechanisms in relation to disputes arising from the abolition of the FSL.

The Monitor's functions fall into three broad categories:

1. Information provision
2. Price monitoring
3. Compliance and enforcement.

This report is structured around these primary functions:

- Section 1 Background
- Section 2 Outlines the information provision activities undertaken during the June quarter 2013;
- Section 3 Reports on the price monitoring function.
- Section 4 Reports on compliance and enforcement-related activities.
- Section 5 Draws on the range of information available to the Monitor to discuss developments in FSL rates and premiums for property insurance up to 30 June 2013.

2. Information provision

A key function of the OFSLM is to inform and educate both policyholders and insurance companies about their rights and obligations with regard to the abolition of the fire services levy from 1 July 2013. This is achieved by providing information to insurance companies and policyholders through the OFSLM website and the media and through a dedicated enquiries and complaints 'hotline'. Consultation with the insurance industry is undertaken and queries by individual insurance companies are responded to.

Information provision activities continued during the second quarter, primarily through the distribution of statutory guidelines to insurers. In addition, a public hearing for insurance companies to explain their pricing decisions to policyholders was held. More detail on these activities is provided below.

2.1 Media and advertising

Implementation of the Monitor's communication strategy continued to inform property insurance policyholders about the abolition of the levy and to raise awareness of the dedicated enquiries and complaints hotline telephone number 1300 300 625. The strategy comprised: issuing media releases to obtain media reportage; and paid advertising.

Media activity

Media releases during the June quarter 2013 focused on the release of industry guidelines, the issuing of a public warning to policyholders, the announcement of a public hearing on insurance premiums and the hearing itself. Two media conferences were held during the quarter – one on the announcement of the public hearing and another on the day of the hearing. Media interviews were also undertaken by the Monitor and Deputy Monitor to raise public awareness of the removal of the fire services levy and to alert consumers of the need for vigilance regarding the removal of the FSL and increases in base premiums. The media activity resulted in coverage in metropolitan and regional media during the period.

Section 2.7 contains an analysis of hotline enquiries and visits to the <www.firelevymonitor.vic.gov.au> website indicating that this media activity and the OFSLM's advertising have been effective in driving websites visits and calls to the hotline.

Advertising

Advertising to raise consumer awareness of the levy removal appeared in regional and metropolitan newspapers (the *Herald Sun* and *The Age*) in the weeks commencing 3 June 2013 and 23 June 2013 and on the *Herald Sun* and *The Age* websites between 5 and 8 June 2013. Radio advertisements were aired on regional radio during the week commencing 23 June 2013.

Public notices

Two public notices – one regarding a 'public warning statement' issued under section 106 of the Act (refer to section 2.3) and another regarding the public hearing (refer to section 2.4) – were published in metropolitan and regional press on 25 May 2013 and 8 June 2013 respectively.

2.2 Guidelines for insurance companies on compliance with the Act

The prohibitions in the Act are:

1. The prohibition on insurance companies engaging in 'price exploitation' (section 26 of the Act).
2. The prohibition on any person in trade or commerce engaging in false representations or misleading or deceptive conduct about the effects or likely effects of the abolition of the FSL (section 31 of the Act).

Section 27 of the Act provides that the Monitor may issue guidelines about when prices for regulated contracts of insurance may be regarded as being in contravention of section 26. Section 6(2)(d) empowers the Monitor to prepare and publish guidelines in relation to the operation and enforcement of the Act. The guidelines were issued under these two sections of the Act.

The guidelines provide the Monitor's interpretation of the legislation and the associated requirements for compliance. The publications also incorporate background and commentary on the application of the guidelines and the formal guidelines themselves. The following sections provide an overview of the process leading to the issuing of the guidelines and the key points of the guidelines. Final guidelines covering compliance with the legislative provisions on price exploitation and false representations or misleading or deceptive conduct relating to the Act were issued on 31 May 2013.

2.2.1 Consultation

Draft guidelines on price exploitation and false representations or misleading or deceptive conduct were issued on 18 April 2013 and posted on the OFSLM's website, along with an invitation to insurance companies and interested members of the public to submit comments by 3 May 2013.

Development of the draft guidelines was assisted by information obtained through consultations with stakeholders including insurers, the Insurance Council Australia (ICA) and the Victorian fire services. The draft drew on additional information obtained from policyholders through complaints and enquiries and from individual insurers in response to a notice issued under section 18 of the Act.

Eighty-two insurance entities (insurers and brokers) contributing to funding the Victorian fire services were notified by mail of the draft guidelines and invited to submit their comments. Two written submissions were received: one from the ICA and one from Assetinsure Pty Ltd.

A meeting was held with representatives from the ICA on 13 May 2013 to discuss their submission. Following the meeting, the submission deadline was extended to 22 May 2013 to allow for a supplementary submission by the ICA which was received on 16 May 2013.

The final guidelines—*Guidelines on price exploitation in relation to the fire services levy reform* and *Guidelines on false representation or misleading or deceptive conduct in relation to fire services levy reform*—were published on the OFSLM website on 31 May 2013 and in the Victorian Government Gazette, as required by sub-section 27(3)(a) of the Act, on 6 June 2013.

Letters were sent to the eighty-two insurance entities advising them of the publication of the guidelines. *The Guidelines on price exploitation* are set out in **Appendix 1** of this report and the *Guidelines on false representations or misleading or deceptive conduct* are set out in **Appendix 2**.

2.2.2 Guidelines on price exploitation

The fundamental aims of the price exploitation provisions of the Act are to prevent insurance companies from:

- collecting more through a fire services levy on policyholders than is required to be contributed to the fire services in 2012–13; and
- not passing on to consumers the full reduction in insurance companies' costs from the abolition of the requirement to fund the fire services.

The Act came into effect on 19 December 2012. The price exploitation provisions apply to regulated contracts of insurance which include insurance against fire, 'issued by an insurance company whether before, on or after the commencement of the Act'. The price exploitation provisions, however, relate specifically to the abolition of the FSL by the *Fire Services Property Levy Act 2012* which received royal assent on 16 October 2012. While the Act suggests retrospective application, it seems unlikely it would apply before 16 October 2012. The provisions will continue in force until 31 December 2014 when the Act is repealed under its sunset provision.

Guideline 1 states that price exploitation can be determined at the level of an individual policy and Guideline 2 states that the price exploitation prohibition is applicable to all components of an insurance price, including the 'base premium', FSL (until 30 June 2013), GST and stamp duty on the insurance contract.

Five factors in assessing if a price is 'unreasonably high'

The Act provides that an insurance company contravenes the prohibition on price exploitation if the company charges a price for the supply of insurance against fire that is 'unreasonably high'. In assessing whether a price is 'unreasonably high' in this context, regard is to be given to the following five factors set out in section 26 of the Act.

Factor 1: The fire services levy reform

The first factor to be considered is the fact of the abolition of the FSL from 1 July 2013. Section 3 of the Act defines 'fire services levy reform' as 'the abolition of the fire services levy by the *Fire Services Property Levy Act 2012*'. The abolition of the requirement for insurance companies to contribute to the funding of the Country Fire Authority (CFA) and Metropolitan Fire and Emergency Services Board (MFESB) takes effect from 1 July 2013 under the *Fire Services Property Levy Act*. This date is central to considerations of the pricing response of insurance companies to the abolition of the FSL.

Factors 2 and 3: Amounts of contributions by insurers to the fire services

The second and third factors to be considered are the amounts insurers are to contribute to the fire services authorities under the *Metropolitan Fire Brigades Act 1958* and *Country Fire Authority Act 1958* for 2012–13. Guideline 5 states that an insurance company collecting FSL from policyholders in 2012–13 should not collect a total levy amount in excess of the amount of the statutory contributions required from that company to the fire services.

Furthermore, any amounts collected by an insurer in excess of the amount due to the fire services authorities will be expected to be refunded directly to the policyholders, or through some other

method of disbursement agreed with the Monitor in a formal undertaking under section 92 of the Act.

Factor 4: History of FSL rates charged by an insurer

Fire services levy rates charged by insurance companies have fluctuated over time and, prior to 2012–13, these fluctuations largely reflected changes in the funding requirements of the fire services. The history of FSL rates applied by an insurance company may be examined in considering compliance with the prohibition of price exploitation.

Factor 5: The costs of supplying insurance against fire

The Monitor interprets the term 'costs' to mean the costs of all inputs involved in a company's supply of fire insurance, including expenses incurred in the normal course of operating a business and the company's costs incurred in any re-insurance arrangement relating to the provision of fire insurance.

Assessing whether a price may be unreasonably high may involve consideration of the allocation of costs across a company's range of insurance products, of which insurance against fire may be one of many. Guideline 7 states that where a premium for fire insurance increases contemporaneously with the abolition of the FSL, and the higher premium reflects a change which increases costs allocated to fire insurance policies in Victoria, the Monitor may investigate the change and will expect the company to justify the change in cost allocation.

Post 30 June 2013 issues

The guidelines considered matters relating to the assessment of price exploitation in relation to a policy renewal after 30 June 2013, with Guideline 8 stipulating that the amount of the total premium for the renewal should be 'less than the immediately preceding total premium by an amount equivalent to the FSL plus GST and stamp duty on the FSL charged in the preceding premium, unless there is a change in policy coverage or risk rating or supply cost increase justifying a lesser difference'.

Guidelines were also provided for other post 30 June 2013 transactions including new policy issue processing delays, adjustments to insurance contracts and commercial declaration adjustments.

Declarations and other matters

Guideline 4 requires insurers to provide declarations signed by the Chief Executive Office (or equivalent) stating that the company has implemented internal controls designed to ensure that no FSL will be charged on new or renewed policies from 1 July 2013.

Under Guideline 11, insurers are to provide declarations of their FSL collected during the 2012–13 financial year accompanied by assurance opinions undertaken under Auditing Standard on Review Engagements *ASRE 2405 Review of Historical Financial Information Other than a Financial Report*.

2.2.3 Guidelines on false representations or misleading or deceptive conduct

Section 31 of the Act provides a prohibition on conduct falsely representing, or being misleading or deceiving about, the effect or likely effect of the abolition of the FSL. The guidelines seek to promote transparency in the removal of the FSL from insurance premiums. With a view to enhancing insurance companies' disclosures about the FSL removal, the guidelines provide guidance on the content of communications from insurers to policyholders.

Central to this guidance is the general principle that an insurance company should provide easily accessible and comprehensible information to its customers on the abolition of the FSL and how their premiums for policy renewals are set to take account of its abolition. Furthermore, a policyholder requesting information on the removal of FSL from a premium for renewal of a policy, and/or an explanation of any increase in base premium concurrent with the apparent removal of FSL, should be provided with information specific to the particular policy. The information should be sufficient to enable the policyholder to assess whether the proposed premium is reasonable.

2.3 Public warning issued under section 106

Information obtained from insurance companies indicates that many insurers were charging a zero per cent FSL rate (in effect they had ceased charging the FSL) on policy renewals from the beginning of April 2013. However, monitoring activities also suggested that this change was, in some cases at least, implemented at the same time as significant increases in base premiums were occurring.

Section 106 of the Act provides a power for the Monitor, if satisfied that it is in the public interest to do so, to publish a public warning identifying and giving information about any matter that 'adversely affects or may adversely affect the interests of persons in connection with the acquisition by them of insurance services'.

On 9 May 2013, a public warning was issued to property insurance policyholders receiving policy renewal notices advising them to:

- examine the notice to ascertain if there is any FSL charged
- compare the 'base premium' amount (that is, excluding FSL, GST, stamp duty and any fees) in the renewal notice with the corresponding amount paid in the immediately preceding renewal
- contact their insurer if there is a significant increase in the base premium amount to obtain an explanation for the increase
- consider obtaining quotes for property insurance from other insurers and switching to another insurer, if their renewal premium increase seems unreasonably high
- contact Office of the Fire Services Levy Monitor, if not satisfied with the explanation of the premium increase.

2.4 Public hearing on insurers' removal of the FSL

The Monitor held a public hearing on 18 June 2013 to facilitate explanations to the public by major insurance companies of their pricing decisions regarding the abolition of the fire services levy. Five insurance companies representing nearly two thirds of property insurance issued annually in Victoria were invited to participate. They were Allianz Australia Insurance, CGU Insurance, Insurance Manufacturers of Australia (IMA), QBE Insurance Australia and Suncorp Insurance. The invitation to participate sought information on '... the movements in the company's property insurance premiums implemented during the 2012–13 financial year (including charging zero FSL) and any movements... (including the removal of FSL) which have been determined by [the] company to apply from 1 July 2013.'¹

¹ Letter of invitation from Professor Allan Fels to five major insurers, dated 20 May 2013.

Thus, the focus of the hearing was on:

- the expected impact of FSL removal on total premiums
- the likely movements in premiums when FSL is removed
- the insurers' communications to consumers about the removal of FSL.

The informal hearing was in line with the Monitor's statutory function to provide public information on abolition of the FSL and was open to the public. The Monitor did not use any statutory powers to require attendance at the hearing.

Submissions were invited from all insurers operating in Victoria. Seven submissions were received, five from the insurers invited to participate in the hearing, with the remaining two from Westpac General Insurance and Zurich Insurance (a summary of submissions is at **Appendix 3**).

All five major insurers invited participated in the hearing which consisted of an hour's allocation for each company to speak to their submission presented, followed by questions from the Monitor and Deputy Monitor and a final summation by the insurer. All submissions, presentations and a transcript of the proceedings are available at the website <www.firelevymonitor.vic.gov.au>.

2.4.1 Context

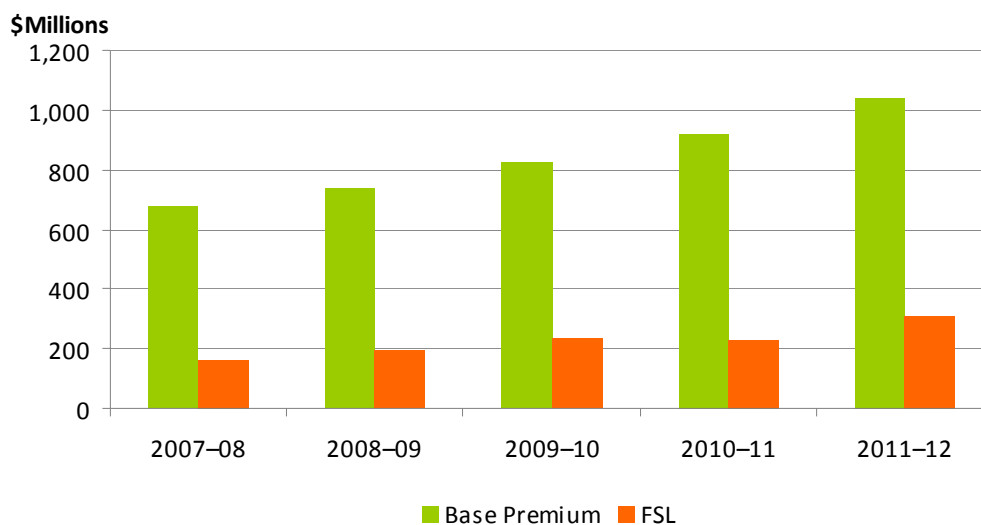
The Monitor opened proceedings by setting out the context in which the hearing was held.

FSL and related revenue

For the 2012–13 financial year, total FSL collections are likely to approximate \$550 million, with a further \$115 million collected for GST and stamp duty on the FSL component of the total premium. Thus, there is an FSL-related revenue pass-through in the insurance industry of the order of \$665 million in that year. Just over half is likely to be collected from around 1.6 million residential policies, with the balance from businesses' policies. FSL-related dollars collected from residential insurance policies in 2012–13 are estimated to comprise approximately \$171 million from policyholders in the CFA region and \$137 million from policyholders in the MFESB region.

Total residential property insurance premiums have increased by 54.4 per cent in the five years to 2011–12, averaging 11.5 per cent annually (see Figure 2.1). This growth reflected rises in the number of policies, sums insured and prices.

Figure 2.1: Residential base premiums and FSL for fire insurance



Source: OFSLM estimate from MFESB and CFA data.

FSL rates over the five years in Figure 2.1 averaged 26.5 per cent of base premium. This average rate represented about 21 per cent of total premiums, after taking GST and stamp duty into account. Hence, with the removal of the FSL, total premiums should fall about 21 per cent on average, all other things being equal.

Market characteristics

Some characteristics of the residential property insurance market noted by the Monitor in setting the context for the hearing are set out below.

Consumer behaviour

Anecdotal evidence around the behaviour of residential consumers prior to the establishment of the OFSLM suggests that consumers were frequently unaware of the individual total premium components (base premium, FSL, GST, stamp duty) or the FSL dollar amounts in total premiums. There also appears to be a significant degree of consumer inertia when purchasing home insurance in that the majority tend to stick with their supplier without testing the prices of alternative suppliers. (However, one insurer presenting at the public hearing estimated that the industry average for switching is reported to be about 20 per cent.²) Since raising public awareness on insurance pricing, there has been some switching behaviour amongst consumers who had lodged complaints with the Monitor.

Lack of transparency

The premium pricing process is also not transparent to the residential insurance consumer, as premium notices/policies do not explain the various factors influencing base premiums and how they may lead to sometimes very significant increases in premium amounts.

Communication issues

Information obtained by the Monitor indicates that there is a general lack of policy-specific explanation of premium changes. For example, despite the industry-wide practice of FSL tapering

² Transcript of proceedings, 18 June 2013 Public Hearing, available at www.firelevymonitor.vic.gov.au QBE p 42.

during 2012–13, customers were not given any explanations for the FSL increases applied in the first half of 2012–13. Further, consumers' enquiries to insurance companies' call centres mostly received highly generalised responses.

In addition, where insurance policies were intermediated through brokers or dedicated retailers that were not setting premiums, brokers/retailers were sometimes unable to explain policy-specific changes in premiums.

Premium movements observed prior to 1 July 2013

During the period leading up to 1 July 2013, the OFSLM observed through complaints received and monitoring data that total premiums in some instances were not falling, despite falls in FSL rates. In these cases, moves to FSL rates being set at zero per cent were offset by rises in base premiums of the order of 25 to 55 per cent. This was a cause for concern in the context of the objective that the benefits of the FSL's abolition should be passed through to consumers.

2.4.2 Summary of themes in the hearing

This section provides a thematic summary of the views of the five major insurers on their pricing in relation to the removal of the FSL

FSL charges

The five insurers stated that they set base premiums independently of the FSL, and FSL charges were calculated as a percentage of base premiums (the FSL rate). With regard to the setting of FSL rates during the 2012–13 financial year, all the insurers stated that they used a tapering model³ to phase out the FSL in an iterative manner, so that the FSL rates were reviewed and adjusted through the year.

At the time, the five insurers represented at the hearing had all tapered their FSL rate to zero per cent, in effect bringing the abolition of the FSL forward from the legislated end-date of 1 July 2013.

Practice of premium pricing

Insurance is a pooling concept where customers contribute to an insurance pool in the form of premium payments, so they could be compensated should an insured event arise. The insurers set the premium in reference to a range of factors including cost of claims, reinsurance, expenses, investment income, cost of capital and profitability targets. In addition, other factors such as changes to the assessment of the degree of risk involved in an individual property and the associated insured's profile may also result in changes to a premium.

A summary of the components of an insurance premium based on a combination of factors indicated by several companies is provided at Table 2.1. A distinction was commonly drawn between 'general pricing factors' and 'policy specific pricing factors'.

³ Higher FSL rate at the start of the 2012–13 financial year and tapering down to zero rate by the end.

Table 2.1: Components of insurance premium – residential property

Property insurance premium components
General pricing factors:
Cost of capital
Cost of claims
Administrative expenses
Profit margin requirements
Reinsurance costs
Policy specific pricing factors:
Characteristics of policyholder
Characteristics of property
Claims history of policyholder
Discounts
'Capping' or 'cupping'/'collaring'
Other

Source: OFSLM based on information from insurers.

According to the insurance companies at the hearing, the past few years had seen significant upward pressures on premium prices driven by the following factors:

- claims costs due to severe weather events⁴
- access to more 'granular' (detailed) and accurate risk data relating to natural hazards such as bushfires, earthquakes and floods.

Level of competition

Insurers generally claimed to be operating in a competitive environment in both residential and commercial property insurance. Suncorp indicated that consumers tended to consider between four to five quotes on average as they go through the renewals process. QBE stated that based on the industry 'churn rate'⁵ of 20 per cent per annum, a significant number would be actively obtaining quotes when purchasing or renewing insurance products.

Communication

According to the insurers, arrangements have been put in place to enhance their communications to customers regarding the FSL and premium movements. For example, Suncorp stated that 'More recently, [we have] decided ... with consultation with the Fire Services Levy Monitor, to expand our communication processes'.⁶ CGU stated that 'Our renewal notices provide information about the removal of FSL and show the FSL being charged ... we invite all of our customers with any questions to call us and speak with our staff especially trained in responding to FSL queries and explaining any changes to the cost of the customer's insurance cover'.⁷

Allianz also stated that 'we will be further enhancing our communication by including direct information in our renewal and new business packs'.⁸ IMA indicated it could 'on request by our

⁴ Commonly cited events were the 2009 Victorian bushfires, 2010 Melbourne hailstorms, 2011 and 2012 Victorian floods and 2011 Christmas Day storm.

⁵ Switching insurers/products.

⁶ Transcript of proceedings – Public Hearing, 18 June 2013; Suncorp p 13.

⁷ Transcript of proceedings – Public Hearing, 18 June 2013; CGU p 81.

⁸ Ibid, Allianz p 63.

customers, give them last year's renewal figure compared to the one that they're receiving from 1 July 2013.⁹

QBE acknowledged that it had 'put some general information or have included general information on our website for our direct customers, but we do accept that we probably need to do more communication to those retail customers over the coming weeks'.¹⁰

Base premium movements

As indicated by the five major insurers, the expected increase in base premiums for 2013–14 is quite varied. Suncorp considering their base premiums to be priced 'at a level that reflects the risk and reinsurance costs and so forth'¹¹—the implication being that it was not foreshadowing significant base premium increases. CGU foreshadowed base premium increases of just above 7 per cent¹² and QBE indicated capping of rises at 8 per cent.¹³

IMA indicated higher rises for RACV Insurance branded residential buildings insurance, due to existing 'cost pressures' in its residential buildings portfolio.¹⁴ A summary of the companies' indications provided at the public hearing is at Table 2.2.

Table 2.2: Base premium changes post removal of the FSL – summary of submissions

Insurer	Base premium changes indicated at public hearing
Suncorp	<p><u>Recent increases:</u> <i>... our premium pool for home insurance has increased... in the order of 16 per cent in the last financial year.</i>¹⁵ <i>Pure rate growth... (for commercial small and medium sized enterprises' policies)... has been...about four or five per cent...</i>¹⁶</p> <p><u>Planned:</u> <i>At the moment, we're probably moving into a territory where as we feel that we've priced the base premiums at a level that reflects the risk and reinsurance costs and so forth...</i>¹⁷</p>
QBE	<p><u>Recent increases:</u> <i>... for the year ended 31 December 2012, our overall increase in Australia nationally across all of our products was just in excess of seven per cent.</i>¹⁸</p> <p><u>Planned:</u> <i>... there are caps on a number of our products, but at the end of the day are we going to have a cap that limits it to eight per cent, significantly lower than the FSL rate...</i>¹⁹</p>

⁹ Ibid, IMA p 55.

¹⁰ Ibid, QBE p 35.

¹¹ Ibid, Suncorp p 24.

¹² Ibid, CGU p 36.

¹³ Ibid, QBE p 40.

¹⁴ Ibid, IMA p 56.

¹⁵ Ibid, Suncorp p 13.

¹⁶ Ibid, Suncorp p 17.

¹⁷ Ibid, Suncorp p 24.

¹⁸ Transcript of proceedings – Public Hearing, 18 June 2013, QBE p 36.

¹⁹ Ibid, QBE p 40.

Insurer	Base premium changes indicated at public hearing
IMA	<p><u>Recent increase:</u> <i>In terms of increases... in respect of the building portfolio... prior to the FSL going out, we would have experienced average premium increases of around about 30 per cent as a result cost increases and the inclusion of flood into policies.²⁰</i></p> <p><u>Planned:</u> <i>... we do forecast that quite a lot of our building customers will see increases, and that reflects the underlying cost pressures that exist in that book and which have existed for a couple of years now.²¹</i> <i>In our building and contents book, 60 to 70 per cent of people will be seeing a decrease. And overall, we're forecasting a decrease for about three in five customers.²²</i></p>
Allianz	<p><u>Recent increases:</u> <i>... an increase in the company premium by an average of eight per cent across the householders and commercial property portfolios in Victoria since 1 July 2012.²³</i></p> <p><u>Planned:</u> Allianz declined to comment.</p>
CGU	<p><u>Recent increases:</u> <i>... compared to last year, the underlying pricing movements on average have been in the order of...seven per cent.²⁴</i></p> <p><u>Planned:</u> <i>... those who are currently receiving renewal notices are likely to be receiving increases in the order of seven per cent, based on a like for like assessment of risk.²⁵</i> <i>... we expect the overwhelming majority of our policy holders to see a reduction in the net price paid.²⁶</i></p>

Source: OFSLM, Transcript of proceedings, 18 June 2013 Public Hearing, at www.firelevymonitor.vic.gov.au.

2.5 Website

A website was established at <www.firelevymonitor.vic.gov.au> to provide information to policyholders and insurance companies about the abolition of the FSL, the Monitor's role and updates about OFSLM activities. As new issues emerge, explanatory material is developed and published on the website.

The website had 11,237 visitors between its launch on 30 January 2013 and 30 June 2013, with 7,655 of these visits being first time visitors (unique visitors). Table 2.3 and Table 2.4 provide detailed information on website visits.

²⁰ Ibid, IMA p 61.

²¹ Ibid, IMA p 56.

²² Ibid, IMA p 56 .

²³ Ibid, Allianz p 67.

²⁴ Ibid, CGU p 83.

²⁵ Ibid, CGU p 83.

²⁶ Ibid, CGU p 82.

Table 2.3: FSML website visits during 2013

Measure	March quarter*	June quarter	Total
Total visits	3,158	8,709	11,237
Per cent of total	28	72	100

* 30 January – 30 March 2013; Revised figures from the March Quarter 2013 report.
Source: Office of the Fire Services Levy Monitor.

Table 2.4: FSLM website visits during 2013 – unique visitors

Measure	March quarter	June quarter	Total
Unique visits**	2,302	5,628	7,655
Per cent of total	29	71	100

** Unique Visitors – The user is counted to have visited a website only once, despite potential multiple visits.
Source: Office of the Fire Services Levy Monitor.

The website complements the site dedicated to the Fire Services Property Levy reform, <www.firelevy.vic.gov.au>, as well as other government sites containing information relating to the reform such as the State Revenue Office, <<http://www.sro.vic.gov.au>> and the Department of Treasury and Finance <<http://www.dtf.vic.gov.au>>.

To ensure maximum coverage of the website, news articles about the Monitor were also published on the Victorian Government and the Department of Justice websites. Communication channels of other bodies, such as the Municipal Association of Victoria, have also been utilised to ensure the distribution of all relevant information to local councils.

To supplement the information on the website, social media has been integrated to enable consumers to share information about the website on social media outlets such as Twitter and Facebook. While the Monitor does not have its own social media presence, its activities are tweeted by the Victorian Government, Consumer Affairs Victoria and the Department of Justice.

2.6 Enquiries and complaints hotline

A dedicated 'hotline' assists policyholders with queries and complaints regarding the abolition of the FSL. The hotline received 1,497 calls between its launch on 30 January and 30 June 2013, 953 of which occurred in the June quarter. The dedicated email enquiries inbox, <enquiries@firelevymonitor.vic.gov.au>, has received 135 emails, 45 of which occurred in the June quarter.

Table 2.5: Mode of contact to the Office of the Fire Services Levy Monitor during 2013

Mode of contact	March quarter	June quarter	Total	Per cent of total
Visits to the website	3,158	8,079	11,237	87
Enquiries via the hotline	544 ^{***}	953	1,497	12
Enquiries via email	90	45	135 ^{***}	1
Total	3,792	9,077	12,869	100

^{***} 30 January – 30 March 2013; Revised figures from the March Quarter 2013 report.
Source: Office of the Fire Services Levy Monitor

2.7 Responsiveness of enquiries and website visits to FSLM media activities and advertising

Figure 2.2 displays the relationship between the OFSLM's media and advertising activities, and the number of calls received by the enquiries hotline. The graph shows that the number of calls rose following individual media activities and shows a generally rising trend in the number of calls.

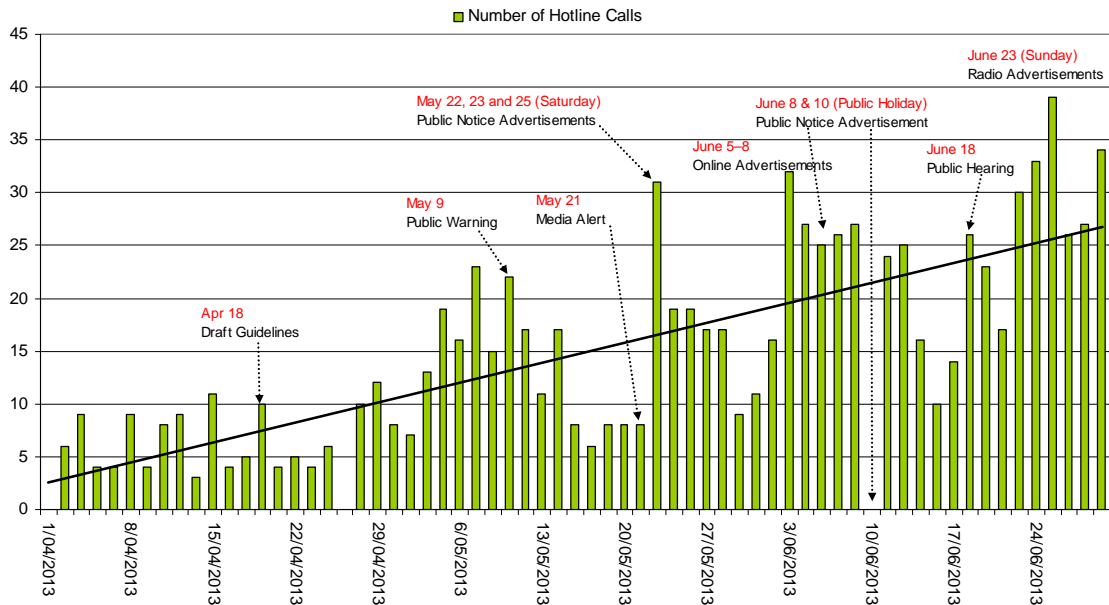
Figure 2.3²⁷ displays the relationship between media and advertising activities, and the number of website visits to the website. This graph similarly shows a direct relationship between individual media and advertising activities and web visits. In particular, spikes in the number of visits to the website corresponded with the advertisements in newspapers, online and on the radio. The public hearing held on 18 June, also coincided with a high number of website visits (222), the second highest number within a 24-hour period since the OFSLM was established.

A four day online advertising campaign (from 5 to 8 June 2013) designed to direct internet users to the FSLM website resulted in 394 visits in total, with the 'Frequently Asked Questions' page recording 47 visits. Overall, the advertisements were displayed 480,589 times over the four days.

There has been a clear rising trend in the number of visits to the website. The analysis of website visits and calls to the hotline indicates that the media and advertising campaigns have been effective in raising public awareness of the abolition of the FSL and the functions of the OFSLM. The website has also been updated to include more consumer focussed information on what to look for in policy renewal notices when renewing insurance after the FSL abolition.

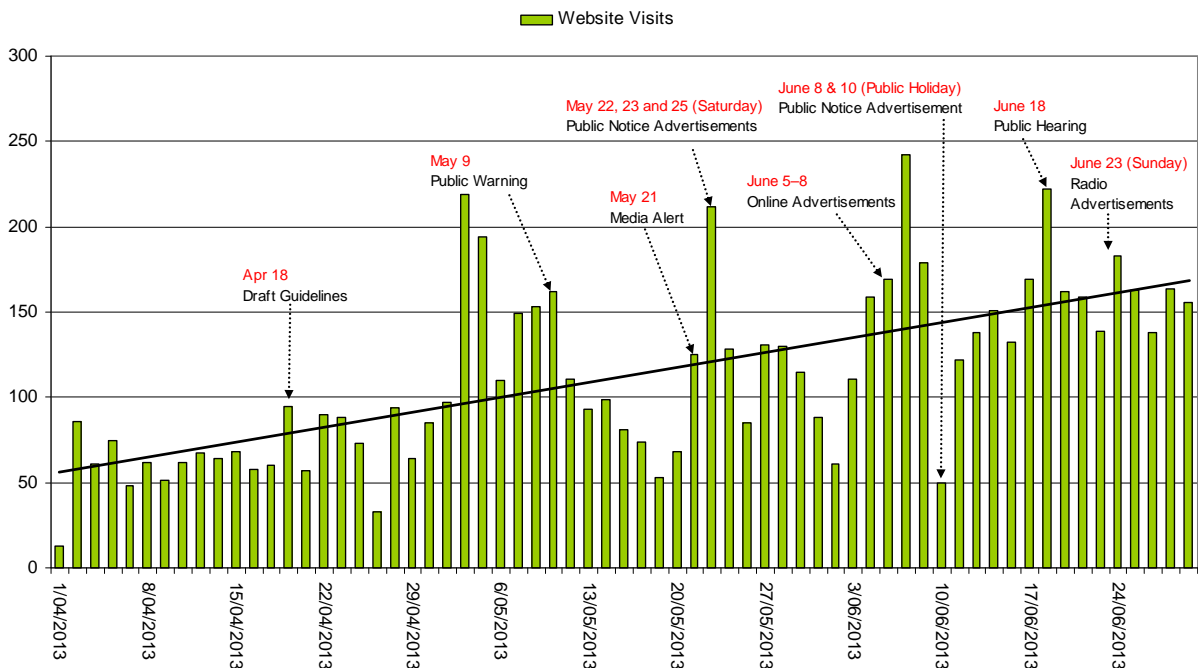
²⁷ Website visits logged from 4 February, 2013; Website launched 30 January, 2013.

Figure 2.2: Relationship between media and advertising activities and calls received by enquiries hotline



Source: Office of the Fire Services Levy Monitor

Figure 2.3: Relationship between media and advertising activities and website visits



Source: Office of the Fire Services Levy Monitor and Google analytics

3. Price monitoring

Under section 6 of the Act, the functions of the Monitor include monitoring premium prices to assess the industry's compliance with the prohibitions on price exploitation and false representation or misleading or deceptive conduct regarding the abolition of the FSL.

Section 18 of the Act gives the Monitor power to require the provision of information that may assist in monitoring compliance with the Act. Section 30 of the Act allows the Monitor to monitor prices to assess the general effect of the abolition of the FSL on prices charged by insurance companies for regulated contracts of insurance and/or to assist in consideration of whether false representation or misleading or deceptive conduct has occurred.

The OFSLM has established an extensive price monitoring program drawing on a range of sources of information, including information obtained under sections 18 and 30, about price changes and pricing behaviour to gain a comprehensive understanding of property insurance pricing and FSL arrangements.

3.1 Section 18 notice on premiums, FSL and communications

As noted in the *March Quarter 2013 Report*, a notice was issued in March under section 18 of the Act to the 82 insurance entities (insurers and brokers) who provided returns to the MFESB and/or CFA in 2011–12 and 2012–13. The aim of the notice was to obtain information on how insurers were intending to remove the FSL from total premiums charged and how they were intending to communicate these changes to their customers.

Thirty-three of the respondents underwrote their own insurance policies (underwriters). The remaining 48 were either brokers or were in run-off.²⁸ A summary of the responses by 35 underwriters is provided below (refer to sections 3.1.1 and 3.1.2). Overall, there were 23 insurers who wrote residential as well as commercial policies (general insurers), seven insurers who wrote residential policies exclusively (residential insurers) and five insurers who wrote commercial policies exclusively (commercial insurers).

3.1.1 Calculation of base premium and fire service levy in 2012–13

Base premium

General insurers calculated their base premiums using actuarial algorithms, which combined underwriting factors and assumptions, including individual risk factors, while commercial insurers generally calculated base premiums on a case-by-case basis.

Except for repricing of risks, the calculation of base premium rates were claimed to have remained generally unchanged during 2012–13. Insurers identified repricing for changes in risk factors and assumptions based on new information, including market factors and reinsurance costs as key issues faced during the transition year.

Fire services levy

The FSL was applied as a percentage of the base premium and this is referred to as the FSL rate. Before 30 June 2012, most insurers used 'advisory' FSL rates provided by the ICA. Most insurers claimed to be operating in an uncertain environment in 2012–13 regarding the calculation of FSL rates caused by:

- the ICA no longer issuing advisory FSL rates
- the absence of clear guidance from Government on the details of the phase-out of the levy

²⁸ Definitions: Brokers are intermediaries who do not underwrite insurance and companies in run-offs no longer write insurance policies.

- the timing of the release of final MFESB and CFA budgets for 2012–13 (required for the calculation of contributions to fund those budgets and related FSL collections)
- uncertainty in final market share used to calculate a company's compulsory contribution
- uncertainty of the impact of FSL refunds due to cancelled policies on final FSL collected
- the lack of accuracy in forecasting written premium in future months.

Consequently, most of the insurers engaged an external consulting firm, Professional Financial Solutions (PFS), to assist them in this task. PFS had previously assisted the ICA in calculating the advisory FSL rates.

Due to the claimed uncertainty around the modelled fire services levy rate, these rates were set in an iterative manner. A 'tapering' approach to FSL rate setting was almost uniformly adopted for 2012–13. A full discussion of tapering and observations on its consequences are contained in Section 5 'Developments in FSL rates and premiums'.

3.1.2 Over-collection and refund

Over-collection

'Over-collection' occurs when the amount of FSL collected from an insurer's policyholders exceeds the amount of the required contribution to the fire services as determined by the MFESB or CFA.

According to the companies' responses, 17 general insurers and seven commercial insurers had processes in place to avoid over-collection. Nine insurers believed that the iterative process in adjusting the FSL rate over the 2012–13 financial year would be effective in avoiding over-collection.

Refund

None of the insurers indicated that they had a process in place to refund over-collected FSL amounts. Generally, the insurers considered this process to be unnecessary, due to their deliberate strategy of targeting an under-collection of the levy for the 2012–13 year. Three of the insurers pointed out that, in the 'unlikely' event of an over-collection, they would contact the Monitor to work out an appropriate course of action, while another stated that it would put a process in place to address the surplus. One of the insurers stated that it would refund any over-collection.

As a result of the lack of consistency in approach, the Monitor determined an appropriate guidance for the companies. Guideline 5 from the Guidelines on price exploitation provides guidance on the topic of over-collection and refunds (see Appendix 1).

3.2 Section 18 notice on base premium changes

In late May 2013, the Monitor issued a notice under section 18 of the Act to 32 insurers to obtain information on the determination of base premiums from 1 July 2011 to 30 June 2014. The OFSLM is currently reviewing the responses.

3.3 Section 30 notice on premium quotes

The Monitor issued notices under section 30 of the Act to eight companies with major property insurance brands to provide insurance premium quotes for various insurance products from 1 July 2012 to 31 December 2013. The companies were:

- Allianz Australia Insurance
- CGU Insurance
- Commlnsure
- Insurance Manufacturers of Australia (underwriters of RACV Insurance)
- QBE Insurance Australia
- Suncorp Insurance (umbrella company for insurance brands Australian Alliance Insurance Company [APIA], Australian Associated Motor Insurers [AAMI], GIO General Insurance and Vero Insurance)
- Wesfarmers General Insurance
- Zurich Australia Insurance.

Selection of the participants was based on market shares, with their 11 brands accounting for approximately three quarters of all fire-services related insurance premiums collected in the Victorian residential and commercial markets.

The purpose of the notice was to obtain information on the FSL and premiums for the 2012–13 financial year and beyond, and across a range of insurance products. To achieve this, insurers were requested to provide monthly quotes for insurance premiums, including FSL charges, under various scenarios.

The Monitor is using the quotes obtained through this mechanism to:

- track movements in base premiums and FSL in insurance premiums
- cross-reference the movements in insurance premiums against information provided by insurers in the section 18 notice issued in March
- cross-reference the movements in insurance premiums against the quotes obtained by the OFSLM from the insurers' own Internet-based quotation facilities.

An analysis of the monitoring data compiled from these various sources is provided in Section 5 'Developments in FSL rates and premiums'.

4. Compliance and enforcement

Consumer Affairs Victoria (CAV) continued to provide services to the OFSLM in relation to enquiries and complaints handling during the June 2013 quarter. These services are provided under a memorandum of understanding between the OFSLM and CAV. A team of specialist trained enquiries and conciliation staff handle and assess telephone and email enquiries and complaints. Complaints are assessed by the OFSLM for further examination. Investigations of matters raised by complaints are undertaken by the OFSLM.

4.1 Complaints

The 1300 300 635 hotline has received 1,338 calls since 30 January 2013, with 794 calls received during the June 2013 quarter, and 565 complaints escalated to the OFSLM for further consideration over this period. Complaints were received about several aspects of the FSL.

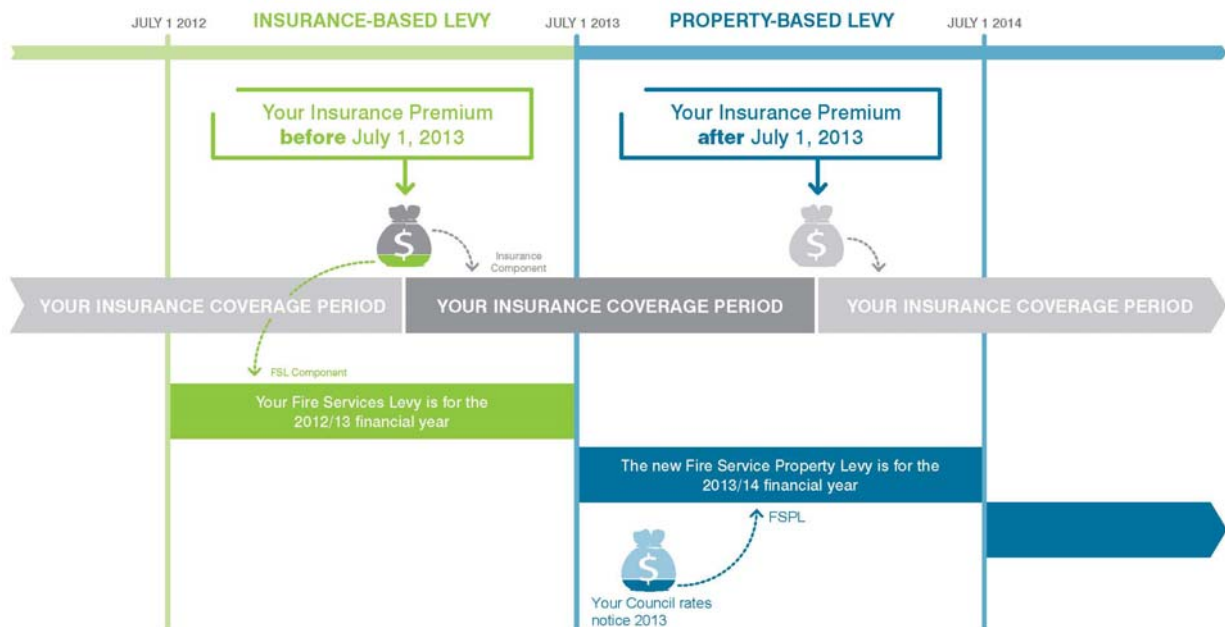
A source of a large number of calls and emails to OFSLM enquiries is the misconception that a policyholder is paying to fund the fire services twice ('double charging') for the same year solely by virtue of paying an FSL amount in an insurance premium prior to 1 July 2013 and then paying the FSPL collected by local councils later in 2013.

The reason there is not a double payment for the fire services in this situation is because the FSL component of an insurance premium is tied to a financial year, not the period of insurance coverage. The FSL and the base premium were for different purposes and relate to different periods, even though they were charged in a single total price. For example, the FSL paid in a policy renewed in December 2012 was to fund the fire services for the 2012–13 financial year. It did *not* fund the fire services for the period of insurance cover, which in this example would be December 2012 to December 2013.

Even in the case of a person whose insurance was paid on 1 June 2013, that premium was included in the insurer's liability to fund the fire services for the 2012–13 financial year. Under the legislation governing insurers' funding of the fire services, the insurer was able to recoup an amount of FSL in the premium charged to the policyholder. However, in practice as 2012–13 progressed, most insurance companies had ceased charging an FSL amount from April 2013.

Figure 4.1 illustrates graphically how the FSL and FSPL relate to consecutive financial years and how the period of insurance cover that the base premium pays for is different to both. In Figure 4.1, merely as an illustrative example, the insurance period is 12 months from July.

Figure 4.1: How the levies and insurance cover apply to different years



Apart from the double charging issue, the most common complaints related to the amount of FSL charged in the first half of 2012–13 (tapering of FSL) and significant increases in some base premiums concurrent with the charging of a zero per cent FSL rate. Section 5 provides a broader analysis of these issues.

4.2 Investigations

The majority of matters escalated for further investigation during the June quarter 2013 involved significant increases in base premiums. These resulted in 12 letters being sent to four insurance companies seeking explanations for particular premium increases. The responses to these letters provided information that will be assessed as part of the overall monitoring program, and may be further investigated.

Notices are issued under section 19 of the Act when the Monitor believes a person is capable of providing information, producing documents or giving evidence relating to a matter that constitutes or may constitute a contravention of the Act. Two insurance companies were issued with section 19 notices requiring the provision of information and documentation relating to home and contents insurance policies. At the end of the June quarter 2013, one investigation had concluded without further action warranted. The other matter involved QBE's pricing error, which the company referred to at the public hearing on June 18 2013. As the Monitor noted at the hearing, this was the subject of a separate investigatory process and remained so at the end of the June quarter.

5. Developments in FSL rates and premiums

Information on FSL rates and base premiums was obtained from various sources including insurers' internet quotation facilities and companies' responses to notices issued under sections 18 and 30 of the Act. An analysis of the information obtained by the OFSLM is provided in this section: Section 5.1 discusses the treatment of FSL during 2012–13, the final year of FSL collection by insurers, and section 5.2 reviews the trends in base premiums leading up to the abolition of the FSL on 1 July 2013. Section 5.3 summarises the major companies' outlooks for base premium changes in 2013, and section 5.4 discusses insurers' communications with policyholders.

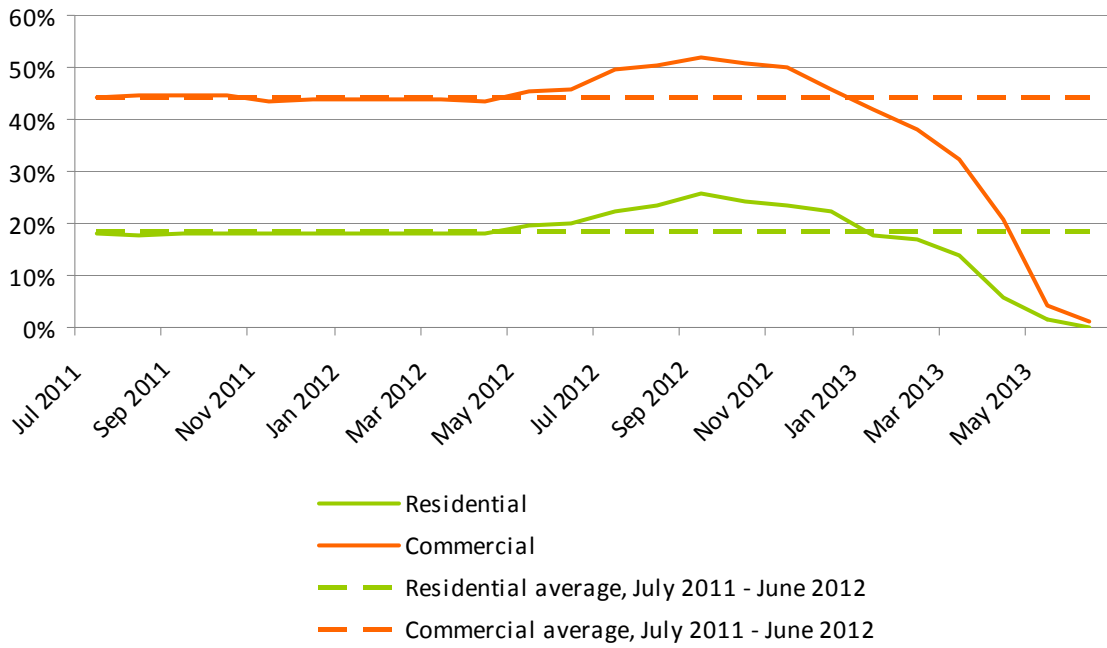
5.1 FSL during 2012–13

Details on insurance companies' actual and expected amounts of FSL collected, the FSL rates and expected FSL liabilities were provided by insurers in response to the statutory notices previously referred to. On-line quotation facilities were also used to obtain FSL quotes for various companies.

5.1.1 Tapering of FSL rates

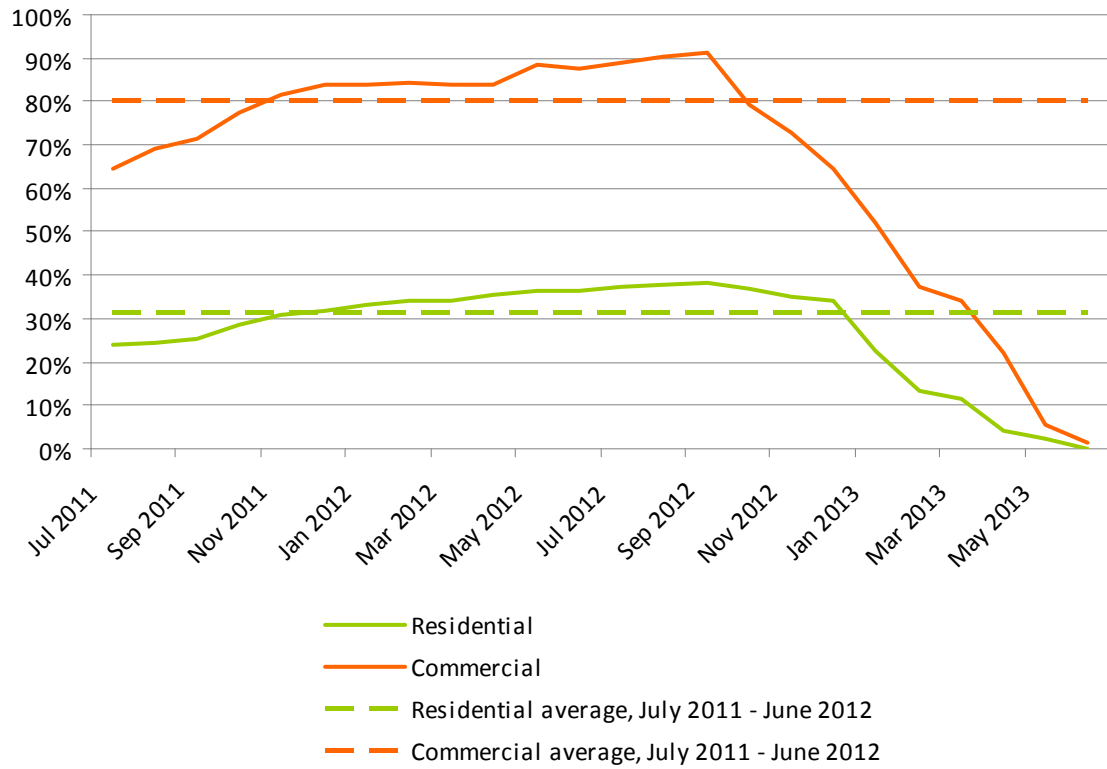
Most insurers in the market applied a tapering approach to FSL rates for the 2012–13 financial year. As shown in Figure 5.1 and Figure 5.2, this involved increasing FSL rates at the start of the financial year, before rates were lowered later during the year. The lowering of rates started around November/December 2012, before dropping to below the average FSL rates of previous years by around January/February 2013. By March/April 2013, many insurers were applying a zero FSL rate, in effect no longer charging any FSL.

Figure 5.1: Market weighted FSL rates, MFESB region



Source: OFSLM, using data obtained from responses to section 18 notice.

Figure 5.2: Market weighted FSL rates, CFA region



Source: OFSLM estimates, using data obtained from responses to section 18 notice.

Two main explanations put forward by insurance companies for the tapering practice were:

- the claimed uncertainty concerning their liability and collection of FSL in 2012–13, accordingly they collected more earlier in the year to ensure that their FSL collection would meet their 2012–13 contributions liability
- the desire to avoid 'gaming' by customers who may not have taken out insurance in the months leading up to 1 July 2013 if FSL rates were significant, accordingly the insurers decided to charge lower FSL rates in the second half of the financial year to achieve this objective.

The insurance industry appears to have generally adopted the tapering approach suggested by PFS, although individual insurers may not have necessarily applied the exact FSL rates indicated by PFS modelling.

5.1.2 Effect of tapering on policyholders

With FSL rates in the first half of the 2012–13 financial year being higher than those charged in the second half of the year, customers renewing or taking out new policies in the earlier months paid a higher total premium for comparable policies than those in the latter part of the year.

By implementing tapering, the companies in effect imposed a loading on FSL amounts in which policies taken out in the first half of the 2012–13 financial year ('front loading' their FSL collection), implicitly subsidised the collection of FSL from policies taken out in the second half of the 2012–13 financial year.

The approach taken by the companies may have effectively removed any uncertainty about being able to raise sufficient funds to meet their fire services contribution obligations, but it was, in retrospect, unfair between policyholders and probably unnecessary. Modelling work undertaken by the OFSLM, for example, indicates that the companies' stated objectives—meeting their contributions obligations and charging zero FSL before 1 July 2013—could have been achieved without raising FSL rates at all from the levels applying immediately prior to the start of the 2012–13 financial year.

OFSLM modelling of a different approach to setting FSL rates

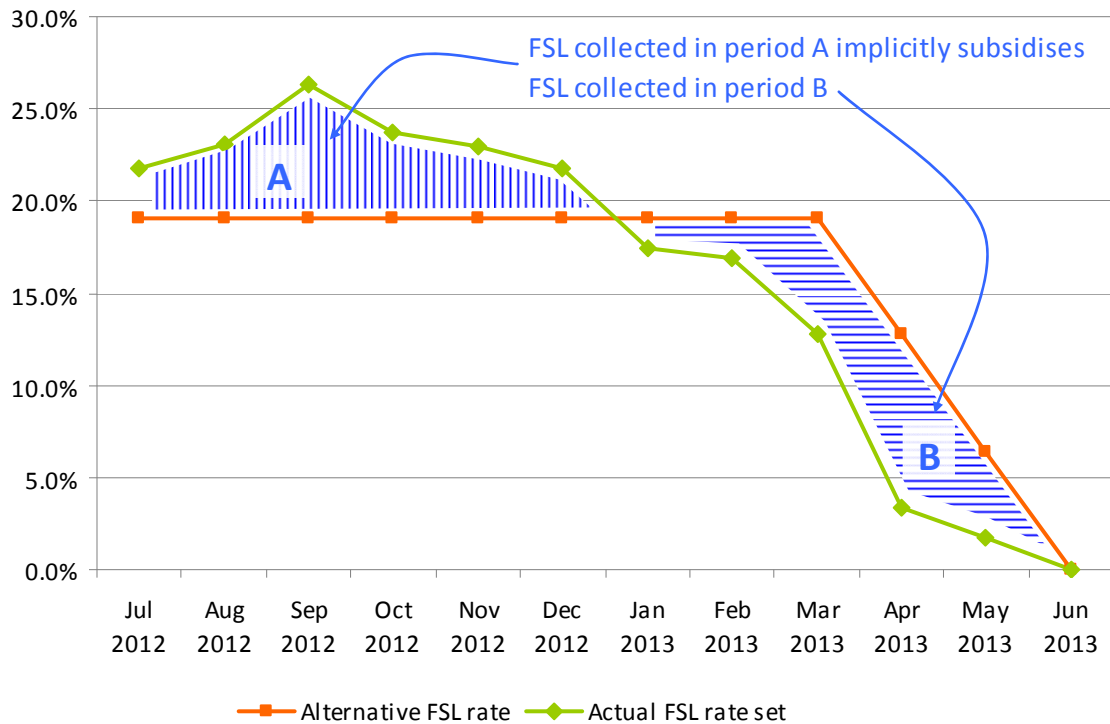
In assessing whether the tapering approach was necessary in meeting individual insurer's expected liabilities, modelling was performed using the following assumptions:

- FSL rates in 2012–13 did not exceed June 2012 rates
- FSL rates would reach zero per cent by 1 June 2013.

It was found that the top five insurers by market shares (Allianz, CGU, IMA, QBE and Suncorp) could have implemented alternative approaches to FSL rates, and still have met their expected liability by early June 2013. For example, Figure 5.3 depicts market share weighted average FSL rates (both an alternative and the actual) for the five insurance companies which could have satisfied their liability requirements without increasing FSL rates at all. This alternative tapering approach would have reduced the implicit cross-subsidy in FSL collection between customers who took up/renewed their policies in the early period of 2012–13 and those who did so in the later parts of 2012–13.

Other alternatives also appear to have been possible. Perhaps the most equitable approach, from a consumer perspective, would have been to reduce the levy on a monthly pro rata basis throughout the year. However, this would have required moderately increasing the FSL rate at the start of the 2012–13 year.

Figure 5.3: Market weighted FSL rates: actual and alternative



Source: OFSLM estimates, using data obtained from responses to section 18 notices.

5.2 Base premiums over 2012–13

Details on insurance companies' actual and expected base premiums were provided by insurers in response to the notices issued under sections 18 and 30 notices (refer to sections 3.1 and 3.3). On-line quotation facilities were also used as a source for information on base premiums.

5.2.1 Price variations across the major insurers

Ongoing monitoring of residential insurance premiums has highlighted the price differences between insurance brands. Total premium values outlined in Table 5.1 represent a sample of on-line quotes gathered by the Monitor for four properties using standardised policy specifications. The differences between the highest and lowest quote premiums for the same property ranged between \$264 and \$825 and in all cases the lowest premium was no more than 62 per cent of the highest premium. Some of the variation in prices at Table 5.1 is likely due to different levels of cover (for example, flood cover is a standard inclusion in six of the eight brands).

Table 5.1: On-line quotes – insurance premiums (30 June 2013)

Property location (\$300,000 sum insured)	AAMI [°]	Allianz	APIA [°]	Comminsure [°]	QBE	RACV [°]	Vero (Bankwest) [°]	Wesfarmers (Coles) [°]	Range	Low as % of high
Glen Iris	\$434	\$437	\$479	\$424	\$588	\$688	\$647	\$616	\$264	62%
Brunswick West	\$399	\$453	\$445	\$410	\$727	\$604	\$595	\$654	\$328	55%
Echuca	\$338	\$397	\$383	\$403	\$634	\$973	\$569	\$1,163	\$825	29%
Bacchus Marsh	\$383	\$416	\$430	\$433	\$587	\$697	\$578	\$570	\$314	55%

[°] Flood cover included

Source: OFSLM, using quotes generating from Internet quotation facilities provided by insurers.

5.2.2 Base premium movements 2012–13

Movements in base premiums provided in responses by insurers to the section 30 notice indicated that these insurers generally adopted one of two strategies when timing their price movements:

- some brands implemented small monthly increments with the occasional larger adjustment
- others generally made adjustments in two tranches during the year, for example, one around the end of the 2012 calendar year and the other in April/May 2013.

The timing of base premium increases occasionally aligned with a reduction in the FSL rate. However, this alignment was usually observed on the first of the month—a common date for all forms of pricing changes to be implemented. Instances of base premium increases and FSL rate reductions aligning on dates other than the first of the month are under examination by the OFSLM.

Residential insurance

Based on the responses to the section 30 notice issued by the Monitor, cumulative rises in the base premiums for residential building insurance in both MFESB and CFA regions averaged about eight to nine per cent since 1 July 2012. However, IMA (RACV Insurance brand), Wesfarmers and QBE had higher premium increases ranging between 13 to 27 per cent.

Base premiums for contents insurance were less volatile during the year, with fewer changes and changes smaller in magnitude. Most contents policies experienced cumulative increases of approximately 5 per cent for both MFESB and CFA regions. House contents insurance for Wesfarmers and Allianz Direct declined during the period.

Commercial insurance

Based on the section 30 responses by the major insurers, base premiums for commercial contents insurance have been increasing steadily across the year in MFESB and CFA regions, resulting in base premiums approximately 10 per cent higher in June 2013 than in June 2012, which is relatively consistent with previous years. Suncorp's brands increased the most across the year, with their two largest increases resulting in an approximate 30 per cent base premium increase within the financial year.

5.3 Outlook for major insurer's base premium changes for 2013–14

As indicated by the five major insurers, the expected increases in base premiums for 2013–14 are also quite varied. Suncorp stated at the 18 June Public Hearing that their base premiums would be priced 'at a level that reflects the risk and reinsurance costs and so forth'²⁹; the implication being

²⁹ Transcript of proceedings – Public Hearing, 18 June 2013; Suncorp p 24.

that it was not foreshadowing significant base premium increases. CGU foreshadowed base premium increases of just above 7 per cent³⁰ and QBE indicating capping of rises at 8 per cent³¹.

IMA indicated higher rises for RACV Insurance branded residential buildings insurance, due to existing 'cost pressures' in its residential buildings portfolio.³² In particular, IMA stated:

*Looking forward, we do forecast that quite a lot of our building customers will see increases, and that reflects the underlying cost pressures that exist in that book and which have existed for a couple of years now. Those price increases are not unique to this year, they have applied in earlier years, and that book is challenged... In our building and contents book, 60 to 70 per cent of people will be seeing a decrease. And overall, we're forecasting a decrease for about three in five customers.*³³

The 'decrease' referred to in the last two sentences of the quote, from the public hearing transcript, is a decrease in *total* premium, not base premium. Thus, by implication, 30 to 40 per cent of RACV Insurance residential home and contents policyholders would see rises in *total* premiums during 2013–14, notwithstanding the removal of the FSL. The OFSLM estimates³⁴ that *base* premiums rises exceeding 26.5 per cent for metropolitan areas and 33.5 per cent for outer metropolitan and country areas, on average, would be necessary to cause *total* premiums to exceed their 2012–13 levels despite the FSL abolition.

5.4 Insurer's communications to policy holders about FSL and premiums

Insurance companies' communications to policyholders regarding their removal of the FSL and pricing of fire insurance is a key focus in administering the Act's prohibition on false representation or misleading or deceptive conduct.

With regard to the companies' responses to the section 18 notice on communication of changes to the levy arrangements, 17 of the general insurers stated that they had a process in place to inform the insured of changes to the levy arrangements; five of which would be undertaken through their intermediaries/brokers. Two of the general insurers did not have a process in place to inform their policyholders of the changes.

As for the commercial insurers, nine of them had a process in place, seven of which would be undertaken through brokers. Two of the insurers did not have a process in place.

Overall, the method of communication was disparate, with planned communications varying from the use of renewal notices, special product disclosure statements, company websites and call centre staff, to information dissemination through intermediaries only. The Monitor observed in the *March Quarter 2013 Report* that communications by insurers with their customers on the increases in FSL rates applied in the first half of 2012 were generally unsatisfactory.

The *Guidelines on false representation or misleading or deceptive conduct* placed considerable emphasis on insurers' communication with customers about the removal of the FSL.

Guideline 2 states:

To reduce risks of engaging in false representation or misleading or deceptive conduct in contravention of Section 31 of the Act, an insurance company should

³⁰ Ibid, CGU p 36.

³¹ Ibid, QBE p 40.

³² Ibid, IMA p 56.

³³ Transcript of proceedings – Public Hearing, 18 June 2013; IMA p 56.

³⁴ Based on the highest FSL rate imposed during 2012–13.

provide easily accessible and comprehensible information to its customers on the abolition of the FSL and how their premiums for policy renewals are set to take account of its abolition.

A policyholder requesting information on the removal of FSL from a premium for renewal of a policy, and/or an explanation of any increase in premium concurrent with the apparent removal of FSL, should be provided with information specific to the particular policy. The information should be sufficient to enable the policyholder to assess the reasonableness of the premium being charged.

Since the issuance of the guideline, at least some major insurers have stated their intention to enhance their communications on the FSL removal and impact on premiums with their customers. Close monitoring of communications by insurers, particularly through call centres and intermediaries, will occur during the September quarter 2013 to check if the promised improvement occurs. Some complaints about large premium increases concurrent with charging zero FSL, that were received prior to the end of the June quarter 2013, suggest that shortcomings remain in the explanations policyholders receive from insurers' call centres. Several of these instances of insurers' communications will be investigated by the OFSLM.

Appendix 1: Guidelines on price exploitation

Guideline 1:

The prohibition on price exploitation applies at the level of the price of an individual contract of insurance issued by an insurance company and regulated under the Act.

Guideline 2:

The prohibition on price exploitation relates to both a base premium component (excluding fire services levy) of a price charged by an insurance company, as well as the fire services levy, GST and stamp duty components of a price. Price exploitation can occur with respect to a base premium or a fire services levy component of a total premium payable, or both, or a charge of any description for the supply of a fire insurance policy, including taxes and duties.

Guideline 3:

The fire services levy will no longer constitute a valid component of a price for a new or renewed contract of insurance issued from 1 July 2013.

However, for policies issued prior to 1 July 2013, monthly instalment payments of premium continuing after 30 June 2013 may continue to include an FSL component.

Guideline 4:

Each insurance company is requested to provide to the Fire Services Levy Monitor a declaration signed by the Chief Executive Officer of the company (or equivalent position) stating that the company has implemented internal controls designed to ensure that no FSL will be charged on new policies issued or policies renewed from 1 July 2013. Each declaration received will be published on the Monitor's website.

Guideline 5:

An insurance company collecting FSL from policyholders in 2012–13 should not collect a total levy amount in excess of the amount of the statutory contribution to a fire service required from that company.

If an insurance company collects an amount of FSL in 2012–13 that is more than the amount it is required to contribute to the MFESB and/or the CFA for 2012–13, it will be expected to refund the amount of over-collection by direct refunds to policyholders or, allowing for the practical difficulties of direct refunds in some circumstances, by other method of disbursement.

The method or formula for allocating refunds or other method of disbursement of an over-collection should be by agreement with the Monitor. Such agreement will be formalised in an enforceable undertaking pursuant to section 92 of the Act.

Guideline 6:

Factors relevant to assessing whether the premium component of a price is unreasonably high are: the reasonable costs of all business inputs involved in a company's supply of fire insurance, including expenses incurred in the normal course of operating places of business; and costs incurred in re-insurance arrangements relating to the provision of fire insurance.

In assessing whether a price is unreasonable, there will be a particular focus on any change in methodology. Where a company incorporates a new factor (or factors) in its pricing methodology for 2013–14, and this factor contributes to an increase in prices in 2013–14, the Monitor expects the company to provide an explanation of the methodology change.

Guideline 7:

A premium for fire insurance should not increase contemporaneously with the abolition of the fire services levy, unless the issuing company can demonstrate a cost basis for the increase.

Where a premium for fire insurance increases contemporaneously with the abolition of the FSL, and the higher premium reflects a change which increases costs allocated to fire insurance policies in Victoria, the Monitor may investigate the change and will expect the company to justify the change in cost allocation.

Guideline 8:

The amount of the total premium for renewal of a regulated contract of insurance in the 2013–14 financial year should be less than the immediately preceding total premium by an amount equivalent to the FSL plus GST and stamp duty on the FSL charged in the preceding premium, unless there is a change in policy coverage or risk rating or supply cost increase justifying a lesser difference.

Expressed alternatively, where:

(A) is the total amount of a premium, including base premium and fire services levy, GST and duty payable on a policy newly issued or renewed during financial year 2012–13; and

(B) is the total amount of the premium, GST and duty payable on renewal of the same policy during financial year 2013–14; and

(C) is the amount of FSL in (A);

(A) minus (B) should be an amount equal to (C) plus 10 per cent GST plus 10 per cent stamp duty, unless there is a difference in policy coverage or risk rating or supply cost increase that demonstrably justifies a lesser difference.

Many companies commenced charging zero FSL prior to the end of the 2012–13 financial year due to widespread tapering of FSL rates raising sufficient revenue to meet their estimated funding obligations to the fire services for 2012–13. Accordingly, the outcome described above should also apply: where a zero FSL is charged prior to 1 July 2013 in a policy renewal notice, the amount of the total premium for renewal should be less than the immediately preceding total premium for the policy by an amount equivalent to the FSL plus GST and stamp duty on the FSL charged in the preceding premium, unless there is a change in policy coverage or risk rating or supply cost increase justifying a lesser difference.

Guideline 9:

Premiums for new policies issued in 2013–14 should be determined on the same methodology as premiums for existing policies being renewed in 2013–14.

Guideline 10:

An insurance company that retains any revenue that was collected as FSL through premiums for domestic building and contents policies will be expected to refund a pro rata portion of that revenue to a policyholder who cancels the regulated contract of insurance before 1 July 2013 and:

- the cancellation results in a reduction in the liability of the insurance company to contribute to the fire services; and
- an invoice for a regulated contract of insurance sent by the company relating to coverage of any period in the 2012–13 financial year specifically identifies that a component of the price is attributable to FSL (howsoever described);

or

- the company withholds, or represents that it is withholding, an amount of money from a refund of premium to a customer on the basis that it is required as a contribution to the fire services.

Guideline 11:

A review engagement should be undertaken under the Auditing Standard on Review Engagements, ASRE 2405, *Review of Historical Financial Information Other than a Financial Report*, to ensure that the FSL collection for the year ending 30 June 2013, declared to the Monitor reconcile in all material respects, and with the amounts recorded in the insurer's accounting system (which have been traced through to fire services levy charges in policyholders' new/renewal schedules). All declarations and assurance opinions should be submitted to the Monitor by the close of business 18 October 2013.

Guideline 12:

Insurance companies should be able to provide sufficient information to justify pricing decisions for contracts of insurance regulated under the Act.

Appendix 2: Guidelines on false representation or misleading or deceptive conduct

Guideline 1:

The prohibition on false representation or misleading or deceptive conduct applies to, but is not limited to, a representation or conduct in relation to an individual price, or any other aspect, of the supply of an individual contract of fire insurance.

Guideline 2:

To reduce risks of engaging in false representation or misleading or deceptive conduct in contravention of Section 31 of the Act, an insurance company should provide easily accessible and comprehensible information to its customers on the abolition of the FSL and how their premiums for policy renewals are set to take account of its abolition.

A policyholder requesting information on the removal of FSL from a premium for renewal of a policy, and/or an explanation of any increase in premium concurrent with the apparent removal of FSL, should be provided with information specific to the particular policy. The information should be sufficient to enable the policyholder to assess the reasonableness of the premium being charged.

Guideline 3:

From 1 July 2013, any insurance company which charges a price for a regulated contract of insurance issued or renewed after 30 June 2013 that includes any dollar amount (other than zero) identified as 'fire services levy' may be considered by the Monitor to have contravened section 31 of the Act.

There may be limited, specific circumstances where documentation received by policyholders after 30 June 2013 may validly show an FSL amount other than zero. These arise from particular circumstances where transactions relating to policies issued before 1 July 2013 occur after the 30 June 2013 end-date of the current contributions arrangements. Such circumstances include:

- post-30 June 2013 processing of policies newly issued or renewed prior to 1 July 2013 due to processing delays;
- post-30 June 2013 adjustments/endorsements on policies newly issued or renewed prior to 1 July 2013; and
- post-30 June 2013 declaration adjustments on commercial policies newly issued or renewed prior to 1 July 2013.

Guideline 4:

An insurance company that provides a policyholder with the following information regarding the renewal of a policy in 2013–14:

- the amount of FSL, GST and duty on the FSL paid for the policy during 2012–13; and
- the base premium paid on the policy during 2012–13; and
- the total amount of premium, including base premium and fire services levy, and GST and duty paid on the policy during 2012–13;

- the total amount of premium, GST and duty payable on the renewal issued during 2013–14; and
- an explanation of the reason for any change in base premium payable in 2013–14

will be less likely to be considered to have contravened section 31 of the Act than otherwise.

Many companies commenced charging zero FSL prior to the end of the 2012–13 financial year due to the tapering of FSL rates raising sufficient revenue to meet their estimated funding obligations to the fire services for 2012–13. Given this situation, an insurance company that provides a policyholder with the following information regarding the renewal of a policy where a zero FSL is charged prior to 1 July 2013:

- the amount of FSL, GST and duty on the FSL paid in the preceding premium; and
- the base premium paid on the policy in the preceding premium; and
- the total amount of premium, including base premium and fire services levy, and GST and duty paid in the preceding premium;
- the total amount of premium, GST and duty payable on the renewal issued prior to 1 July 2013; and
- an explanation of the reason for any change in base premium between the two

will be less likely to be considered to have contravened section 31 of the Act than otherwise.

Appendix 3: Summary of Public Hearing submissions

The table provides a summary of the key themes in the submissions. In addition to the five participants in the 18 June 2013 public hearing (Allianz Australia Insurance, CGU Insurance, Insurance Manufacturers of Australia, QBE Insurance Australia and Suncorp Insurance), Westpac General Insurance and Zurich Australia Insurance also provided public submissions.

	Rising costs / falling investment income	Victorian versus national pricing	Natural peril models, introduction of flood cover and address level pricing	FSL tapering / transitional complexities	Communications with customers
Allianz	<p>Reinsurance cost has increased materially over recent years translating to increases in householders and commercial property classes premiums</p> <p>Investment yield falls in the March and June 2012 quarters required increase its premium rates on property.</p>	<p>Victoria has been one of the areas most impacted by increase in severity / frequency of large events leading to increase in premium for Victorian customers.</p>	<p>Offering flood insurance to Victorian customers on opt-out basis from September 2012.</p> <p>Inclusion of additional cover will affect claim costs.</p>	<p>Have used tapering³⁵ model provided by external consultants</p> <p>Has undertaken extensive preparation to avoid the risk of over-collection of FSL</p>	<p>No comment</p>
CGU	<p>Increased severity and frequency of severe weather events have significantly increased the cost of providing insurance cover.</p> <p>Tripling of reinsurance costs over the past three years.</p>	<p>No comment</p>	<p>Cost of providing flood cover will increase premiums.</p>	<p>Progressively reduced FSL rates during the 2012–13 financial year – zero from 27 April 2013.</p>	<p>Provided timely communication and tools to intermediaries and internal staff on its approach – aimed to ensure consistent understanding of FSL transition and accurate information provided to policyholders.</p> <p>Information available on the homepage of the CGU website.</p>

³⁵ Increased rates at start of the year, which declines as the year progresses.

	Rising costs / falling investment income	Victorian versus national pricing	Natural peril models, introduction of flood cover and address level pricing	FSL tapering / transitional complexities	Communications with customers
Insurance Manufacturers of Australia	<p>Major natural disasters across Australia in past few years led to a significant increase in claims costs for insurers, resulting in the need to review risk ratings and increase premiums.</p> <p>Insurers are paying more for reinsurance.</p> <p>With large catastrophes, claims are subject to post loss inflation – where a large scale loss leads to supply and demand led inflation of costs.</p>	<p>Have increased home building insurance premiums in Victoria. Note that IMA underwrites RACV policies which only operates in Victoria</p>	<p>Community understanding of natural peril risk undermined by a lack of national comprehensive natural peril data and mapping – contributed to poor planning decisions and development in areas of unacceptable risk.</p> <p>Focusing on making pricing more granular and dynamic, including geo-coding for individual street addresses and using data on individual risk factors.</p>	<p>Adopted a quarterly tapering approach, reducing rate to zero from 27 May 2013.</p>	<p>No comment</p>
QBE	<p>Adverse insurance results exacerbated by the number and size of catastrophic events experienced over recent times.</p> <p>Conditions exacerbated by diminishing investment returns on invested assets in the wake of the GFC.</p> <p>Given high levels of catastrophe activity reinsurance rates have increased.</p>	<p>Increased cost has been passed on to all property classes in all parts of Australia.</p> <p>Over past 4 years, claims to premium ratio in Victoria (94 per cent) is much higher than the rest of Australia (70 per cent).</p>	<p>Rezoning geographical models;</p> <p>Material change in the level of underlying coverage – some distribution channels have introduced flood cover.</p> <p>Price changes driven by refinements to assessment models (rezoning geographical models; implementation of new bushfire model).</p>	<p>There are significant system constraints, lengthy lead times and costly investments required to meet FSL obligations that will add to the cost base of insurers given the retrospective nature of obligations and system constraints.</p> <p>Tapering was an idea put forward by the Victorian Government³⁶. QBE adopted the PFS tapering model.</p> <p>FSL rate reduced to zero from 27 April 2013.</p>	<p>Provided ongoing information / updates to intermediated business partners about the removal of FSL in Victoria.</p> <p>Recent internal review discovered inadvertent calculation error in underwriting systems – Monitor advised – immediate steps taken to remedy the issue and in the process of directly contacting affected policy holders (4 per cent of renewals) to refund any FSL over-collection.</p>

³⁶ Note that the 'tapering' approach undertaken by insurers was conceptually different from the pro-rata tapering approach discussed by the Government.

	Rising costs / falling investment income	Victorian versus national pricing	Natural peril models, introduction of flood cover and address level pricing	FSL tapering / transitional complexities	Communications with customers
Suncorp	Significant reinsurance premium increases over the past few years	Premiums were increased across Victoria to address its increasing cost of supply relative to the other states.	<p>Built into the charge for perils is a “natural hazard allowance” – allowance has more than doubled since 2009.</p> <p>Continually updates natural peril models at address level as more information becomes available. Updated bush-fire risk information for Victoria has meant an increase in technical premium for some policy holders.</p> <p>Flood model data now included in premium calculation. Recent flood events have meant high risk areas subject to premium increases.</p>	Has not charged FSL on home insurance policies issued or renewed in Victoria since 1 Apr 2013.	<p>(Supplementary) PDS provided to some customers in Victoria (depending on when they took out or renewed their policy) to inform them of contract changes resulting from removal of the FSL. Customers had cooling off period during which time they were able to decide whether to accept the policy or cancel and receive a refund.</p> <p>Suncorp's websites (across all brands) have been updated to include information about the removal of the FSL.</p>
Westpac	Premiums may increase or decrease due to costs, unrelated to FSL, either incurred or expected to be incurred by Westpac General Insurance	No comment	No comment	No FSL charged on new policies or renewing policies issued from 21 March 2013.	Will provide information about removal of FSL charge and additional information on how to identify the impact on customers premiums and a contact telephone number to obtain more detailed information.
Zurich	No comment	Pricing was low in Victoria and has increased from July 2012.	For catastrophe related costs, past claims information often insufficient or too volatile to form reasonable view for the future. Have adopted improvements to its flood rating capability across Australia.	Have tapered according to their own model.	No comment

Appendix 4: OFSLM monitoring under section 30 sample of policy specifications used in a quote scenario

Section 30 notices were sent to eight insurers for the purpose of obtaining insurance premium prices on a monthly bases from 1 July 2012 to 31 December 2013. Quotes were obtained for nine scenarios using specified commercial, farming, residential building and contents policy requirements across metropolitan and country areas. An example of an insurance policy specification is below.

Appendix Table A: Scenario G – Country residential building (Bacchus Marsh)

Type of cover	Building (listed/defined events cover)
<u>Home address</u>	[specific address provided] Bacchus Marsh, VIC 3340
Permanent residence or rental/holiday home	Owner occupied Permanent residence – live with immediate family Family home only – no business activity/tenancy/boardings
Is the house currently being renovated, being demolished or for sale?	No
<u>Home details</u>	
Year built	1990
Description	Single storey Free standing house on slab/foundations 3 bed rooms, 2 bathrooms, no carport or garage Size 200 sq metres Average construction quality Well maintained and good condition No outdoor structures or features/fittings or landscaping (no deck, no pool, no shed etc) Not heritage listed
Elevation	No – flat ground
Exterior walls	Brick veneer
Roof	Terracotta tiles
Part of strata plan	No
Site exceeds 20,000 sq metres	No
Someone normally home during the day	No
Flood cover	No
Cover for damaged caused by theft/fusion or power surges	Yes
Accidental damage or accidental glass breakage	Yes
Home security	Key operated locks and deadlocks on all external doors Key operated locks on all accessible windows No local/back to base smoke or burglar alarms No bars/grills on accessible windows

Type of cover	Building (listed/defined events cover)
<u>Building cover</u> Replacement value	\$300,000
Date of birth of oldest policy holder	1 Jan 1973
Previously/continuously insured	Yes
Claims/loss history in last 5 years	Nil
Excess	Standard/default
Applicant background	No criminal charges / conviction / bankruptcy or refusal/cancellation of insurance policy