

The logo consists of a white outline of a house with a chimney on the left side. Inside the house shape, the words "FIRE SERVICES LEVY MONITOR" are written in white, uppercase, sans-serif font, stacked vertically.

**FIRE
SERVICES
LEVY
MONITOR**

**Report to the
Minister for Consumer Affairs**

September quarter 2014

THIS PAGE DELIBERATELY LEFT BLANK

Letter to Minister



PO Box 24374
111 Bourke Street
Melbourne Victoria 3001
HotLine 1300 300 635
www.firelevymonitor.vic.gov.au

5 December 2014

Ref: CD/14/470586

Hon Jane Garrett MP
Minister for Consumer Affairs
Level 26, 121 Exhibition Street
MELBOURNE VIC 3000

Dear Minister

I am pleased to present my report for the September quarter 2014 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). As required by section 110(4) of the Act, this report relates to the quarter ending 30 September 2014.

In view of the forthcoming repealing of the Act on 31 December 2014 – as per section 117 of the Act – this will be the final quarterly report.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Allan Fels'.

Professor Allan Fels AO
Fire Services Levy Monitor

THIS PAGE DELIBERATELY LEFT BLANK

Index

Glossary/abbreviated terms.....	xi
Executive summary	xiii
Introduction	xiii
Background to the establishment of the FSLM	xiii
Fire service funding reform.....	xiii
Issues in the transition between funding schemes.....	xiv
Victorian Government objectives.....	xiv
Key components of the legislative scheme	xv
Property insurance market context.....	xvi
Complex supply chain relationships	xvi
Differences in residential and commercial property insurance	xvi
Information asymmetry in the residential property insurance market	xvii
Concentration and profitability in the residential property insurance market	xvii
FSLM focus on residential insurance in response to market characteristics	xviii
Key compliance risks	xviii
Pricing decisions in the period leading up to and following FSL reform.....	xviii
Insurers' communications with policyholders regarding abolition of the FSL.....	xviii
Regulatory strategy addressing key compliance risks	xix
Information provision	xx
Enquiries and complaints.....	xx
Complaints about 'double charging'/'paying twice'	xxi
Complaints about amount of premium charged	xxi
Price monitoring.....	xxi
Investigations and enforcement.....	xxii
Exercise of statutory powers in investigations	xxiii
Completion of resolution of over-collection of FSL.....	xxiii
Investigation continuing as at 30 September 2014	xxiv
Did the FSLM achieve its regulatory objectives?	xxv
Objective 1: Benefits of abolition of FSL passed on to consumers.....	xxv
Objective 2: Consumers of insurance are protected in the transition	xxix
Lessons for regulation in fire service funding reform.....	xxxi
What worked well	xxxi
Difficulties encountered	xxxi
Elements of regulatory oversight of transition	xxxii

1.	Introduction.....	1
2.	The <i>Fire Services Levy Monitor Act 2012</i>.....	3
2.1	Background to the establishment of the Fire Services Levy Monitor	3
2.1.1	Insurance-based funding scheme.....	3
2.1.2	Fire service funding policy change.....	4
2.1.3	Property-based funding scheme	5
2.2	Issues in the transition between funding schemes.....	6
2.3	Victorian Government objectives.....	8
2.4	Outline of key components of legislative scheme	8
2.4.1	Functions and powers of the FSLM	8
2.4.2	Prohibition on price exploitation	9
2.4.3	Prohibition on false, misleading or deceptive conduct.....	10
2.4.4	Information provision and guidelines for industry	10
2.4.5	Price monitoring	11
2.4.6	Investigatory powers	11
2.4.7	Remedies	12
2.4.8	Reporting.....	12
3.	Property insurance market context	13
3.1	Industry relationships.....	13
3.2	Differences in residential and commercial property insurance	14
3.3	Information asymmetry in the residential property insurance market	15
3.4	Industry concentration and profitability.....	16
3.5	FSLM focus on residential property insurance.....	19
4.	Key compliance risks	21
4.1	Pricing decisions in the period leading up to and following FSL reform.....	21
4.2	Insurers' communications with policyholders regarding abolition of the FSL.....	21
4.3	Regulatory strategy addressing key compliance risks	22
5.	Information provision.....	27
5.1	Media and public relations.....	27
5.2	Website.....	27
6.	Enquiries and complaints	31
6.1	Complaints and enquiries line – 1300 300 635	31
6.2	Sources and trends of enquiries and complaints	32
6.3	Double charging/paying twice	34
6.4	Complaints about the amount of FSL or base premium charged	35

7.	Price monitoring of individual insurers.....	37
7.1	Ongoing premium quotes	37
7.2	Developments in premiums.....	37
7.3	Premium data supplied by insurers – 12 months ending September 2014	38
7.4	Premium data supplied by insurers – September quarter 2014.....	39
7.5	Premium quotes obtained from insurers' websites.....	40
7.6	Price variations across the major insurers	41
8.	Investigation and enforcement	43
8.1	Over-collection of FSL by insurers in 2012–13	43
8.1.1	Policyholder refunds	44
8.1.2	Payments to consumer organisations.....	45
8.1.3	Application of funds disbursed to consumer organisations	46
8.2	Continuing investigations as at 30 September 2014.....	47
8.2.1	Insurers	47
8.2.2	Amnesty for brokers and insurers.....	48
9.	Did the FSLM achieve its regulatory objectives?.....	49
	Objective 1: Benefits of abolition of FSL passed on to consumers	49
9.1	Criteria for a successful transition	49
9.2	Consumers were refunded over-collected FSL.....	49
9.3	Were premium movements reasonable?	51
9.3.1	The role of FSL rate tapering	51
9.3.2	How did residential property insurance premiums change?.....	54
9.3.3	Will the premium reductions due to the elimination of the FSL be sustained into the future?.....	59
	Objective 2: Insurance consumers protected.....	59
10.	Lessons relating to abolition of insurance-based funding of fire services.....	63
10.1	What worked well	63
10.1.1	Engagement with consumers.....	63
10.1.2	Formal industry monitoring	63
10.1.3	Strong regulatory regime	63
10.2	What difficulties were encountered	64
10.2.1	Lack of historical requirement for clear declaration to policyholders of FSL collection by insurers.....	64
10.2.2	Communications between insurers and their customers during transition.....	64
10.2.3	Insurers' preparation for compliance.....	65
10.2.4	Resolving over-collection of FSL	65

10.3	Elements of regulatory oversight of a policy transition.....	66
10.3.1	Timely establishment of transition arrangements	66
10.3.2	Supporting framework for fire service funding reform.....	67
10.3.3	Effective regulatory oversight of levy transition	68
Appendix A: Insurance market relationships		69
Appendix B: Total disbursement of over-collected FSL by insurer		73
Appendix C: ICA comments on the regulatory scheme for the fire services levy reform.....		75
Appendix D: Regulatory intervention supporting funding policy change.....		79
D.1	Prices response to tax change.....	79
	Economic theory and the effects of taxation	79
	Application of taxation theory to the insurance market	81
	The role of competition.....	82
D.2	Interventionist rationale and precedent	82
Bibliography / references.....		83

Index of figures

Figure 1	Total premium and base premium for the MFESB region – July 2012 to September 2014	xxvii
Figure 2	Total premium and base premium for the CFA region – July 2012 to September 2014	xxvii
Figure 3	Average total premium for residential property insurance in Melbourne vs other Australian capital cities – June quarter 2011 to June quarter 2014	xxviii
Figure 4	Types of insurance industry relationships	14
Figure 5	After-tax return on equity for insurers vs banks – 2005 to 2013	19
Figure 6	Inter-relationship between complaints and price monitoring	23
Figure 7	Website traffic sources overview – July 2013 to September 2014	28
Figure 8	Visits (by day) to the FSLM website – September quarter 2014	29
Figure 9	Visits (by month) to the FSLM website – February 2013 to September 2014	29
Figure 10	Calls (by day) to the FSLM complaints and enquiries line – September quarter 2014	31
Figure 11	Calls (by month) to the FSLM complaints and enquiries line – February 2013 to September 2014	32
Figure 12	Residential building insurance base premium, average change in insurers' quotes in MFESB region – September 2013 to September 2014	38
Figure 13	Residential building insurance base premium, average change in insurers' quotes in CFA region – September 2013 to September 2014	39
Figure 14	FSL rates applied to residential property insurance in Victoria – June 2011 to June 2013	52
Figure 15	Total premium and base premium for the MFESB region – July 2012 to September 2014	55
Figure 16	Total premium and base premium for the CFA region – July 2012 to September 2014	55
Figure 17	Average total premium for residential property insurance in Melbourne vs other Australian capital cities – June quarter 2011 to June quarter 2014	56
Figure 18	Total premium and implied base premium for residential property insurance in Melbourne – June quarter 2011 to June quarter 2014	58
Figure 19	Underwriter / retailer relationship with policyholders	69
Figure 20	Distributor / agent relationship with underwriters and policyholders	70
Figure 21	Straightforward broker relationships with underwriters and policyholders	70
Figure 22	Broker really a distributor / agent	71
Figure 23	Broker operating through a network	72
Figure 24	Effect of imposing a tax on a good or service	79
Figure 25	Relative burden of a tax	80
Figure 26	Taxes on insurance	81

Index of tables

Table 1	Aggregate outcome of FSLM oversight: revenue not retained by insurers.....	xxii
Table 2	Rates for Fire Services Property Levy – 2014-15	5
Table 3	Value of residential and commercial property insurance premium written in Victoria – 2012–13.....	13
Table 4	Market shares for residential property insurance in Victoria – 2012–13.....	17
Table 5	Market shares for commercial property insurance in Victoria – 2012–13.....	18
Table 6	Compliance risk and FSLM mitigation measure.....	23
Table 7	All visits FSLM to website in each quarter – March quarter 2013 to September quarter 2014	27
Table 8	Unique visits FSLM to website in each quarter* – March quarter 2013 to September quarter 2014	28
Table 9	Enquiries/complaints to the FSLM – March quarter 2013 to September quarter 2014	32
Table 10	Enquiries / complaints by category – August 2012 to September 2014	33
Table 11	Complaints by insurance brand – August 2012 to September 2014.....	33
Table 12	Statutory notices issued under monitoring and investigation power – September quarter 2014	37
Table 13	Total premium for residential insurance by brand, per cent change from previous quarter – September quarter 2013 to June quarter 2014.....	40
Table 14	Indicative base premium by brand – March quarter 2013 to September quarter 2014	41
Table 15	On-line building only insurance premium quote for FSLM specified properties (\$300,000 sum insured) – 1 October 2014	42
Table 16	Aggregate outcome of FSLM oversight: revenue not retained by insurers.....	43
Table 17	FSL payments disbursed by relevant insurers to recipient organisations.....	46
Table 18	Range of over-collection of FSL by insurers in Victoria’s MFESB and CFA regions – 2012–13.....	50
Table 19	Average FSL rates applied to property insurance in the MFESB and CFA regions – 2010-11 to 2012–13	52
Table 20	Change to total premium following FSL reform.....	54
Table 21	Changes to total and base premium for residential property insurance in Melbourne.....	58

Index of boxes

Box 1	Components of total premium for property insurance	6
Box 2	Transition out (tapering) of insurance-based levies	53

Glossary/abbreviated terms

Term	Description
CFA	Country Fire Authority
CGU	CGU Insurance Limited
CGU undertaking	An enforceable undertaking to the FSLM entered into by CGU Insurance Limited on 29 August 2014
DTF	Department of Treasury and Finance (Victoria)
FSL	fire services levy
FSLM	(The statutory positions of) Fire Services Levy Monitor, the Deputy Fire Services Levy Monitor and/or the staff employed by the Monitor
FSL reform	fire services levy reform – as defined in s.3 of the FSLM Act <i>the abolition of the fire services levy by the Fire Services Property Levy Act 2012</i>
FSPL	Fire Services Property Levy
GST	Goods & Services Tax
ICA	Insurance Council of Australia
IMA	Insurance Manufacturers of Australia Pty Limited
IMA undertaking	An enforceable undertaking to the FSLM entered into by IMA on 16 January 2014
LoU	letter of understanding
MFB	Metropolitan Fire Brigade
MFESB	Metropolitan Fire and Emergency Services Board
MoU	memorandum of understanding
PDS	product disclosure statement
QBE	QBE Insurance (Australia) Limited
RBA	Reserve Bank of Australia
regulated contract of insurance	As defined in s.3 of the FSLM Act: <i>(a) a policy of insurance against fire; or</i> <i>(b) a combined or comprehensive policy of insurance which includes insurance against fire—</i> <i>Issued by an insurance company whether before, on or after the commencement of this Act;</i>

THIS PAGE DELIBERATELY LEFT BLANK

Executive summary

Introduction

This is the seventh and final report prepared in accordance with s.110 of the *Fire Services Levy Monitor Act 2012* (the FSLM Act) on the performance of the functions of the Fire Services Levy Monitor (the FSLM). The FSLM Act is to be repealed on 31 December 2014 by virtue of s.117 of the FSLM Act.

In addition to reporting on the performance of functions in the September quarter 2014, this report also provides an overview of performance for the period from 19 December 2012, the commencement date of effect of the FSLM Act, to 30 September 2014 and some general observations of the regulatory scheme established by the FSLM Act.

The report outlines the FSLM Act, the property insurance market context in which it operates and the key compliance risks addressed. The major functions and performance information are described. Observations on the achievement of the Government's objectives and lessons from the FSLM's experience are provided.

Background to the establishment of the FSLM

Fire service funding reform

Prior to 1 July 2013, Victoria's fire services were funded largely through contributions made by insurance companies. Insurance companies were required by legislation to contribute the bulk of annual expenditure for the Metropolitan Fire and Emergency Services Board (MFESB) and Country Fire Authority (CFA). Insurance companies historically chose to recoup their contribution costs through a 'fire services levy' (FSL) charged to residential and commercial policyholders in their premiums for insuring property against fire. The FSL was an additional charge to the 'base premium' and was based on applying a percentage rate (the 'FSL rate') to the base premium.

In 2011, the Victorian Government began the implementation of a recommendation of the 2009 Victorian Bushfires Royal Commission (VBRC) to replace the insurance-based funding of the fire services with a property-based levy on all Victorian property owners. Major criticisms of the insurance-based levy included the resulting non-contribution of uninsured property owners and the partial contribution of underinsured property owners, and the lack of transparency of the funding arrangement due to the wide discretion available to insurers in recouping their contributions. In addition, Goods & Services Tax (GST) and stamp duty were charged on top of the levy thus further increasing costs.

The new Fire Services Property Levy (FSPL), introduced from 1 July 2013, applied to all property in Victoria and comprised a fixed and variable component, with the variable component based on the capital improved value of the property. The FSPL is collected via local council rates notices and varies depending on property location and type. GST and stamp duty are not payable on the amount of FSPL. The removal of the insurance-based levy is expected to increase uptake of home insurance through lower insurance costs to households improving affordability of insurance. The new funding model provides a more

equitable funding of the fire services, being spread across all property owners rather than just those with insurance, and a more transparent source of revenue for the fire services.

Issues in the transition between funding schemes

The key issue in the transition out of the insurance-based funding scheme to the property-based scheme was whether the significant amount that FSL represented in insurers' premium revenues would be removed from their revenues after the abolition of the insurers' requirement to contribute to the fire services. The total of insurers' contributions to the fire services required in the final year 2012–13 was \$549 million – equivalent to 22.5 per cent of residential property insurance base premium revenue, and 63.2 per cent of commercial property insurance base premium revenue in Victoria. Associated GST and stamp duty was a further \$115 million. Thus, the total revenue stream to the insurance industry related to the funding of the fire services was \$665 million in 2012–13. If price competition in insurance markets is not fully effective, there is a danger that such significant reductions in prices related to removal of statutory charges may be passed on slowly, or even only partially.

Another issue, although one not restricted solely to the final year of the insurance-based scheme, was whether insurers would recoup more through the FSL than was necessary to cover their statutory contributions. There had been concerns in the past regarding the transparency of matching FSL collected and contributions, which resulted in amendments to the fire services' legislation in 2005. However, there remained no mechanism within the administration of the insurance-based scheme to ensure that the revenues actually recouped from policyholders in each year matched the contributions made to the fire services.

The communications from insurers to policyholders regarding the implications of the abolition of FSL charged to particular policyholders was a further issue. What information would insurers provide about the abolition of FSL and how effective would that information be in assisting policyholders assess the effect of the removal (or otherwise) of FSL from the premiums they pay? Many policyholders were unaware that they paid FSL and how significant a component it was in the cost of their property insurance, or even what it was for.

Victorian Government objectives

On 28 August 2012, the Victorian Government announced that it would establish an independent Fire Services Levy Monitor to oversee the period of transition to new levy arrangements. The then Minister for Consumer Affairs stated in the 14 November 2012 second reading speech on the *Fire Services Levy Monitor Bill 2012* (FSLM Bill), that the purpose of establishing the FSLM was '... to ensure that the interests of consumers are protected during the transition to the new fire services property levy'. The FSLM Bill introduced a new prohibition on insurance companies ('price exploitation') to prevent situations where '... an insurance company does not pass on to consumers the full reduction in cost from the abolition of the insurance-based levy or seeks to recover more in FSL from policy-holders than the insurance company is required to remit to the government'.

The FSLM's role was described by the then Treasurer as '... making sure insurance companies did the right thing by consumers...the Government is putting strong mechanisms in

place to ensure consumers are protected. This legislation will see serious penalties apply to any company caught engaging in price exploitation'.¹

The Government clearly regarded the fire service funding reform as significant, with the Treasurer describing the change in his State Budget 2013–14 speech as 'a major tax reform that puts our fire services on a firmer financial footing'.² The then Premier has described the change to the FSPL as 'the biggest tax reform in 20 years'.³ The regulatory oversight established by the FSLM Act was critical to the success of the reform on at least two counts. If insurance price reductions did not occur, the policy rationale of improved affordability of home insurance would not be realised. Furthermore, the public's perception of the reform as equitable would be undermined if that occurred, as insurers' would be seen to have opportunistically taken a windfall gain.

Key components of the legislative scheme

The *Fire Services Levy Monitor Act 2012* came into effect on 19 December 2012 and public-facing operations of the office commenced on 30 January 2013. The regulatory scheme established by the FSLM Act centres on the prohibitions on price exploitation and on falsely representing, misleading or deceiving any person about the effect, or likely effect, of the fire services levy reform (FSL reform).

The key functions of the FSLM provided for in the FSLM Act are to:

- provide information, advice and guidance to policyholders and insurers in relation to the abolition of the FSL
- prepare and publish guidelines in relation to the operation and enforcement of this Act
- monitor insurance premiums, including base premiums and FSL
- monitor the compliance of the insurance industry with the prohibitions
- receive and deal with complaints
- investigate potential contraventions and take appropriate enforcement action.

These functions are supported by strong investigatory powers to obtain information and documents from insurers in relation to potential contraventions. Also reflecting the Government's objective to have insurers pass on the abolition of the FSL to consumers, the FSLM Act provides very substantial civil penalties in the event of contraventions of the prohibitions: a maximum of \$10 million for a body corporate and \$500,000 for a natural person in respect of each contravention.

¹ Media Release, The Hon Michael O'Brien and the Hon Kim Wells, 'Tough new consumer protections to support abolition of fire services levy', Wednesday 14 November 2012. Available at: http://www.premier.vic.gov.au/images/stories/documents/mediareleases/2012/November/121114_O'Brien_Wells_-_Tough_new_consumer_protections_to_support_the_Fire_Services_Levy_transition.pdf, accessed 30 October 2014.

² The Hon Michael O'Brien MP, Treasurer Victoria, *Budget Speech 7 May 2013*

³ The Hon Ted Baillieu MP at: <http://www.tedbaillieu.com.au/about/former-premier>, accessed 23 October 2014

Property insurance market context

The property insurance market is comprised of two broad segments, residential and commercial property insurance. In the 2012–13 financial year, the market in Victoria received gross premium revenue of about \$2.6 billion, with two-thirds of that attributable to the residential sector. While the Government's decision to establish a new regulator did not appear to rest on a particular view of the nature of the property insurance market, the characteristics of the market were relevant considerations in the administration of the scheme. Several aspects of the supply side of the market are directly relevant to the approach taken to the administration of the regulatory scheme.

Complex supply chain relationships

First, the scope of the regulatory scheme extended to 89 insurance companies required to make contributions to the fire services in 2012–13. This was a significant number of entities to deal with, given the short lifespan of the FSLM and the complexity of supply chain relationships in which many of the companies operate. There are multiple layers of supply: underwriters; agents; brokers (and networks of brokers); and integrated insurers encompassing underwriting through to retailing policies. As later became evident in the investigation into brokers charging FSL after 30 June 2013, this sometimes made it difficult to establish which entity in the supply chain was responsible for charging FSL.

Differences in residential and commercial property insurance

Second, there are significant differences between the residential property and commercial property segments of the market. On the supply side, products issued for the purposes of *residential* property insurance tend to be of a standardised nature, with only limited scope for (prospective) policyholders to tailor aspects of policy coverage. However, *commercial* property insurance policies are more likely to be bespoke products, given the diverse nature of commercial operations and business structures. Supply chain structures throughout the industry tend to differ according to the type of insurance being sold: residential property insurance is a mix of mostly direct sales through integrated entities websites or call centres, with some intermediated sales through brokers; and commercial property insurance is almost entirely intermediated through brokers.

On the demand side, commercial and residential policyholders have differing characteristics. Most commercial insurance policyholders, being operators of businesses themselves, are likely to take a relatively sophisticated approach to meeting their insurance needs. Their commercial acumen and the engagement of insurance brokers in policy selection and price negotiation are more likely to ensure they understand the nuances of policies and achieve a competitive price.

Residential policyholders, on the other hand, often lack the resources or time to understand complicated residential property insurance policies. (Despite this, they still tend to purchase their insurance via direct contact with underwriters or their associated distributors.) Adding to the complicated demand-side of the property insurance market, prior to the abolition of the insurance-based levy there was a low level of awareness of the FSL as a component of the total premium charged and what the exact purpose of the FSL was.

Information asymmetry in the residential property insurance market

There appears to be a substantial degree of information asymmetry between insurers and their customers in the residential property insurance market that operates to the disadvantage of customers. Insurers have garnered a wealth of information regarding detail of the properties they might insure and the extent of the risks involved, yet that same information is not necessarily accessible to persons seeking insurance. The legislated requirement on prospective policyholders to fully disclose relevant information to insurers is not mirrored in insurers' obligations to prospective policyholders. Difficulties in understanding and comparing policies arise because there is no standardised form for presentation of key provisions of policies or of product disclosure statements (PDS). Many policyholders are likely to be overwhelmed by the volume of information presented in a PDS that is usually 60 to 90 pages long.

Concentration and profitability in the residential property insurance market

Despite the large number of suppliers of property insurance in total, supply in the residential property market is quite concentrated. The combined brands and underwriting activities of three corporate entities – Suncorp Group (AAMI, APIA, GIO, Vero brands), Insurance Australia Group (RACV, CGU brands) and QBE Insurance (Australia) Limited (QBE) – accounted for over 70 per cent of the Victorian residential property insurance market. In comparison, the commercial property insurance market in Victoria is less concentrated, with seven separate corporate entities – QBE, Suncorp Group, Insurance Australia Group, Wesfarmers, Allianz, Zurich and FM Insurance – accounting for 70 per cent of that market.

Although there are no publicly available estimates of the profitability of residential property insurance, general insurance – which property insurance is a component of – is clearly a profitable business. Large insurers have generally been very effective in recent years in managing the overall balance between risks and premiums. Over the nine years to 2013, the annual average return on equity on general insurers' across-the-board portfolios was 19 per cent for underwriters with a significant presence in the Victorian residential property insurance market.⁴ Profitability for these insurers over this period has, on average, exceeded that of Australia's 'Big Four' banks.

There appears to be some cyclical in property insurance prices and profitability. Costs associated with a run of natural disasters rise and profitability is relatively squeezed, but in response the industry is able to raise prices to move back towards target rates of return and profitability is restored. It may have been the case that the FSLM role coincided with the latter stages of prices rising to restore profitability after the cost pressures associated with natural disasters in the 2008 to 2011 years.

Despite the large total number of suppliers and the occurrence of new entry, most recently by Youi Pty Ltd, based on FSLM monitoring there appear to be persistent substantial price differences among insurers' very similar policies for identical properties. This, the continuing relatively high profitability already noted, and persistent price differences between insurers for

⁴ Sample chosen to represent all underwriters with a 2012-13 market share in Victorian residential property insurance of 2% or greater with the following exceptions: Suncorp Metway Insurance Limited included to avoid anomalies created by the effects of financial transfers between members of the Suncorp Group of companies; Wesfarmers Federation Insurance Limited is the forerunner to Wesfarmers General Insurance Limited.

insuring the identical properties, suggest that overall price competition in the residential insurance market is not particularly vigorous. This concern that the residential property market was the least competitive segment informed the approach to oversight of the insurance companies in the FSL reform.

FSLM focus on residential insurance in response to market characteristics

The combination of the above factors and the Government's objective that the interests of consumers be protected during the transition to the new property-based levy, led the FSLM to focus more attention on residential property insurance policyholders as those more likely to require some form of assistance in the transition. Information provided to policyholders by the FSLM was premised on residential policyholders having minimal awareness of the FSL and the implications of its abolition for their insurance premiums. This approach was consistent with a risk-based approach to regulating the transition.

Key compliance risks

The key risks in the abolition of the insurance-based levy, which reflected the transitional issues outlined above, fall into two broad categories: those relating to insurers' pricing decisions, and those relating to the implementation of the abolition of the FSL in practice, such as in adjustments to billing systems and in communications with policyholders.

Pricing decisions in the period leading up to and following FSL reform

Specific risks associated with the periods leading up to and following FSL reform – pre-transition period (2011–12), the transition period (2012–13) and the post-transition period (2013–14) included:

- property insurance base premiums being increased 'excessively' in 2011–12 (following the Government's announcement of reform in May 2011) to gain higher price levels before the FSL is formally abolished and monitoring put in place
- property insurance base premiums being increased excessively around the time of abolition of FSL, in the knowledge that the removal of the significant FSL component of a policyholder's total premium provides 'cover' to increase base premiums without increasing the total premium invoiced for renewal of a policy
- more revenue being collected from policyholders as FSL in 2012–13 than insurers needed to fund their contributions to the fire services
- property insurance premiums being increased excessively after 31 December 2014 when the FSLM's oversight function ceases.

Insurers' communications with policyholders regarding abolition of the FSL

Specific risks associated with communication between insurers and policyholders about the effects of fire service funding reform included:

- insurers not providing easily accessible and readily comprehensible general information about the abolition of the insurance-based levy to policyholders to alert policyholders to the change
- insurers not providing sufficient information specific to the premiums of individual policyholders to enable them to assess the effects of FSL rate changes, the abolition of the FSL and any changes in base premiums during the transition year
- insurers, intermediaries and/or brokers not adjusting their billing systems correctly to ensure that FSL is properly removed by the 1 July 2013 date
- insurers and/or brokers not having mechanisms to deal with policyholders' enquiries or complaints regarding premium changes with the removal of FSL.

Regulatory strategy addressing key compliance risks

Prior to the commencement of public-facing operations on 30 January 2013, a coherent strategy was developed to address the compliance risks identified above within the framework of the FSLM Act. The strategy had four main inter-connected components:

- information provision to the general public, policyholders and insurers, and guidelines to insurers, intermediaries and brokers on how to comply with the FSLM Act
- monitoring of:
 - prices charged by insurers (FSL, base premiums and total premiums)
 - compliance with the statutory guidelines
 - enquiries and complaints received through the website, the 1300 line, emails and letters
- investigation of potential breaches of the FSLM Act that were indicated by complaints or monitoring activities
- enforcement actions following appropriate investigations where breaches of the FSLM Act were considered to have occurred.

An important element of the strategy was the integration of monitoring of enquiries and complaints and the monitoring of prices. Individual complaints and patterns revealed by analysis of enquiries and complaints data helped target monitoring activities; the analysis of monitoring data provided context for individual complaints and assisted the assessment of whether further investigation was appropriate.

Another important element of the strategy was the focus on the compliance of *individual* insurers with the FSLM Act – as the Act required – rather than a focus on industry positions or dealing with the industry association as the centrepiece of endeavours to promote compliance by individual insurers.

The operations of the FSLM reflected the functions assigned by the FSLM Act and the components of the strategy above. The description below provides an overview of operations up to the end of the September quarter 2014.

Information provision

The FSLM website (www.firelevymonitor.vic.gov.au) has been the principal means of providing information to insurers, policyholders and the public, generally about the abolition of the FSL, the role of the FSLM and updates about activities. There have been a cumulative total of 37,117 visits to the website from inception of the website to the end of September 2014. The website also contains the FSLM's 'register of undertakings' as required by s.94 of the FSLM Act. There are 19 enforceable undertakings on the register: three relating to pricing; and 16 relating to over-collection of FSL in the final year.

In May 2013, after a consultation process, guidelines were issued under s.27 and s.6(2)(d) on how to comply with the two prohibitions contained in the FSLM Act:

- *Guidelines on price exploitation in relation to the fire services levy reform* (FSLM May 2013 guidelines on price exploitation)
- *Guidelines on false representation or misleading or deceptive conduct in relation to the fire services levy reform* (FSLM May 2013 guidelines on misleading / deceptive conduct)

Further guidelines were issued in March 2014 concerning the refunding of FSL over-collected by insurers in 2012–13 – *Resolution of insurers' over-collection of fire services levy in 2012–13* (FSLM March 2014 guidelines on resolution of over-collection).

Two advertising campaigns were undertaken in the print and online news media: one in June 2013 alerting the public that the FSL was about to be abolished and that the FSLM existed to protect consumers' interests and take enquiries/complaints; the second in October 2013 reminding policyholders to check that their total premiums had fallen in policy renewals issued from 1 July 2013.

'Public warnings', issued under s.106 of the FSLM Act, were placed in Victoria's major newspapers: in May 2013 to alert property insurance policy holders to check that their total premiums in renewal notices were reduced; and in October 2013 to warn brokers that they should not still be charging FSL after 30 June 2013.

Twenty media releases were issued on various subjects concerning the abolition of the FSL and the outcomes of FSLM activities between January 2013 and September 2014.

Enquiries and complaints

A dedicated enquiries line assisted policyholders with their enquiries and complaints regarding fire service funding reform. The enquiries line received a total of 6,128 calls between its launch on 30 January 2013 and 30 September 2014. Call rates to the enquiries line have declined substantially since the peak of September 2013 and by September 2014 were the least since the inception of the service. In addition, 726 emails and 268 letters were received over the same period, a total of 7,122 enquiries and complaints across all sources.

Of the total 7,122 enquiries and complaints, 2,659 were more than a general enquiry and the subject matter was able to be categorised. Of these 2,569 complaints, 57 per cent related to the perception of 'double charging'/'paying twice' and 35 per cent related to the amount of premium (either FSL or base premium) charged to policyholders.

Complaints about 'double charging'/'paying twice'

The double charging concern was that policyholders would pay a levy to insurers and a levy to the Government in the same year. This issue was addressed at the outset in the explanatory material provided on the FSLM website from its commencement in January 2013. However, the double charging perception was frequently raised throughout 2013, despite the website explanation, the efforts of FSLM enquiries staff who took calls on this issue and other direct communications with individual policyholders who made this complaint.

The explanation as to why this was a misconception and not a double payment for the fire services was that the FSL component of an insurance premium was tied to financial years, not the period of insurance coverage. The FSL and the base premium were for different purposes and related to different periods, even though they were charged in a single total price.

Paying twice would have arisen only if an insurer failed to remove the levy on policies inceptioned on or after 1 July 2013: a policyholder in reality would be charged twice: through the insurance premium and through the FSPL included with 2013–14 councils rates notices. However, should this have occurred, it would have raised compliance issues and insurers would have faced investigation and potential enforcement action.

Where insurers did the correct thing and removed the FSL from insurance premiums, policyholders did not pay for the fire services twice for the same year. This was the case even where a policyholder paid an FSL amount in a total premium prior to the 1 July 2013 abolition date and also paid the FSPL later in 2013.

Complaints about amount of premium charged

Complaints about the amount of FSL or premium charged to policyholders were received in two 'waves' during 2012–13. The first wave of complaints related to increased amounts of FSL charged in the first half of 2012–13 which reflected most insurers' practice of 'tapering' FSL rates. This involved initially increasing FSL rates in that period. Many of these complaints were received by Consumer Affairs Victoria prior to the operation of the FSLM and were passed to the FSLM for examination. The second wave of complaints related to large increases in base premiums coinciding with some insurers removing FSL from their total premiums. These were received in the second half of 2012–13 and most were from Insurance Manufacturers Australia Pty Limited (IMA) policyholders.

Price monitoring

The FSLM Act provided strong powers to monitor prices in order to assess: the general effect of the abolition of the FSL on prices charged by insurance companies; and/or whether price exploitation or false representation or misleading or deceptive conduct have occurred. Four sources of residential property insurance price information were utilised in monitoring:

- prices provided monthly by 11 major insurers for a constant sample of properties in response to notices 'relating to prices or the setting of prices' issued under s.30 of the FSLM Act
- prices obtained monthly anonymously from eight insurers' website online quotation facilities for a sample of properties

- prices provided weekly by an actuarial consulting firm for a sample of properties
- indexes of home insurance prices collected by the Australian Bureau of Statistics (ABS) for the quarterly Consumer Price Index.

Due to the bespoke nature of commercial property insurance policies and the focus on the interests of residential policyholders explained above, regular monitoring of prices for commercial property insurance was not undertaken. However, some complaints about premiums for commercial policies were received during 2013 and examined. Also, the investigation into the charging of FSL after 30 June 2013 by certain brokers related mostly to commercial property policies.

Section 18 of the FSLM Act also provided power to obtain information or documents 'that may assist...in monitoring compliance with the FSLM Act'. Failure to comply with a notice issued under s.18 carries penalties of up to \$15,000 for corporations. During the period January 2013 to the end of September 2014, 207 notices were issued as part of the monitoring of prices.

The conclusions drawn from this monitoring regarding whether FSL was removed from premiums are summarised later (see under section *Did the FSLM achieve its regulatory objectives?*)

Investigations and enforcement

There were four major areas of investigation and enforcement activity: two of these related to pricing by individual companies in the lead-up to the abolition of the FSL; one was the almost industry-wide occurrence of over-collection of FSL due to insurers having to estimate their contributions for 2012–13; and one was the charging of FSL after 30 June 2013 by some brokers. There were developments in respect of the last two in the September quarter 2014.

Nearly \$27 million in revenues received in 2012–13, that otherwise would have been retained by insurers, has been returned to policyholders or otherwise disbursed by insurers. The components of this amount are shown in Table 1.

Table 1 Aggregate outcome of FSLM oversight: revenue not retained by insurers

Compliance issue	No. of policyholders where refunds made	Amount disbursed (\$ million)
Pricing error on reducing FSL rates	11,500	1.3
Charging FSL after planned cessation	1,051	0.1
Price increase just before abolition of FSL	206,000	11.3
Over-collection of FSL in 2012–13	40,538	8.1
Over-collection of FSL in 2012–13	Refunds paid to consumer organisations	4.4
CGU payment to CFA		1.2
Brokers and insurers charging FSL after 30 June 2013	120*	0.5*
Total not retained by insurers		26.9

* Includes \$314,000 identified as a result of the amnesty that ran through October 2014.

The two largest enforcement outcomes, in terms of refunds to policyholders, were:

- the enforceable undertaking to the FSLM entered into by IMA on 16 January 2014 (IMA undertaking) in relation to an alleged contravention of the price exploitation prohibition by a large increase in base premiums in June 2013 coinciding with the removal of the FSL (\$11.3 million)
- the administrative resolution of the over-collection of FSL due to insurers having to estimate their statutory contributions for 2012–13 (\$8.1 million refunded to policyholders and \$4.4 million disbursed to consumer organisations and \$1.2 million to the CFA).

Exercise of statutory powers in investigations

Section 19 of the FSLM Act provides power to obtain information, documents and evidence relating to matters that are, or may be, contraventions of the FSLM Act. Failure to comply with a notice issued under s.19 carries penalties of up to \$44,000 for corporations. During the period January 2013 to end of September 2014, 52 notices were issued as part of investigations into potential contraventions of the prohibitions on: price exploitation; and false representations or misleading or deceptive conduct.

Completion of resolution of over-collection of FSL

It was anticipated that that at least some insurers would collect more FSL than was ultimately required to meet their statutory contribution in 2012–13. This outcome was almost inevitable given that the final determination of the amount of statutory contribution for 2012–13 would not be made until October 2013. Accordingly, the FSLM May 2013 guidelines on price exploitation provided that where an insurance company over-collected FSL, it should directly refund the excess to affected policyholders.

On 7 March 2014, more detailed guidelines (FSLM March 2014 guidelines on resolution of over-collection) were issued. They provided that insurers who had over-collected for one fire service, but under-collected in relation to the other, would be able to offset the 'under' amount against the 'over' amount. This had the effect of reducing the total amount of over-collection of FSL across 56 affected insurers, to \$12.7 million.

The FSLM March 2014 guidelines on resolution of over-collection provide that verified cancellation-related FSL refunds made by insurers before 1 March 2014 (in connection with 2012–13 incepted policies) would also be accepted as an offset against the amount of over-collection. In circumstances where refunds to policyholders would be impractical, due to small amounts per policy or the complexities of intermediated arrangements with policyholders, the guidelines provided that aggregation of over-collected FSL would be acceptable. Such aggregated amounts were to be disbursed to organisations representing the interests of Victorian consumers of insurance.

In the report for the June quarter 2014, it was noted that, as at 30 June 2014, 55 of the 56 insurance companies that over-collected FSL had participated in a process to resolve their over-collection. In the September quarter 2014 (29 August), an enforceable undertaking to the FSLM was entered into by CGU Insurance Limited (CGU undertaking) that resolved the over-collection by CGU. Fifteen other companies that had readily agreed to follow the FSLM March 2014 guidelines on resolution of over-collection also provided enforceable undertakings. In total, 16 insurers provided formal undertakings pursuant to s.92 of the FSLM

Act to resolve their over-collection. All undertakings were placed on the FSLM website. The remaining insurers in differing circumstances completed agreements with the FSLM.

Insurers agreed to make direct refunds to policyholders totalling \$6.674 million. The addition of the applicable GST and stamp duty increased the refunds by \$1.401 million to \$8.076 million. Where other insurance companies met the conditions for aggregating some or all of the refund amounts into a single sum, relevant insurers agreed to disburse those monies to approved consumer organisations to benefit Victorian consumers of insurance. The total amount of aggregated FSL payments disbursed by relevant insurers among seven recipient organisations undertaking projects totalled \$4.372 million. The FSLM also accepted as part of the CGU undertaking that \$1.2 million be paid to the CFA.

A list of the 56 insurance companies required to disburse their net over-collected FSL, along with their disbursement to either policyholders or consumer organisations, is at Appendix B: Total disbursement of over-collected FSL by insurer.

Investigation continuing as at 30 September 2014

The final area of investigation and enforcement activities related to the charging of FSL after 30 June 2013. Most policies known to be affected by this practice were construction or building insurance contracts. The policies were incepted on or before 30 June 2013 with adjustments made after 30 June 2013. Such adjustments did not alter the insurer's FSL liability for the 2012-13 financial year and, therefore, had no consequences for FSL collection. Consequently, the charging of FSL after 30 June 2013 raised significant issues of compliance with the FSLM Act. Refunding the charge directly to all policies was considered by the Monitor to be the appropriate remedy.

The extent of the improper charging of FSL established was limited in terms of the number of policies and the amount of FSL paid by policyholders. Prior to the end of September 2014, the FSLM identified close to \$200,000 of FSL that was charged on or after 1 July 2013. The policies in question involved of the order of 20 brokers and intermediaries and were underwritten by only a few insurance companies. Enforcement outcomes included the issuance of formal warnings, a court enforceable undertaking, and one pending court action.

Given the imminent repeal of the FSLM Act on 31 December 2014 and the costs associated with a continuing widespread investigation by the Director of Consumer Affairs Victoria following the repeal of the FSLM Act, the FSLM instituted an 'amnesty' period from 1 October to 31 October 2014. The amnesty allowed for brokers and insurers to advise the FSLM that they charged FSL on or after 1 July 2013 in connection with adjustments to policies incepted before that date. As a result of the amnesty, six brokers and two insurers advised that they had improperly charged a total of \$314,000 of FSL after 30 June 2013, in connection with 457 mostly commercial property insurance policies. Each of the brokers and insurers concerned has confirmed that the FSL has been refunded to the relevant policyholders as required by the FSLM.

As a result of activities conducted prior to the end of September 2014 and the amnesty conducted through October 2014, a total of approximately \$500,000 of FSL charged on or after 1 July 2013 has been identified and returned to policyholders.

Did the FSLM achieve its regulatory objectives?

The key measure of the performance of the FSLM is whether it achieved the objectives set by Government when establishing the regulatory scheme. The efficiency of operations intended to achieve this is also important. As previously noted, the objectives were:

1. insurers pass on the benefit of the abolition of FSL to property insurance consumers
2. consumers of insurance are protected in the transition from the insurance-based levy to a property-based levy.

Objective 1: Benefits of abolition of FSL passed on to consumers

Measuring whether the benefits of abolition of FSL were passed on to consumers centres on the observed changes in *total* premiums – the price for insurance cover alone (commonly referred to as the *base* premium) plus FSL (when applicable) plus GST and State stamp duty – after the abolition of FSL compared to before the abolition. A complication in assessing the observed changes is whether base premiums changed contemporaneously with the abolition of FSL. If base premiums rose at the same time, the outcome in total premiums is the *net* effect of the removal of FSL and any increases in base premiums moving in opposite directions.

A further complication is that insurers ‘tapered’ FSL rates through 2012–13 (high in the first half of the financial year and low to zero in the second half). The year-to-year changes in total premiums experienced by individual policyholders when renewing their policies differed markedly depending on:

- the time of year the renewal falls on and the FSL rate applying at that time
- the region in which the property is located (MFESB or CFA)
- the commercial or residential nature of the property, which greatly affects the level of the FSL rate applying (commercial property FSL rates were generally much higher than residential FSL rates).

Given the known changes in FSL rates during 2012–13, potential changes in total premium can be estimated *assuming that base premiums did not change*. In such circumstances, the average total premium changes pre- to post-abolition for:

- insurance on residential property located in the MFESB region, would be 14.3 per cent lower in 2013–14 than 2012–13
- insurance on residential property located in the CFA region, would be 19.3 per cent lower in 2013–14 than 2012–13

The effect of the time of year annual renewals fall on is illustrated by the example of a residential property located in the CFA region. For renewals in September 2012, the estimated reduction in the total premium following the abolition of the FSL would be 27.7 per cent. However, for the same policy with renewal in February 2013, the expected reduction in the total premium following the abolition of the FSL would be just 11.7 per cent.

Of course, the assumption that base premiums do not increase from one renewal to the next is unrealistic. Property insurance premiums tend to rise over time. Annual increases for

residential property insurance over recent years have been in the order of 7 to 10 per cent. The existence of cycles in the movement of premiums, as already noted, involves the rate of price increases varying substantially over time. It may be that the range of 7 to 10 per cent observed in the years leading up to FSL reform was in the 'upcycle' phase of premium movements as insurers endeavoured to return their profitability to target levels. The commencement of the FSLM role may have coincided with the latter stage of that phase.

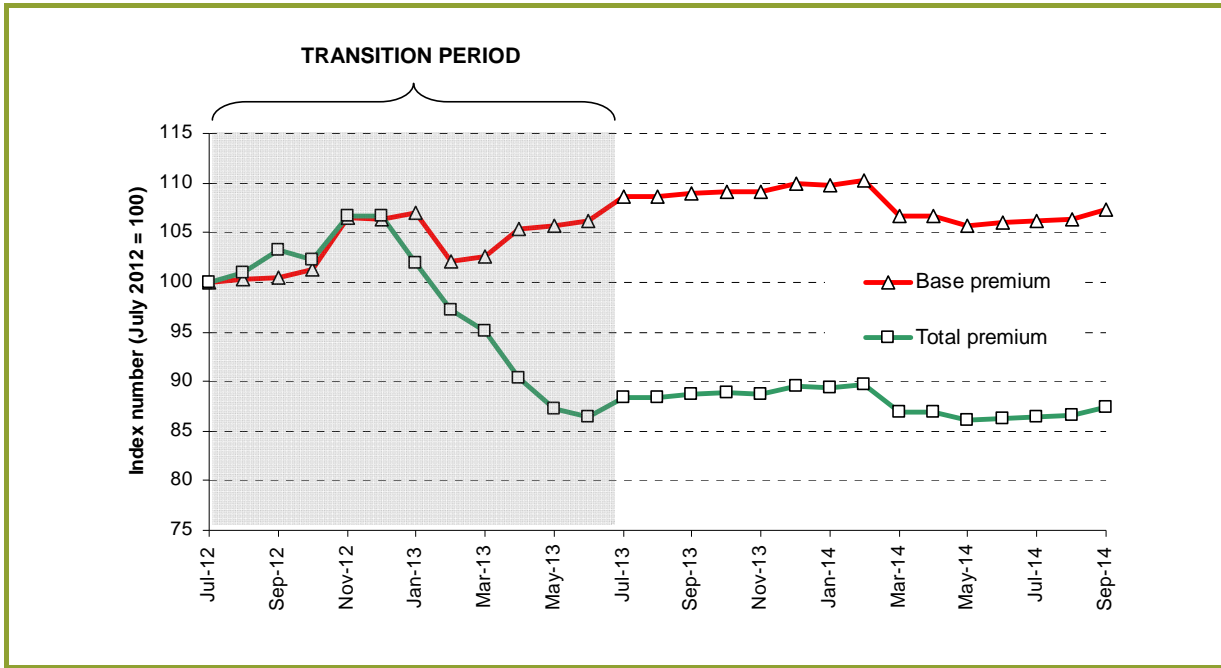
This reality of annual base premiums increases needs to be factored into the assessment of reasonableness of observed total premiums changes when the FSL was abolished. Price observations from both FSLM-sourced data and the Australian Bureau of Statistics indicated an average increase in base premiums from 2012–13 to 2013–14 consistent with price trends in the preceding few years. The estimated annual average increase in base premium from 2012–13 to 2013–14 was 7.7 per cent, within the range of previous years' premium increases in Victoria. Thus, in the absence of a firm basis for an alternative predictor, the removal of FSL was overlaid on this recent record of base premium increases. The relatively flat trend in premiums on average across all capital cities, as indicated by ABS data since the September quarter 2013, may indicate that the cycle of premium rises has turned down.

Did total premiums fall?

Through the first half of the 2013 calendar year, reductions were observed in total premiums in both the MFESB and CFA regions as the FSL was progressively removed leading up to FSL reform. There were also moderate increases in base premiums on average, which were a little more pronounced in the CFA region.

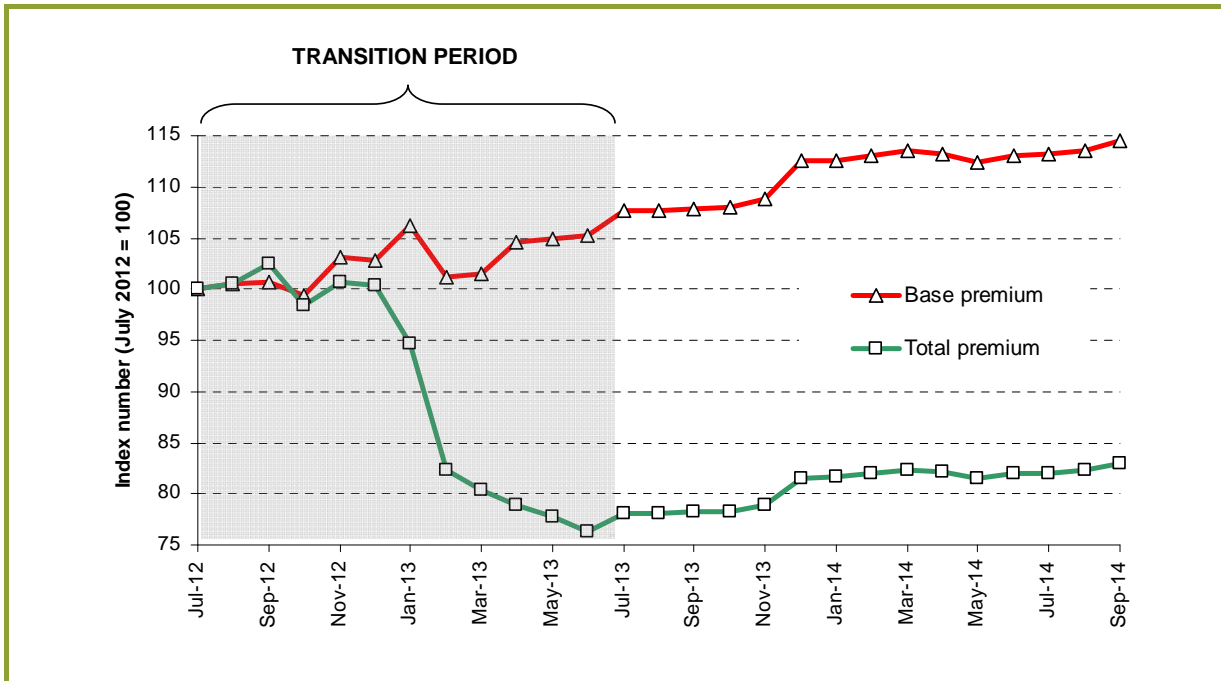
Figure 1 and Figure 2, based on data provided by insurers, show that total premiums fell significantly in the first half of calendar year 2013 leading to the statutory abolition date. The data include premiums relating to properties outside the Melbourne metropolitan area. The fall in total premiums was larger in the CFA region than in the MFESB region, reflecting the fact that in the CFA region FSL rates were higher and thus a larger proportion of total premium was removed.

Figure 1 Total premium and base premium for the MFESB region – July 2012 to September 2014



Source: FSLM estimates

Figure 2 Total premium and base premium for the CFA region – July 2012 to September 2014



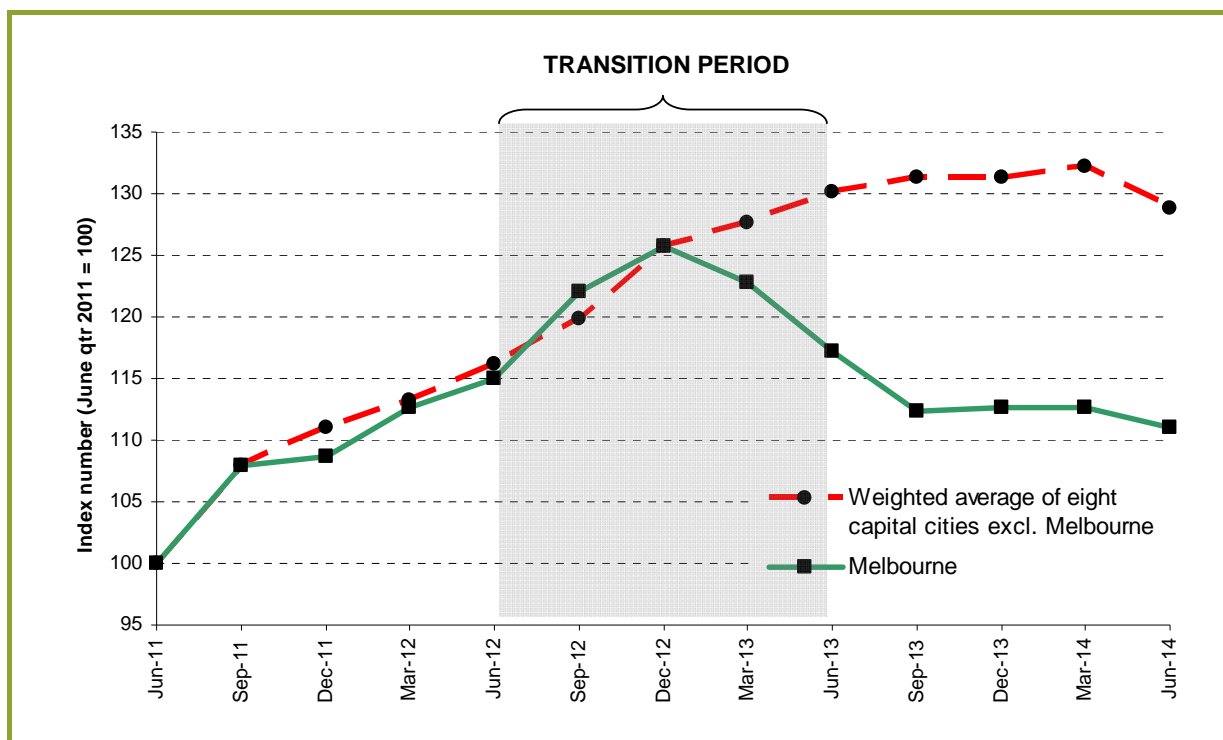
Source: FSLM estimates

Confirmation of the reduction in total premiums reflecting the abolition of the FSL is provided by ABS price data. This also has the advantage of providing a comparison over time of

changes in total premiums in Victoria (more precisely the Melbourne metropolitan region) with those in the capital cities of the other States and Territories. In effect, it indicates broadly what total premium movements in Melbourne would have been without the abolition of the FSL.

The path of quarter-by-quarter movements in indexes of average total premiums in each of Melbourne and a weighted average of the other seven Australian capital cities is shown in Figure 3. The divergence between Melbourne and the other seven capital cities is clear and significant. Data for non-metropolitan areas is not collected for the CPI.

Figure 3 Average total premium for residential property insurance in Melbourne vs other Australian capital cities – June quarter 2011 to June quarter 2014



Source: Australian Bureau of Statistics

Analysis of annual average movements from 2012–13 to 2013–14 in total premium for residential property insurance in Melbourne, based on ABS data, indicates a reduction by an average of 8.1 per cent, rather than the 14.3 per cent estimated above on the assumption that base premiums did not rise. However, once recent years' average annual increases in base premiums is factored in, the observed reduction in total premiums is in line with the removal of FSL. The average change in total premiums over the same period for the other seven capital cities was an increase of 4.0 per cent.

Also already noted, a fairly flat trend in total premiums from the September quarter of 2013 to the September quarter of 2014 is apparent. This suggests that insurers in Victoria are not 'clawing back' the reduction in total premiums caused by the removal of the FSL. The similar flatness in premium movements in the other capital cities is consistent with the hypothesis of pricing cycles.

The analysis of price data above leads to the conclusion that the benefit of the abolition of FSL, in the form of reduced total premiums levels, on the whole was passed on relatively

quickly to consumers of residential property insurance who were the focus of the FSLM's activities. While monitoring of commercial property insurance premiums was limited, no evidence came before the FSLM that this conclusion was not also applicable to the removal of FSL from commercial property insurance.

Will the premium reductions due to the elimination of the FSL be sustained into the future?

The FSLM has closely monitored premiums both before and after FSL reform. The FSLM has no doubt that during this time insurers have exercised a degree of restraint in their pricing that may not have otherwise been there. This does raise a potential concern as to whether premiums may rise faster than otherwise after the FSLM's role ceases. The FSLM considers this to be a possibility. The main safeguard against this happening is the operation of competitive market forces and, in particular in this regard, the role that empowered consumers can play in shopping around and switching suppliers to get a better deal. The FSLM has considered a number of initiatives that may help to promote consumer empowerment and competition in the longer term. These include improvements to mandatory information disclosure and the introduction of price comparators to the market.⁵

Objective 2: Consumers of insurance are protected in the transition

In addition to ensuring that the benefit of the abolition of the FSL in prices was passed on to consumers, statements by the Government – at the time of the introduction of the legislation establishing the FSLM and the provisions of the legislative scheme – indicate that 'protecting consumers' meant:

- consumers have access to information from a source independent of insurers about the abolition of the FSL and what it means for their premiums
- there is an independent body to whom insurance consumers can make enquiries or complaints about insurers' pricing and conduct related to the abolition of the FSL
- there are remedies available to address detriment to insurance consumers arising from the actions of insurers' associated with the abolition of the FSL.

The three requirements for protecting consumers were met through the operations of the FSLM. The following are key indicators of the protection afforded consumers.

- Consumers have access to independent information about the abolition of the FSL, demonstrated by:
 - 37,117 visits to the FSLM website
 - two State-wide advertising campaigns in the print and online news media alerting the public that the FSL was about to be abolished, the FSLM existed to assist consumers and warning policyholders to check that their total premiums fell
 - two 'public warnings' placed in Victoria's major newspapers
 - 20 media releases issued on various subjects in the abolition of the FSL and the outcomes of FSLM activities.

⁵ See FSLM 2014b

- Consumers can make enquiries or complaints about insurers and the abolition of the FSL, demonstrated by:
 - 6,128 calls by consumers to the FSLM enquiries and complaints line
 - 726 emails and 268 letters from policyholders setting out complaints
 - a total of 7,122 enquiries and complaints across all sources.
- Remedies are available to consumers, demonstrated by:
 - 52 notices requiring information and documents issued as part of investigations into potential price exploitation and false representations or misleading or deceptive conduct
 - refunds of \$0.6 million following investigations and enforcement activity related to pricing by individual companies, over-collection of FSL and the charging of FSL after 30 June 2013
 - refunds of \$1.3 million to customers of QBE due to QBE's pricing error that led to excess FSL being charged
 - refunds of \$11.3 million to customers of IMA who were charged a price increase implemented days before the statutory abolition of the FSL
 - refunds of \$8.1 million to individual policyholders of 55 insurers and \$4.4 million disbursed to consumer organisations representing the interests of Victorian insurance consumers due to the over-collection of FSL in 2012–13 and \$1.2 million to the CFA
 - a total of \$26.9 million in excess revenues not retained by insurers in the reform transition, but instead disbursed to Victorian residential and commercial insurance customers or organisations representing the interests of consumers.

The information provided to consumers, the processes put in place to address issues raised by insurance consumers and the remedial outcomes above, together with the observed reductions in total premiums, substantiate a conclusion that the Government's objectives in establishing the FSLM were achieved.

South Australia in 1999 and Western Australia in 2003 have each undergone transitions from insurer-based to property-based funding of fire services. The policy implementations in those jurisdictions were examined to provide further context for Victoria's experience. The fundamental difference between Victoria on the one hand, and South Australia and Western Australia on the other, was the absence of independent regulatory oversight of the abolition of the FSL in the latter States. While there was an *ex post* review of implementation in each of those States, there was no independent oversight of insurers' responses as the transition unfolded.

The Victorian experience demonstrates that:

- pricing errors by insurers can occur
- some insurers may even take opportunistic advantage of the abolition of FSL and simultaneously increase base premiums
- too much FSL revenue may be collected and retained by insurers
- some policyholders may be charged FSL despite it being abolished by law.

In South Australia and Western Australia, there were no mechanisms in place to detect such transition problems. Unlike in Victoria, there were no specific measures to protect the interests of consumers. The fire service funding reform outcome for Victorian consumers comprised lower total premiums *and* recovery from insurers of the proceeds of inappropriate FSL charges, price increases, and excess collection of FSL.

Lessons for regulation in fire service funding reform

Drawing on the experience of administering the regulatory scheme, those aspects of the regulatory scheme that contributed to the achievement of the Government's objectives, and those aspects where some difficulties were encountered are identified below.

What worked well

A key contribution to the FSLM's effectiveness was the engagement with consumers via the website and telephone enquiries and complaints facilities. It is most likely that the two advertising campaigns, two public warnings and numerous media releases and interviews in the first half on 2013 also generated awareness among policyholders. A result of this engagement was that the FSLM became aware of potential breaches of the FSLM Act. As noted previously, investigations triggered by consumers' complaints led to the return to policyholders of IMA's excessive price increase in June 2014.

The price monitoring program provided an essential understanding of industry pricing patterns and highlighted apparently anomalous pricing behaviour by insurers. As a consequence, investigations into potential price exploitation and misleading or deceptive conduct were better focussed and a critical assessment of whether the removal of the FSL had been passed on to policyholders could be made.

The legislation that established the prohibitions on price exploitation and false representations or misleading or deceptive conduct was supported with strong powers to compel the provision of information and facilitate the conduct of investigations. Although not capable of measurement, the substantial penalties provided for contraventions are also likely to have contributed to insurers' willingness to comply with the oversight scheme.

The total amount of money related to the abolition of the FSL that insurers were unable to retain as a result of the activities of the FSLM was \$26.9 million. Such an outcome would not have been possible with negligible oversight activity.

Difficulties encountered

The first difficulty, which arose from historical arrangements for the collection of FSL to recoup the cost of insurers' statutory contributions, was the absence of any requirement for a clear indication by insurers (or their intermediaries) on their invoices to policyholders of the amount of FSL charged. Many, if not most, policyholders would have been unaware of the important distinction to be made between base premium, statutory charges (FSL, GST and stamp duty) and total premium. This undermined the capacity for policyholders to themselves assess their insurers' pricing response to the abolition of the FSL.

The second (related) difficulty was the lack of communication from insurers about the effects of the abolition of the FSL, particularly the effects of applying FSL rate tapering during 2012–13. As already observed, because of FSL tapering, policyholders' experience of total premium reductions when renewing policies was directly related to the time of year renewals fell. As soon as was practicable, guidance was provided to insurers regarding the form of communication insurers should provide to policyholders to enable them to readily understand changes in FSL and base premiums.⁶

Notwithstanding the issuing of FSLM guidelines, insurers generally still failed to provide clear advice to policyholders with respect to how tapering of FSL rates and the abolition of the FSL affected the components of the total premium they were charged. The FSLM's experience with policyholders' enquiries and complaints indicates that insurers' responses to policyholders, through their customer call centres and intermediaries, were not always accurate and sometimes were perfunctory. A circumstance perhaps contributing to this situation was that the FSLM's focus on individual insurer's compliance with the law was a contrast to both: the industry level engagement with the Government's in the formulation of the detail of the fire service funding reform policy; and the previous role of the ICA in the setting of 'advisory' industry-wide FSL rates

A third difficulty arose from the constrained timetable for the preparation of detailed guidance for insurers on appropriate conduct leading up to and after the abolition of the FSL. This meant that there was limited opportunity for insurers to prepare compliance regimes on matters relevant to the transition before issues arose. Some insurers managed their compliance effort within that constraint better than others.

The lack of recognition that some over-collection of FSL was almost inevitable, given the requirement on insurers to estimate their contributions for 2012–13, and the absence of legislative provisions on the status of over-collected FSL and for addressing over-collection, complicated the resolution of over-collection. The process would have been much more straightforward if the FSLM Act had required over-collected FSL to be refunded directly to policyholders who had paid FSL in 2012–13.

Elements of regulatory oversight of transition

The Victorian experience of fire service funding reform suggests that appropriate regulatory oversight can contribute to more equitable and efficient outcomes for the community where there is market failure and constrained price competition, even where the affected industry supports the originating policy change. The likely success of reform, and public confidence in the merits of the originating policy change, are enhanced by regulatory oversight to protect consumer interests in the consequences of the policy change.

Based on the FSLM's experience in the abolition of the insurance-based levy, the following highlights elements of regulatory oversight of the implementation of a policy change that affects the prices of a consumer product.

- There should be timely establishment of transition arrangements co-coordinating the initiating policy change and any associated regulatory oversight. This would allow suppliers and the regulator to have an early common understanding of what

⁶ Draft guidelines were issued for consultation in April 2013 and published in final form in May 2013.

would constitute acceptable and unacceptable conduct on the part of suppliers during the course of transition.

- The key elements of a supporting framework for reform should be specified in legislation, encompassing measures such as:
 - prominent disclosure by suppliers of the components of prices, reconciliation of the tax actually collected from consumers and amounts remitted to government,
 - specification of the treatment of any over- and under-collection of tax in the final period by a supplier,
 - specified constraints on any mechanisms to adjust the charging of the tax in the final period.
- There should be legislatively-based oversight with appropriate powers and resources reflecting the Government's assessment of market failures, price competition and community concerns about equity outcomes in the transition.

THIS PAGE DELIBERATELY LEFT BLANK

1. Introduction

This is the seventh and final report prepared in accordance with s.110 of the *Fire Services Levy Monitor Act 2012* (the FSLM Act) on the performance of the functions of the Fire Services Levy Monitor (the FSLM). The FSLM Act is to be repealed on 31 December 2014 by virtue of s.117 of the FSLM Act.

In addition to reporting on the performance of functions in the September quarter 2014, this report also provides an overview of performance for the period from 19 December 2012, the commencement date of effect of the FSLM Act, to 30 September 2014 and some general observations of the regulatory scheme established by the FSLM Act.

The report outlines the FSLM Act, the property insurance market context it operates in and the key compliance risks addressed. The major functions and performance information are described. Observations on the achievement of the Government's objectives and lessons from the FSLM's experience are provided.

This report examines the activities of the FSLM in the September quarter 2014 and the performance of the fire services levy monitor regulatory scheme through the following structure:

- section 2 explains the previous insurance-based funding arrangements, the reform's policy change to a broader property-based funding arrangement, issues in the transition and the Government's objectives in establishing the FSLM
- section 3 describes the property insurance market context, identifies some issues regarding competition in the market and explains the FSLM's focus on residential property insurance
- section 4 examines the key compliance risks and how the FSLM addressed them
- sections 5 to 8 provide an overview of each of the main operations of the FSLM – information provision, enquiries and complaints handling, price monitoring and investigation and enforcement
- section 9 assesses whether the FSLM achieved the Government's objectives
- section 10 suggests some 'lessons' from the FSLM's experience for intervention to support a policy change that affects prices in a consumer market.

THIS PAGE DELIBERATELY LEFT BLANK

2. The Fire Services Levy Monitor Act 2012

2.1 Background to the establishment of the Fire Services Levy Monitor

The FSLM Act was established to facilitate the transition from insurance-based funding to funding by a levy on all property in Victorian property. The two funding schemes are outlined in this section and policy issues in the transition identified. The Victorian Government's objectives for regulation of the transition and the key components of the regulatory scheme are summarised below.

2.1.1 Insurance-based funding scheme

The requirement for insurers to contribute to funding of fire services has its origins with the establishment of private fire brigades set up by insurance companies following the 'Great Fire of London' in 1666, to protect the property of persons who paid for insurance.⁷

The practice of multiple insurers funding their own brigades in a given area eventually evolved into the development of commonly funded single fire brigades. A process of insurers funding common brigades was adopted in most Australian States from the early 1900s and enshrined in legislation with insurers required to make specific contributions to the publicly-owned fire services. Typically, this obligation further evolved to a form where insurers (as a collective) made a specified contribution to the annual budget of fire services – be that a nominated dollar amount or a percentage of the total budget – with each insurer's annual share determined by some measure of premium collected.

Prior to its abolition from 1 July 2013, the insurance-based fire services levy (FSL) in Victoria had the following general characteristics:

- the contributions required to be made by insurers to the funding of fire services were defined in legislation through each of the *Metropolitan Fire Brigades Act 1958* (MFB Act) and the *Country Fire Authority Act 1958* (CFA Act)
- the method by which insurers were able to recoup from policyholders the amounts contributed to FSL was not prescribed by any legislation
 - insurers made their own decisions as to the amount of FSL collected from each policy – although insurers were required by the MFB Act and the CFA Act to report the amount of levy collected from policies on particular classes of property insurance
 - there was no requirement on the part of insurers to specify, for the benefit of policyholders, the amount of levy applying to any particular insurance policy – although some insurers did volunteer such information.

⁷ Each insurance company used its own fire insurance mark – a durable plaque placed at the front of a property to identify the buildings to be protected by that company's fire brigade in the event of fire. An insurance company's fire brigade would not extinguish a blaze affecting a property unless it had the appropriate fire mark.

2.1.2 Fire service funding policy change

The successful push to replace insurance-based funding of fire services with property-based funding gained impetus from the deliberations of the 2009 Victorian Bushfires Royal Commission (VBRC). The final report of the VBRC noted:

Fire services in Victoria are currently funded through a mix of contributions from insurance companies, the State and municipal councils. Insurance companies recoup the cost of their statutory contribution to the CFA and the MFB by imposing a Fire Services Levy on insurance premiums for building and contents insurance.

The current model's claimed benefit is that the insurance premium is a good way of linking the charge for fire services to the fire risk of individual properties. Evidence suggests, however, that this link is at best tenuous. Fundamentally, the Commission considers that the current funding model lacks transparency and is inequitable since people who are not insured or are under-insured do not make a fair contribution to the funding of fire services.

*The Commission takes the view that the lack of equity and transparency in the current arrangements constitutes a good reason for moving to another system. Several other Australian states and territories already require all property owners to contribute to fire services via a levy on property, as opposed to insurance, and the Commission proposes that Victoria also move to replace the Fire Services Levy with a property-based levy. [Emphasis added]*⁸

The insurance-based levy was widely acknowledged as an inefficient tax,⁹ with non-insurance and under-insurance noted by the VBRC as factors in impeding the rebuilding process after the bushfires. A study of consumers' sensitivity to the price of insurance conducted around the time of the VBRC, indicated that a reduction in the price of (at least) residential *contents* insurance would contribute to increased purchase of such insurance.¹⁰

The policy decision and a timetable to replace the insurance-based levy with a property-based levy was announced in a Government media release as early as May 2011:

The government intends to introduce legislation in early 2012 and there will be a transition period that will commence on 1 July 2012 to allow insurers to phase out the FSL prior to full implementation from 1 July 2013.¹¹

Similar policy changes had previously been made in Queensland (1985), South Australia (1999), Western Australia (2004).

Efficiency issues were added to the VBRC's concerns about the lack of equity of the insurance-based funding model in an options paper on fire service funding arrangements prepared by the Department of Treasury and Finance (DTF 2011), which noted:

⁸ VBRC 2010, p18

⁹ The Henry review 2009 noted (at p.57): 'Australia has several ... taxes that should be phased out over time ... Imposing specific taxes on insurance deters people from insuring their property and encourages them to bear unnecessary risks, rather than pooling risk with others. Rates of non-insurance (for building and content insurance) generally are higher at lower incomes, yet low-income people are less able to bear the risk.'

¹⁰ Barker & Tooth 2008, in a work commissioned by the ICA, indicated a price elasticity of demand for contents insurance in the range of -0.45 to -0.6 – that is, a 10% reduction in price could lead to a 4.5 per cent to 6 per cent increase in the number of contents policies purchased.

¹¹ Media release by the Hon Peter Ryan MP and the Hon Kim Wells MP, 14 May 2011. Available at: <http://www.premier.vic.gov.au/media-centre/media-releases/947-coalition-government-announces-timetable-for-introduction-of-new-fire-services-funding-model-.html>, accessed 22 August 2014

- the inefficiency of insurance taxes that distort the market for insurance and impose a deadweight loss on society¹²
- owners of fully insured properties over-contribute to fire service funding relative to owners of property that is either not insured at all or under-insured.

The replacement of the insurance-based levy with a property-based levy through the Government's legislation change had support across the Parliament, each party expressed their support for the principle of the reform, if not for all the detail contained within the bills that were put to Parliament.¹³

2.1.3 Property-based funding scheme

On 1 July 2013, the levy on insurance premiums was abolished and replaced by a property-based levy collected by councils with rates notices. The Fire Services Property Levy (FSPL) incorporates:

- a fixed charge component for the 2014-15 financial year of \$102 for residential property including vacant land and \$205 for non-residential property
- a charge based on the 'capital improved value' of the property – that is, the value of land with improvements as determined by the relevant local council. A revaluation of land is completed by each of Victoria's 79 municipalities every two years in accordance with guidelines specified by the Valuer-General of Victoria. Most non-rateable land is leviable.

The levy rate varies for residential, industrial, commercial and primary production (farms) properties. Separate levies are charged in the Metropolitan Fire and Emergency Services Board (MFESB) and Country Fire Authority (CFA) regions in recognition of the different costs associated with funding each service.

The FSPL variable rates for 2014-2015 are set out in Table 2.

Table 2 Rates for Fire Services Property Levy – 2014-15

Property sector	MFESB region rate*	CFA region rate*
Residential (including vacant residential land)	6.5	10.9
Commercial	55.0	88.0
Industrial	85.9	132.0
Primary production	15.4	24.6
Public benefit	6.5	10.9
Vacant (non-residential land)	6.5	10.9

* Cents per \$1,000 of capital improved value

Goods & Services Tax (GST) and stamp duty is not charged on the FSPL, in contrast to the insurance-based levy where GST was charged on the levy and insurance contracts stamp

¹² For further discussion on the concept of 'deadweight loss' see *Appendix D: Regulatory intervention supporting funding policy change*.

¹³ For example, refer debate on the FSLM Bill in the Legislative Council, 9 October 2012, pp.4392-4398

duty was charged on the levy and GST amounts. Concessions are now available for holders of an eligible Pensioner Concession Card or Department of Veterans Affairs Gold Card (TPI).

The State Government continues to fund 12.5 per cent of the MFESB budget and 22.5 per cent of the CFA budget. The metropolitan council contribution under the insurance-based levy has been abolished and local councils are now treated like any other property owner (with some special treatment for recreational land).

2.2 Issues in the transition between funding schemes

The total premium charged by insurers to individual policyholders prior to fire services levy reform (FSL reform) was made up of amounts that covered the costs incurred by the insurer for providing insurance services, a profit margin, the FSL, plus other statutory charges as outlined in Box 1.

Box 1 Components of total premium for property insurance

Prior to 1 July 2013, the premium charged to policyholders for contracts of property insurance in Victoria comprised the following elements:

Base premium

The amount that goes to the insurer for providing insurance services including a profit margin and meeting the costs of operating its business

+ **Fire services levy (FSL)**

An amount charged by an insurer¹⁴ for the purpose of recouping contributions required to be paid by an insurance company under s.37(1)(c) of the Metropolitan Fire Brigades Act 1958 or s.76(1)(b) of the Country Fire Authority Act 1958, as those Acts existed prior to 1 July 2013

+ **GST = 10% x (base premium + FSL)**

Collected by an insurer and passed to the Commonwealth Government

+ **Stamp duty = 10% x (base premium + FSL + GST)**

Collected by an insurer and passed to the Victorian Government

= **TOTAL PREMIUM**

The amount paid by a policyholder

From 1 July 2013, the premium for contracts of insurance comprised the following elements:

Base premium

+ **GST**

+ **Stamp duty**

= **TOTAL PREMIUM**

The key issue in the transition out of the insurance-based funding scheme to the property-based scheme was whether the significant amount that FSL represented in insurers' premium revenues would be removed from their revenues after the abolition of the insurers' requirement to contribute to the fire services. Also relevant is the costs to insurers of administering the scheme and any additional revenues that might be earned by insurers through interest on FSL monies retained pending transfer to relevant agencies.

¹⁴ Each insurer separately determined the FSL rate (or % of base premium) charged on each policy.

The total of insurers' contributions to the fire services (both MFESB and CFA) required in the final year 2012–13 was \$549.3 million. In that year, that amount was equivalent to 22.5 per cent of residential property insurance base premium revenue and 63.2 per cent of commercial property insurance base premium revenue in Victoria. A breakdown of FSL rates, and the movements in FSL rates over time as they applied to various groups is included as part of an analysis in section 9.3 of whether the benefits of abolition of FSL were passed on to consumers (see Table 19, p.52)

If competition in insurance markets is not fully effective, there is a danger that reductions in statutory charges may be passed on more slowly than is desirable, or even only partially. Section 3 discusses the market context in which reforms were implemented.

The full removal of the FSL charged also was central to the realisation of the potential improvement in the 'affordability' of residential property insurance that the change to property-based funding offered. With GST and stamp duty charged on top of FSL, the abolition of FSL would result in a reduction in the cost of property insurance in Victoria of \$665 million, other things being equal.

Residential property insurance total premiums in 2012–13 were \$1,727 million in Victoria and the removal of FSL would represent about an 18.3 per cent reduction in the total cost of home insurance. In comparison, commercial property insurance total premiums in 2012–13 were \$904 million and the removal of FSL would represent about a 38.6 per cent reduction in the total cost of commercial property insurance.

Another issue, although one not restricted solely to the final year of the insurance-based scheme, was whether insurers would recoup more through the FSL than was necessary to cover their statutory contributions to the fire services. In a review of fire service funding arrangements conducted by the Department of Treasury and Finance in 2003 ('DTF 2003 review') concerns were expressed regarding the transparency of matching FSL collected and contributions. Subsequent amendments to the MFB Act and the CFA Act regarding declaration of FSL collected only partly addressed this, as there remained no legislated requirement for insurers' receipt of FSL revenues to be audited against the amounts reported to the fire services as being received by insurers for each year. Thus, there was no mechanism within the fire services' administration of the insurance-based scheme to ensure that the revenues actually recouped from policyholders in 2012–13 as FSL to fund their contributions matched the contributions made to the fire services. As discussed later in the context of the strategies dealing with key compliance risks (see Table 6 (page 23), the FSLM addressed this deficiency by requiring each insurer to provide an independent audit 'review' of the amount collected and shown in the accounts as FSL, so that it could be compared against what they reported to the fire services as 'FSL collected'.

The communication from insurers to policyholders regarding the change in funding arrangements, and particularly the specific implication of the abolition of contributions for premiums charged, was a further issue in the transition. What information would insurers provide about the abolition of FSL and how effective would it be in assisting policyholders assess the removal of FSL from the premiums they pay? Many policyholders were unaware that they paid FSL and how significant a component it was in the cost of their property insurance or what it was for, despite many insurers showing FSL somewhere (albeit not necessarily prominently) on invoices.

2.3 Victorian Government objectives

On 28 August 2012, the Victorian Government announced that it would establish an independent Fire Services Levy Monitor to oversee the period of transition to new levy arrangements. The then Minister for Consumer Affairs stated in the second reading speech on the FSLM Bill, on 14 November 2012, that the purpose of establishing the FSLM was ‘...to ensure that the interests of consumers are protected during the transition to the new fire services property levy’. The bill introduced a new prohibition on insurance companies (‘price exploitation’) to prevent situations where ‘...an insurance company does not pass on to consumers the full reduction in cost from the abolition of the insurance-based levy or seeks to recover more in FSL from policy-holders than the insurance company is required to remit to the government’.

The FSLM’s role was described by the then Treasurer as ‘...making sure insurance companies did the right thing by consumers...the Government is putting strong mechanisms in place to ensure consumers are protected. This legislation will see serious penalties apply to any company caught engaging in price exploitation’.¹⁵

The Government clearly regarded fire service funding reform as significant, with the Treasurer describing the change in his State Budget 2013–14 speech as ‘a major tax reform that puts our fire services on a firmer financial footing’.¹⁶ The then Premier has described the change to the FSPL as ‘the biggest tax reform in 20 years’.¹⁷ The regulatory oversight established by the FSLM Act was critical to the success of the reform on at least two counts. If insurance price reductions did not occur, the policy rationale of improved affordability of home insurance would not be realised. Furthermore, the public’s perception of the reform as equitable would be undermined if that occurred, as insurers’ would be seen to have opportunistically taken a windfall gain.

2.4 Outline of key components of legislative scheme

The *Fire Services Levy Monitor Act 2012* (the FSLM Act) established the positions of Fire Services Levy Monitor and Deputy Fire Services Levy Monitor and supporting arrangements.

2.4.1 Functions and powers of the FSLM

The FSLM Act confers a range of functions and powers on the FSLM. These include:

- provide information, advice and guidance to consumers and insurers in relation to the abolition of the FSL
- monitor the price of insurance premiums and investigate where appropriate
- formulate guidelines about when prices for regulated insurance contracts contravene the prohibition on price exploitation
- receive complaints and arrange for the mediation and conciliation of disputes

¹⁵ Media Release, The Hon Michael O’Brien and the Hon Kim Wells, ‘Tough new consumer protections to support abolition of fire services levy’, Wednesday 14 November 2012

¹⁶ The Hon. Michael O’Brien MP, Treasurer Victoria, *Budget Speech*, 7 May 2013

¹⁷ The Hon Ted Baillieu MP at: <http://www.tedbaillieu.com.au/about/former-premier>, accessed 23 October 2014

- issue public statements warning about price exploitation or misleading or deceptive conduct
- take enforcement action, including instituting court proceedings
- report to the Minister for Consumer Affairs each quarter about the performance of the FSLM's functions in the period.

Pivotal to the functions and powers of the FSLM are the two key prohibitions introduced by the FSLM Act:

- a prohibition in s.26 on insurance companies engaging in 'price exploitation'
- a prohibition in s.31 on any person engaging in false representations or misleading or deceptive conduct in trade or commerce about the effects or likely effects of the abolition of the insurance-based levy.

2.4.2 *Prohibition on price exploitation*

The prohibition on 'price exploitation' essentially provides that if the price for a relevant insurance contract (called a 'regulated contract of insurance') is 'unreasonably high', the insurance company will have contravened the FSLM Act. The term 'unreasonably high' is not defined, though s.26 does stipulate several criteria that must be applied to that determination. These include the amount the insurer was liable to pay as its statutory funding contribution, historical rates of FSL and 'the costs of supplying insurance against fire'.

NOTE: 'Insurance against fire' does not exist as a standard stand-alone policy. In standard property insurance policies, insurance against fire is usually bundled with cover against other risks such as flood, theft, malicious damage.

The fundamental aim of the price exploitation prohibition was to prevent insurance companies from charging an unreasonably high price for insurance in the context of the FSL reform and thereby:

- collecting more through an FSL on policyholders than was required to be contributed to the fire services

or

- not passing on to consumers the full reduction in insurance companies' costs from the abolition of the requirement to contribute to funding the fire services, thereby making windfall gains.

The Minister for Consumer Affairs stated in the Second Reading Speech on the FSLM Bill:

The prohibition on price exploitation ensures that insurance companies do not charge an unreasonably high price for insurance having particular regard to the fire services levy reforms. Price exploitation may occur where an insurance company does not pass on to consumers the full reduction in cost from the abolition of the insurance-based levy or seeks to recover more in fire services levy from policyholders than the insurance company is required to remit to the government.¹⁸

2.4.3 Prohibition on false, misleading or deceptive conduct

This prohibition, in s.31 of the FSLM Act, provides that where a person in trade or commerce engages in false, misleading or deceptive conduct – about the effect or the likely effect of FSL reform – such conduct contravenes the FSLM Act. It applies to a wider range of actors than s.26, in that any ‘person’ is liable, whereas s.26 addresses the conduct of insurance companies only.

The FSLM interpreted s.31 as preventing an insurance company from falsely representing – or being misleading or deceptive about – the effect of abolishing the FSL on its fire insurance premiums. The principal effect of the abolition of the FSL on 1 July 2013 was expected to be to reduce the total premium payable on most policies of insurance against fire from what it would otherwise have been.

2.4.4 Information provision and guidelines for industry

The FSLM Act reflects the importance accorded to information and education by conferring several such functions on the FSLM, including to:

- provide information, advice and guidance about fire service funding reform
- formulate guidelines about when prices for regulated insurance contracts contravene the prohibition on price exploitation (s.27)
- advise persons of their rights and obligations.

The FSLM website has been extensively used to meet the FSLM’s information and guidance responsibilities, but the FSLM also used targeted media campaigns.

The FSLM issued three formal sets of guidelines on:

- price exploitation, under s.27 (FSLM May 2013 guidelines on price exploitation)
- false representation and other conduct, under s.6 (FSLM May 2013 guidelines on misleading / deceptive conduct)
- resolving the over-collection of FSL, made under both s.6 and s.27 (FSLM March 2014 guidelines on resolution of over-collection).

There is another category of information that the FSLM Act expressly includes: namely, public statements or public warnings about ‘price exploitation and prohibited conduct’ and public statements or warnings about any other matter that adversely affects the interests of persons

¹⁸ The Hon Michael O’Brien MP, Minister for Consumer Affairs, Hansard, Legislative Assembly, 14 November 2012, p.4961

acquiring insurance services. This information mandate is found at s.106 of the FSLM Act. This was the basis for a public warning issued in May 2013 reminding policyholders to check their renewals for any FSL charged after 30 June 2014, and to compare the new base premium with the previous one. A second public warning was issued in October 2013 in relation to insurance brokers.

NOTE: Although a 'broker' does not fall within the definition of 'insurance company' within the definition of the FSLM Act, the prohibition on falsely representing or misleading or deceiving a person about the effect, or likely effects, of FSL reform in s.31 of the FSLM Act relates to any persons engaging in trade or commerce. Thus, a broker of insurance products falls within the purview of the activities of the FSLM.

2.4.5 Price monitoring

As the title of the Fire Services Levy Monitor Act suggests, monitoring is a significant aspect of the FSLM's remit. There are two sorts of monitoring referred to in the functions specified in s.6 of the FSLM Act:

- price monitoring
- monitoring compliance with the prohibitions on price exploitation and on false, misleading or deceptive conduct

The monitoring of premiums fastens, logically, on insurance companies whereas the monitoring of false, misleading or deceptive conduct applies to anyone.

Price monitoring is addressed in two different ways. Section 6 of the FSLM Act states that monitoring 'insurance premiums' includes examining the components of the insurance premium: base premium, FSL and GST/stamp duty. Section 30 of the FSLM Act makes reference to monitoring 'prices' for either or both of the following purposes:

- 'assessing the general effect of the fire services levy reform on prices ...'
- assisting with the consideration of whether the prohibition on false, misleading or deceptive conduct has been contravened.

Part 3 of the FSLM Act is titled '*Monitoring Powers*'. It gives power to require information and documents to be provided to the FSLM and further, to require a person to appear before the FSLM to give information orally. These powers are available where 'the Monitor believes [a person] is capable of providing information or producing documents that may assist ... in *monitoring compliance with this Act ...*' [emphasis added].

2.4.6 Investigatory powers

The FSLM has extensive investigatory powers commensurate with the importance the Parliament attached to the prohibitions contained in the legislation.

The FSLM has investigative powers where he/she 'believes that a person is capable of providing information, producing documents *or giving evidence*, relating to a matter that constitutes, or may constitute, *a contravention of this Act ...*' [emphasis added]. This provision was used in the context of investigations of potential contraventions of the FSLM Act.

Part 7 of the FSLM Act provides power for duly appointed inspectors to enter and search premises, with consent, if they believe on reasonable grounds that a contravention of the FSLM Act has occurred. Where consent is not given, a magistrate can be approached to obtain a search warrant. In addition, there is provision for an inspector, if they believe on reasonable grounds that a contravention of the FSLM Act has occurred, to seek a court order from a Magistrate requiring the relevant person to answer questions and or/produce documents, at a time and place of the inspector's choosing. This power was also used in the course of investigations.

2.4.7 Remedies

Penalties for contravention of the price exploitation prohibition are consistent with the penalties introduced by the Commonwealth Government into the then *Trade Practices Act* 1974 in the late 1990s in respect of similar prohibitions associated with the introduction of the New Tax System changes, including the GST, and its effects on consumer prices.

Both the price exploitation prohibition and the prohibition on false, misleading or deceptive conduct attract a civil penalty, up to a maximum penalty of \$10 million for a body corporate and \$500,000 for an individual, in respect of each contravention by an insurer.

The FSLM could also seek compensation orders on behalf of consumers who have suffered loss or damage as a consequence of a contravention of the legislation, or they can do so in their own right.

2.4.8 Reporting

The FSLM Act requires that the FSLM provide quarterly reports to the Minister for Consumer Affairs 'on the performance of the functions of the FSLM during the quarter.' (s.110 (1)). The first quarterly report was issued for the March Quarter 2013 and a quarterly report has been issued for each subsequent quarter. The Minister is required to publish such a report 'as soon as practicable' after the Minister receives the report (s.110(3)).

There are other reporting mechanisms in the FSLM Act. Under s.93, an enforceable undertaking must be placed on a register maintained by the FSLM and available for inspection by the public. This has been achieved by posting undertakings on the FSLM's website. Undertakings set out the background and the reasons that the undertaking was offered to the FSLM by the insurance company.

The FSLM Act also requires the gazettal of price exploitation guidelines made under s.27. The FSLM issued two sets of guidelines that relied on whole or in part on s.27: FSLM May 2013 guidelines on price exploitation; and FSLM March 2014 guidelines on resolution of over-collection. These guidelines were duly gazetted.

The FSLM has also taken the initiative to publish other material providing additional insights into issues related to the abolition of the FSL and the role and operations of the FSLM. Included in this category is a transcript of the proceedings of a public forum conducted by the FSLM in June 2013 and submissions made by five insurance companies; and reports about issues confronting Victorian consumers of insurance, such as lack of transparency, complexity of products, difficulty in comparing products.

3. Property insurance market context

The property insurance market is comprised of two broad segments, residential and commercial property insurance. In the 2012–13 financial year, the market in Victoria received gross premium revenue of about \$2.6 billion, with two-thirds of that attributable to the residential sector (see Table 3).

Table 3 Value of residential and commercial property insurance premium written in Victoria – 2012–13

	Residential (\$million)	Commercial (\$million)	Total (\$million)
MFESB region	755	446	1,200
CFA region	972	459	1,431
All Victoria	1,727	904	2,631

Source: FSLM estimates based on MFESB and CFA data

While the Government’s decision to establish a new regulator did not appear to rest on a particular view of the nature of the property insurance market, the characteristics of the market were relevant considerations in the administration of the scheme.

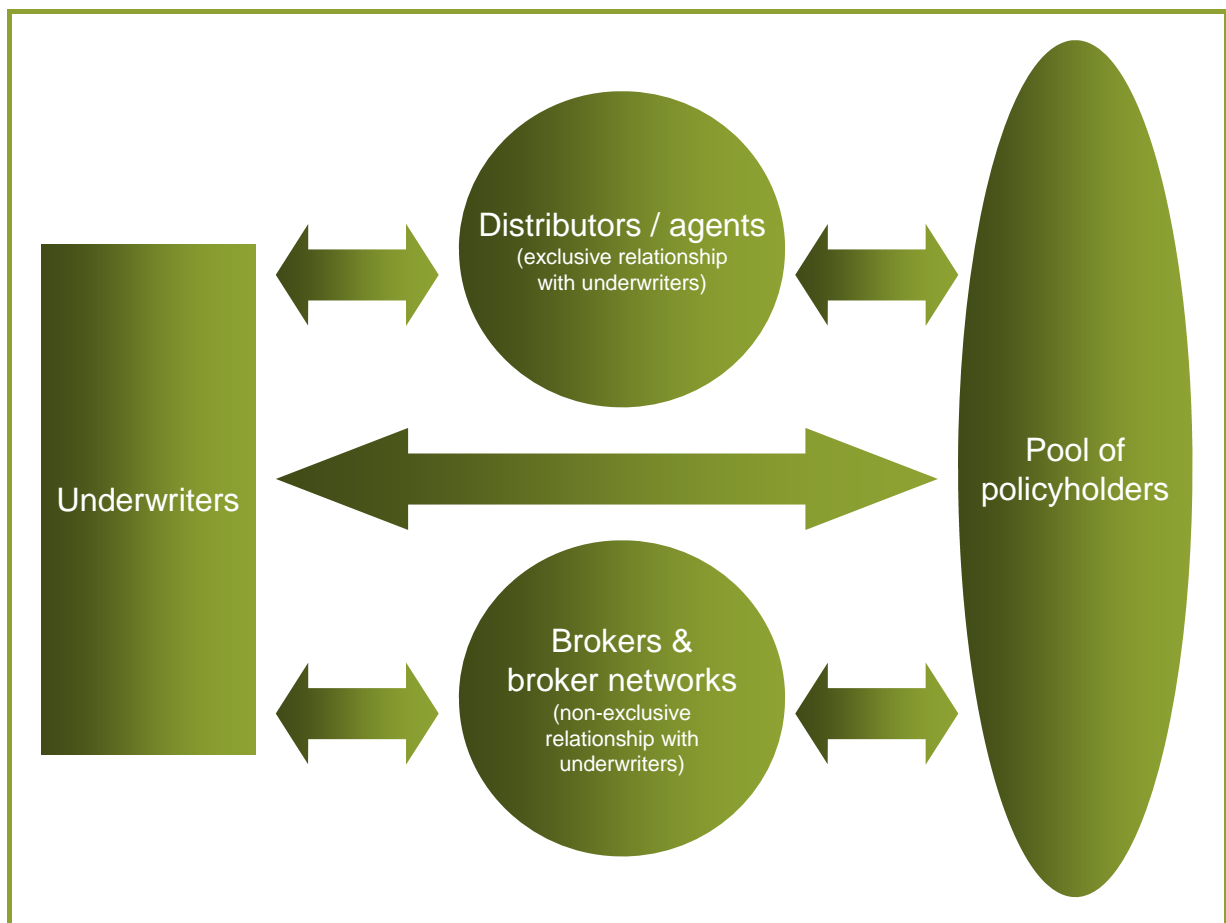
Several aspects of the supply side and the demand side of the market are directly relevant to the approach taken to the administration of the regulatory scheme. The scope of the regulatory scheme extended to 89 insurance companies required to make contributions to the fire services in 2012–13.

3.1 Industry relationships

There was a significant number of entities to deal with, given the short lifespan of the FSLM and the complexity of supply chain relationships that many of the companies operate in. As depicted in Figure 4, there are multiple layers of supply: underwriters; distributors/agents; brokers (and networks of brokers); and integrated insurers encompassing underwriting to retailing policies. As later became evident in the investigation into brokers charging FSL after 30 June 2013, the complexity of industry relationships sometimes made it difficult to establish which entity in the supply chain was responsible for charging FSL.

Appendix A: Insurance market relationships provides some further detail as to the nature of the relationships that exist within the insurance industry.

Figure 4 Types of insurance industry relationships



3.2 Differences in residential and commercial property insurance

There are significant differences between the residential property and commercial property segments of the market.

- residential property insurance policies tend to be of a standardised nature, with only limited scope for (prospective) policyholders to tailor aspects of policy coverage through, for example, specifying high value contents or varying the size of the excess.
- commercial property insurance (fire & industrial special risks) policies, are likely to be bespoke given the diverse nature of commercial operations and business structures to which insurance coverage is applied.

Supply chain structures throughout the industry tend to differ according to the type of insurance being sold:

- residential property insurance is a mix of mostly direct sales through integrated entities¹⁹ (and their associated distributors) websites or call centres with some intermediated sales through brokers²⁰
- commercial property insurance is almost entirely intermediated through brokers.

On the demand side, commercial and residential policyholders have differing characteristics. Most commercial insurance policyholders, being operators of businesses themselves, are likely to take a relatively sophisticated approach to meeting their insurance needs. Their commercial acumen and the engagement of insurance brokers in policy selection and price negotiation are more likely to ensure they understand the nuances of policies and achieve a competitive price.²¹ Residential policyholders, on the other hand, tend to lack the resources or do not have sufficient time to understand the complicated residential property insurance policies that dominate the market. Many residential policyholders may not have sufficient understanding of policies or the time to obtain the optimum outcome, yet they still tend to purchase their insurance via direct contact with underwriters or their associated distributors.

Adding to the complicated demand-side of the property insurance market, prior to the abolition of the insurance-based levy, there was a low level of awareness of the FSL as a component of the total premium charged and what the exact purpose of the FSL was.

3.3 Information asymmetry in the residential property insurance market

Especially in the residential property insurance market, there appears to be a substantial degree of information asymmetry between insurers and their customers that is to the disadvantage of customers. Insurers have garnered a wealth of information regarding detail of the properties they might insure and the extent of the risks involved, yet that same information is not necessarily accessible to persons seeking insurance.

Analysis of complaints, conduct of general monitoring activities and research by the FSLM point to considerable room for improvement in insurers' efforts to help consumers make well-informed decisions regarding the value for money of residential property insurance policies. Difficulties in understanding and comparing policies arise because there is no standardised form for presentation of a product disclosure statement (PDS) and many (or even most) policyholders are likely to be overwhelmed by the volume of information presented in a PDS that is usually 60 to 90 pages long.

Even when residential property insurance policyholders are not necessarily looking to change insurers, but are merely seeking to understand changes to policies at the time of renewal, complaints received by the FSLM indicated that insurers tend *not* to be forthcoming when asked to provide more information.

¹⁹ For example, underwriters such as IMA (via the RACV brand), Suncorp Group (via AAMI, APIA and GIO brands) and Allianz Australia Insurance Limited

²⁰ For example, underwriters such as CGU Insurance Limited

²¹ Arguably, many small business operators would not be in a position to understand all of the commercial terms of insurance policies.

A frequently recurring theme of complaints around the abolition of the FSL was that insurers failed to advise renewing policyholders why their base premium increased. Many complaints to the FSLM were about increases of 30 to 50 per cent in a single renewal.

Complainants to the FSLM recounted that their enquiries to insurers' call centres often elicited vague responses from the call centre operator along the lines of: 'our costs have increased' or 'risks at your property have been re-rated'. When pressed for further information, call centre operators were mostly not able to provide further detail. When enquiries were escalated, callers sometimes received inconsistent responses from their insurer's representatives.

These experiences formed much of the context of the FSLM's discussion paper entitled *Enhancing the consumer experience of home insurance: Shining a light into the black box* (FSLM 2014b), which was released on 3 July 2014.²² Indicators of information asymmetry identified in FSLM 2014b, include the following:

- consumers appear to be unaware of the substantial discounts offered by insurers for new business – the reward from shopping around
- some insurers use unverifiable 'no claim bonuses' and 'loyalty discounts' to discourage policyholder switching between insurance providers
- insurers fail to disclose the extent of additional charges incurred by policyholders who choose to pay premiums by instalments
- insurers fail to adequately explain, or even acknowledge, substantial premium changes on renewal
- insurers' assessment of key property risks such as flood is imperfect but consumers do not have adequate opportunity to correct inaccurate information used by insurers
- some insurers make problematic claims regarding restrictions on their ability to share information with policyholders.

3.4 Industry concentration and profitability

Despite the large number of suppliers of property insurance in total, supply in the residential property market is quite concentrated. The combined brands and underwriting activities of three corporate entities – Suncorp Group (AAMI, APIA, GIO, Vero brands), Insurance Australia Group (RACV, CGU brands) and QBE Insurance (Australia) Limited – accounted for over 70 per cent of the Victorian residential property insurance market (Table 4).

²² FSLM 2014b. There was media interest after the report was published and other regulators commented favourably on it. The background to the (then draft) discussion paper along with a comprehensive summary of the paper can be found in the June quarter 2014 report at section 3.2.

Table 4 Market shares for residential property insurance in Victoria – 2012–13

Companies / underwriters	Brands	Market share (percent)
Insurance Manufacturers of Australia Pty Limited	RACV	18.8
Suncorp Group	AAMI*	15.0
QBE Insurance (Australia) Limited	QBE	11.3
CGU Insurance Limited	CGU	9.2
Suncorp Group	GIO*	7.8
Commonwealth Insurance Limited	CommInsure	7.4
Suncorp Group	APIA	6.3
Westpac General Insurance Limited	Westpac	5.0
Allianz Australia Insurance Limited	Allianz	3.3
Wesfarmers General Insurance Ltd	WFI / Coles / OAMPS / Lumley	3.0
Suncorp Group	Vero*	2.3
Chubb Insurance Company of Australia Limited	Chubb	1.8
Calliden Insurance Limited	Calliden	1.3
Auto & General Insurance Company Limited	Budget	1.2
Youi Pty Ltd	Youi	1.2
Others (31 different underwriters / brands)		5.1

Source: MFESB, CFA and FSLM estimates

* Each of these brands were also separate underwriting entities prior to 1 July 2013, but all are now underwritten by a single entity, AAI.

The commercial property insurance market in Victoria is substantially less concentrated than is the residential property insurance market, with seven separate corporate entities – QBE, Suncorp Group, Insurance Australia Group, Wesfarmers, Allianz, Zurich and FM Insurance – accounting for the first 70 per cent of commercial market share (Table 5).²³

²³ Vero Insurance Limited and GIO General Limited are each owned by the Suncorp Group. The Insurance Australia Group owns CGU Insurance Limited and acquired Wesfarmers General Insurance Ltd in 2014.

Table 5 Market shares for commercial property insurance in Victoria – 2012–13

Companies / underwriters (brand)	Market share (percent)
QBE Insurance (Australia) Limited	17.6
Suncorp Group – Vero*	11.9
CGU Insurance Limited	9.8
Wesfarmers General Insurance Ltd	8.7
Allianz Australia Insurance Limited	8.6
Zurich Australian Insurance Limited	6.3
FM Insurance Company Limited	4.0
Suncorp Group – GIO*	3.6
ACE Insurance Limited	3.0
AIG Australia Limited	3.0
Great Lakes Australia	2.4
Catholic Church Insurances Limited	2.3
Guild Insurance Limited	1.8
Chubb Insurance Company of Australia Limited	1.7
Ansvar Insurance Limited	1.2
Swiss Re International SE	1.1
Miramar Underwriting Agency Pty Ltd	1.0
Others (62 different underwriters / brands)	12.0

* Vero and GIO were also separate underwriting entities prior to 1 July 2013, but both are now underwritten by a single entity, AAI.

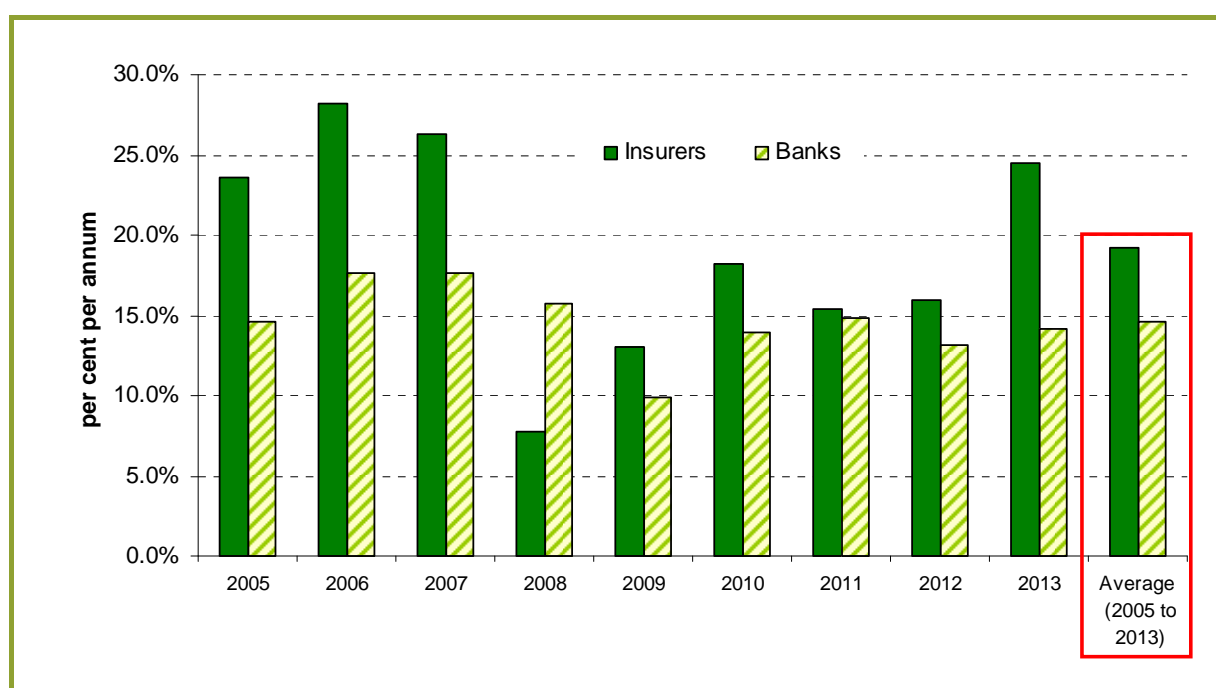
Although there are no publicly available estimates of the profitability of residential insurance – of which property insurance is a component – general insurance is clearly a profitable business. Large insurers have generally been very effective in recent years in managing the overall balance between risks and premiums. Over the nine years to 2013, the annual average return on equity on general insurers' across-the-board portfolios was 19 per cent for underwriters with a significant presence in the Victorian residential property insurance market.²⁴ Profitability for these insurers over this period has, on average, exceeded that of Australia's 'Big Four' banks (see Figure 5). Further, the Reserve Bank of Australia (RBA) has recently acknowledged the profitability of insurers:

General insurers' profitability is ... strong – the industry recorded an annualised return on equity of 17 per cent in the first half of 2014 ... The aggregate underwriting result remained robust, mainly reflecting a favourable outcome for claims expenses. Natural catastrophe claims in 2014 to date are at their lowest levels in a couple of decades, with no substantial claims events recorded as yet ...²⁵

²⁴ Sample chosen to represent all underwriters with a 2012-13 market share in Victorian residential property insurance of 2% or greater with the following exceptions: Suncorp Metway Insurance Limited included to avoid anomalies created by the effects of financial transfers between members of the Suncorp Group of companies; Wesfarmers Federation Insurance Limited is the forerunner to Wesfarmers General Insurance Limited.

²⁵ RBA 2014, p.29

Figure 5 After-tax return on equity for insurers vs banks – 2005 to 2013



* For example, 2012 includes results for entities with reporting years ending June 2012, September 2012 and December 2012.

Data sources:

1. APRA, *General Insurance Institution-level Statistics*, December 2013. Available at: <http://www.apra.gov.au/GI/Publications/Pages/General-Insurance-Institution-Level-Statistics.aspx>
2. ANZ, Commonwealth, NAB and Westpac annual reports.

Strong profit results over the nine years to the end of 2013 were achieved despite financial pressures caused by:

- a difficult investment climate following the global financial crisis of 2008 – insurers have a relatively strong reliance on investment income from the pool of funds retained from premiums pending return to policyholders via claims
- a relatively high frequency of significant natural peril events between 2007 and 2012.

Major insurers asserted in submissions to the FSLM's public hearing in June 2013 that there is strong competition in the residential property insurance market given there are several suppliers and only moderate barriers to entry. The emergence of new entrants to the residential property insurance market, such as Youi and Real, could be examples of increasing competition.

3.5 FSLM focus on residential property insurance

Despite the large total number of suppliers and the occurrence of new entry, based on FSLM monitoring there appears to be persistent and substantial price differences among insurers' (very similar) policies for identical properties – refer to the later discussion in section 7.6. Thus, the continuing relatively high profitability and persistent price differences between insurers' quotes for identical properties suggest that price competition in the residential insurance

market is not particularly vigorous. This has been a concern colouring the approach to oversight of the insurance companies in fire service funding reform.

The combination of the above factors – and the Government’s objective that the interests of consumers be protected during the transition to the new levy – led the FSLM to focus more attention on residential property insurance policyholders as those more likely to require some form of assistance in the transition. Information provided to policyholders by the FSLM was premised on residential policyholders having minimal awareness of the FSL and the implications of its abolition for their insurance premiums.

4. Key compliance risks

The key risks in the abolition of the insurance-based levy reflected the transitional issues outlined in section 2.2. The risks can be grouped into two broad categories:

- 1) insurers' pricing decisions in the period leading up to and following FSL reform, including the period after monitoring has ceased, 'take advantage of' the statutory abolition of the requirement to contribute to funding the fire services
- 2) implementation of the abolition of the FSL in practice, through billing systems and communications with policyholders, results in policyholders not being able to assess whether the removal FSL has been passed on to them, or not have confidence that it has.

The particular risks that arise under these two headings are outlined below.

4.1 Pricing decisions in the period leading up to and following FSL reform

Specific risks associated with the periods leading up to and following FSL reform – the pre-transition period (2011–12), the transition period (2012–13) and the post-transition period (2013–14) – are as follows:

- Property insurance base premiums are increased 'excessively' in 2011–12, following the Victorian Government's announcement of reform timing in May 2011, to set a higher price level for total premiums to fall from when the FSL is formally abolished from 1 July 2013.
- Property insurance base premiums are increased excessively around the time of abolition of FSL, in the knowledge that the removal of the significant FSL component of a policyholder's total premium provides 'cover' to increase base premiums without increasing the *total* premium invoiced for renewal of a policy.
- Insurers collect more revenue from policyholders as FSL in 2012–13 than they need to fund their contributions to the fire services for 2012–13.
- Property insurance base premiums are increased excessively after 1 July 2013 to take up the 'slack' created by the fall in total premiums due to the removal of the FSL component.
- Property insurance premiums being increased excessively after 31 December 2014 when the FSLM's oversight function ceases.

4.2 Insurers' communications with policyholders regarding abolition of the FSL

Specific risks associated with communication between insurers and policyholders around the process of fire service funding reform include the following:

- Insurers do not provide easily accessible and readily comprehensible general information about the abolition of the insurance-based levy to policyholders to alert policyholders to the change.

- Insurers do not provide sufficient information specific to the premiums and policies of individual policyholders to enable them to assess the effects of FSL rates charged, the abolition of the FSL and any changes in base premiums on their total premiums during the 2012–13 transition year.
- Some insurers, intermediaries and/or brokers involved in the property insurance supply chain do not adjust their billing systems correctly to ensure that FSL is properly removed by the 1 July 2013 abolition date and is not charged on policies incepted or amended after 30 June 2013.
- Insurers, intermediaries or brokers do not have mechanisms to deal with policyholders enquiries or complaints regarding their premium changes around the removal of FSL.

4.3 Regulatory strategy addressing key compliance risks

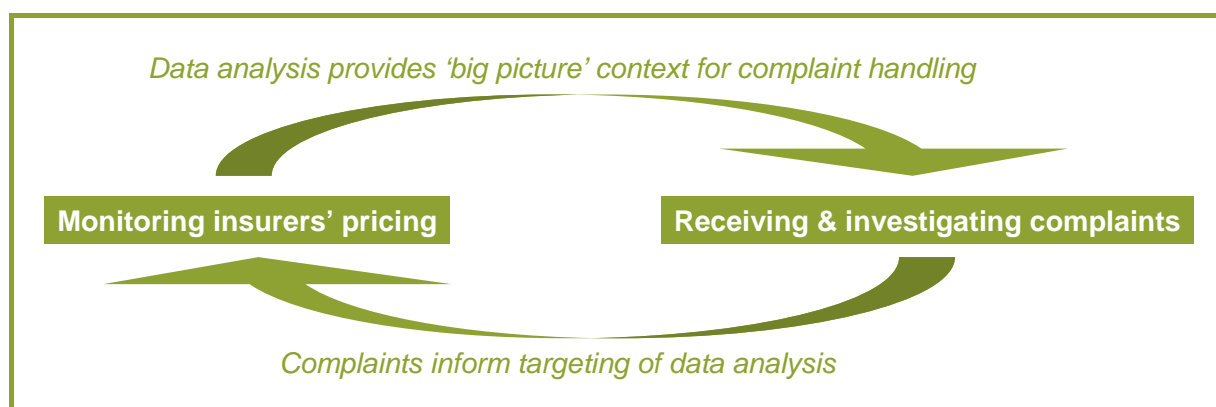
The FSLM Act was passed by Parliament on 11 December 2012 and came into effect on 19 December 2012. Public-facing operations – the website and the enquiries and complaints ‘1300’ line – commenced on 30 January 2013. During this timeframe a coherent strategy was developed to address the compliance risks identified above within the legislative framework provided by the FSLM Act.

The strategy had four main inter-connected components:

- **Information provision** to the general public, policyholders and insurers, particularly information to insurers, intermediaries and brokers through guidelines issued under the FSLM Act which provided guidance on how to comply with the FSLM Act
- **Monitoring of**
 - prices charged by insurers (FSL, base premiums and total premiums)
 - compliance with the statutory guidelines
 - enquiries and complaints regarding insurers by policyholders received through the website, the 1300 line, emails and letters
- **Investigation** of potential breaches of the FSLM Act which were indicated by complaints or the monitoring activities outlined above
- **Enforcement** actions following appropriate investigations where breaches of the FSLM Act were considered to have occurred.

An important characteristic of the strategy was the integration of monitoring of enquiries and complaints about insurers and the monitoring of prices through price information provided directly to the FSLM by insurers and information obtained independently from the market. This integration is represented diagrammatically in Figure 6. Individual complaints and patterns revealed by analysis of enquiries and complaints data helped target monitoring activities; the analysis of monitoring data provided context for individual complaints and assisted the assessment of whether further investigation was appropriate.

Figure 6 Inter-relationship between complaints and price monitoring



The relationship between complaints, price monitoring and investigations is illustrated by the case of the increase in base premiums in the first half of calendar 2013 by Insurance Manufacturers of Australia Pty Limited (IMA). A substantial investigation of IMA's pricing led to an enforceable undertaking to the FSLM entered into by IMA on 16 January 2014 (IMA undertaking). The investigation originated from some individual policyholders' complaints about large increases in base premiums (30 to 50 per cent) on policy renewals in early 2013. Price monitoring confirmed that these increases were exceptional among insurers generally and warranted further investigation. Complaints involving IMA policies were then investigated in more detail.

A summary of the risks identified, and mitigation measures adopted, by the FSLM is provided in Table 6.

Table 6 Compliance risk and FSLM mitigation measure

Risk	FSLM mitigation measure
<ul style="list-style-type: none"> Insurers collect more revenue from policyholders as FSL in 2012–13 than they need to fund their contributions to the fire services for 2012–13. 	<ul style="list-style-type: none"> Issue FSLM May 2013 guidelines on price exploitation and FSLM May 2013 guidelines on misleading/deceptive conduct to insurers. Require insurers to provide auditor's assurance opinion of collection of FSL by insurer; and check against declaration of FSL revenue to fire services and final contribution determined by fire services.

Risk	FSLM mitigation measure
<ul style="list-style-type: none"> • Insurers increase property insurance base premiums ‘excessively’ around the time of the removal of FSL, with the removal of the significant FSL component of a policyholder’s total premium providing ‘cover’ to increase base premiums (without increasing the total premium invoiced for renewal of a policy). • Insurers increase property insurance base premiums excessively after 1 July 2013 to take up the ‘slack’ in total premium levels, compared to pre-abolition levels, created by the fall in total premiums due to the removal of the FSL component. 	<ul style="list-style-type: none"> • Issue FSLM May 2013 guidelines on price exploitation and FSLM May 2013 guidelines on misleading / deceptive conduct to insurers. • Monitor insurers’ prices: <ul style="list-style-type: none"> ○ prices provided by insurers under s.30 of FSLM Act ○ ‘phantom shopper’ quotes obtained from insurers’ websites ○ prices provided by third party ○ ABS ‘home insurance’ price indexes from CPI collection ○ monitor/investigate policyholders’ complaints. • Investigate ‘exception’ results in monitoring data analysis. • Take enforcement action on potential contraventions of the FSLM Act.
<ul style="list-style-type: none"> • Insurers, intermediaries and/or brokers in the property insurance supply chain continue charging FSL after 30 June 2013, e.g. do not adjust their billing systems correctly to ensure that FSL is removed by 1 July 2013 abolition date. 	<ul style="list-style-type: none"> • Issue FSLM May 2013 guidelines on price exploitation and FSLM May 2013 guidelines on misleading / deceptive conduct to insurers. • Require CEO of each insurer to declare that insurer has implemented internal controls to ensure that no FSL will be charged after 30 June 2013. • Monitor insurers’ prices: <ul style="list-style-type: none"> ○ prices provided by insurers under s.30 of FSLM Act ○ ‘phantom shopper’ quotes obtained from insurers’ websites ○ prices provided by a third party ○ ABS ‘home insurance’ price indexes from CPI collection. • Monitor/investigate policyholders’ complaints. • Investigate ‘exception’ results in monitoring data analysis. • Take enforcement action on potential contraventions of the FSLM Act.
<ul style="list-style-type: none"> • Insurers do not provide easily accessible and readily comprehensible general information about the abolition of the insurance-based levy to policyholders to alert policyholders to the change 	<ul style="list-style-type: none"> • Publish information for policyholders and the public generally on FSLM website. • Advertising campaign in the news media that FSL is being abolished and the FSLM exists to protect consumers’ interests and take enquiries/complaints. • Issue FSLM May 2013 guidelines on price exploitation and FSLM May 2013 guidelines on misleading/deceptive conduct to insurers. • Publish ‘public warning’ of risk to policyholders that FSL is not removed.
<ul style="list-style-type: none"> • Insurers do not provide sufficient information specific to the premiums and policies of individual policyholders to enable them to assess: the effects of FSL rates charged, and the abolition of the FSL and any changes in base premiums on their total premiums during the 2012–13 transition year. 	<ul style="list-style-type: none"> • Publish information for policyholders and the public generally on FSLM website. • Advertising campaign in the news media that FSL is being abolished and the FSLM exists to protect consumers’ interests and take enquiries/complaints. • Receive policyholders’ enquiries and complaints and respond to substantive complaints regarding premium and FSL changes. • Monitor insurers’ price to assess the effects of FSL rates charged, the abolition of the FSL and changes in base premiums on total premiums during the 2012–13 transition year.

Risk	FSLM mitigation measure
<ul style="list-style-type: none"> Insurers, intermediaries or brokers do not have mechanisms to deal with policyholders enquiries or complaints regarding their premium changes around the removal of FSL. 	<ul style="list-style-type: none"> Publish information for policyholders and the public generally on FSLM website. Advertise extensively in the news media that FSL is being abolished and the FSLM exists to protect consumers' interests and take enquiries/complaints. Receive policyholders' enquiries and complaints and respond to substantive complaints regarding premium and FSL changes. Monitor/investigate policyholders' complaints.
<ul style="list-style-type: none"> Premium increases 'suppressed' by the operations of the FSLM may emerge once the FSLM ceases at the end of 2014. 	<ul style="list-style-type: none"> Beyond the scope of the FSLM. However, to the extent that there are subsequent pro-competition initiatives in the market, the potential for sustained excessive premiums increase will diminish. Such an initiative would be the establishment of an online home insurance premium comparison tool.

THIS PAGE DELIBERATELY LEFT BLANK

5. Information provision

5.1 Media and public relations

Media and public relations activities continued in the September quarter 2014. Media releases were issued in connection with the publication of the FSLM's June quarter 2014 report and the publication of a major discussion paper, *Enhancing the consumer experience of home insurance: Shining a light into the black box*, in early July 2014 (FSLM 2014b). A media release was also issued at the beginning of September 2014 to report the an undertaking by CGU Insurance Limited (CGU) to the FSLM signed on 29 August 2014 (CGU undertaking) – CGU being the last insurance company to resolve its over-collection of FSL.

The discussion paper attracted media interest, with coverage in the Australian Financial Review, the Herald Sun, ABC Online and at least one industry publication.

5.2 Website

The FSLM's website (www.firelevymonitor.vic.gov.au) has been the main platform for providing information to policyholders and insurance companies about the abolition of the FSL, the role of the FSLM, and updates about activities. Significant additions to the website during this quarter have included details of progress against the resolution arrangements of the 56 insurance companies required to disburse their over-collected FSL.

The FSLM website had 2,566 visitors during the September quarter 2014, bringing the cumulative total from inception to the end of September 2014 to 37,117 hits from 24,697 unique visitors. The reducing level of contacts, quarter by quarter, continues a trend that started in the December quarter 2013, coming off the high point of the September quarter 2013. This suggests that more than a year after the abolition of the FSL, the community generally, and policyholders in particular, are familiar with the intent of fire service funding reform and that the level of concern about its impact on premiums is very low. Data on visits to the FSLM website is provided in Table 7 and Table 8.

Table 7 All visits FSLM to website in each quarter – March quarter 2013 to September quarter 2014

Measure	Mar qtr 2013	Jun qtr 2013	Sep qtr 2013	Dec qtr 2013	Mar qtr 2014	Jun qtr 2014	Sep qtr 2014	Total
Total visits	3,158	8,079	11,482	5,813	3,268	2,751	2,566	37,117
% of total	8.5	21.8	30.9	15.7	8.8	7.4	6.9	100

Source: FSLM estimates and Google Analytics.

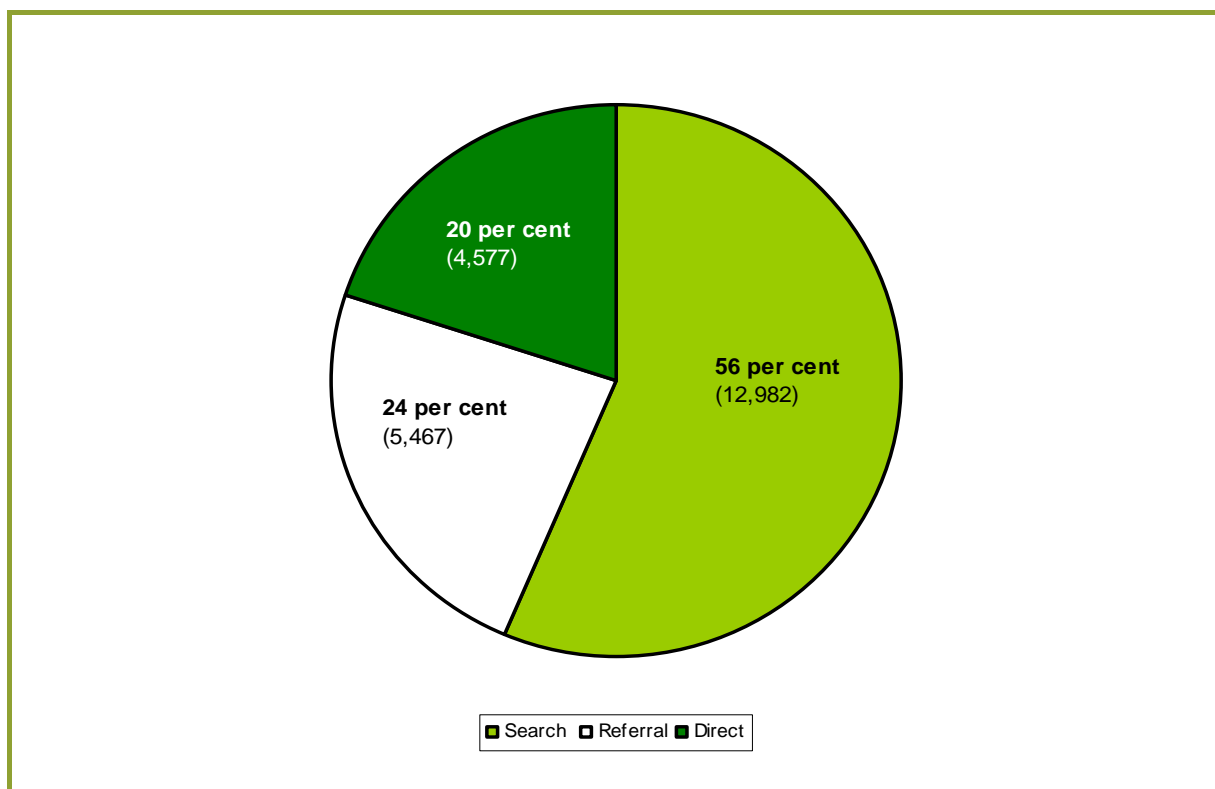
Table 8 Unique visits FSLM to website in each quarter* – March quarter 2013 to September quarter 2014

Mar qtr 2013	Jun qtr 2013	Sep qtr 2013	Dec qtr 2013	Mar qtr 2014	Jun qtr 2014	Sep qtr 2014
2,302	5,628	7,865	4,415	2,544	1,816	1,626

* Unique to that quarter. Any given visitor to the website could be counted as 'unique' in multiple quarters. Hence, the sum of the quarterly unique visitors could (and does) exceed the number of unique visitors (24,697) measured over the entire period from the March quarter 2013 to the September quarter 2014.
Source: FSLM estimates and Google Analytics.

Other government agencies have hosted information about the FSLM, including the Consumer Affairs Victoria website (www.consumer.vic.gov.au) and the Victorian Government website (www.vic.gov.au). Links to the FSLM website have provided additional opportunities for consumers and policyholders to acquire information or reacquaint themselves with the fire service funding reform. These 'referral' visits represented 24 per cent of traffic to the FSLM website in the period for which data is available: September quarter 2013 to September quarter 2014. The majority of website visits in this extended period (56 per cent) originated through consumers and policyholders using a search engine, though 20 per cent found their way direct to the website.

Figure 7 Website traffic sources overview – July 2013 to September 2014

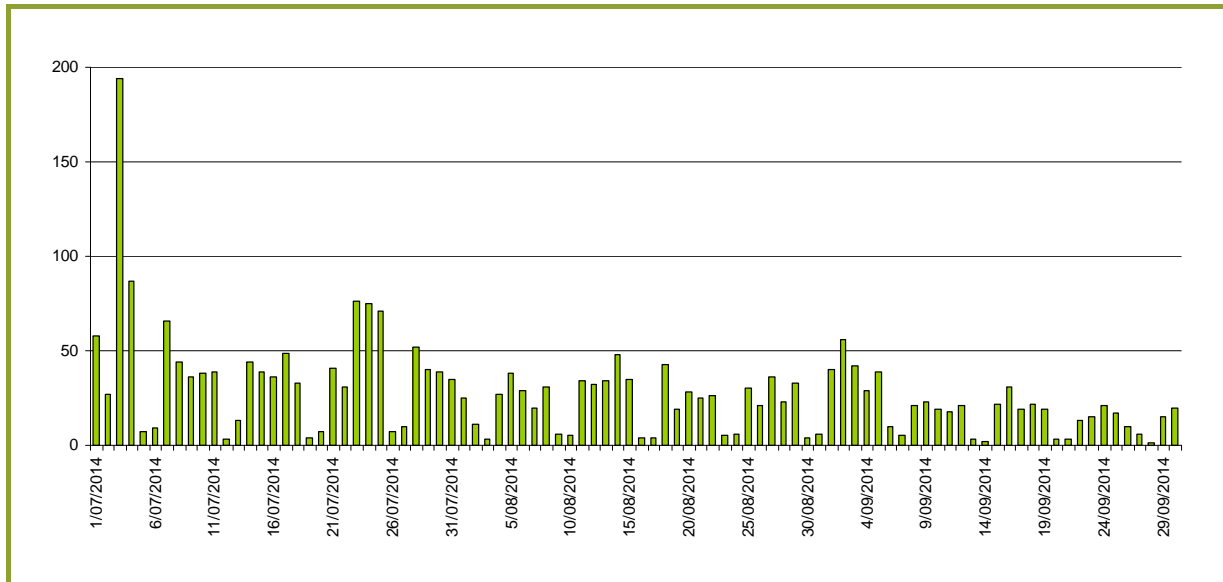


Source: FSLM estimates and Google Analytics. Sources comprising less than 1 per cent of visits not shown.

Figure 8 shows a large degree of consistency throughout the September quarter in the number of daily website visits, with the exception of the spike very early in the quarter, which could be attributable to the release of the Discussion Paper. Figure 9 demonstrates that while

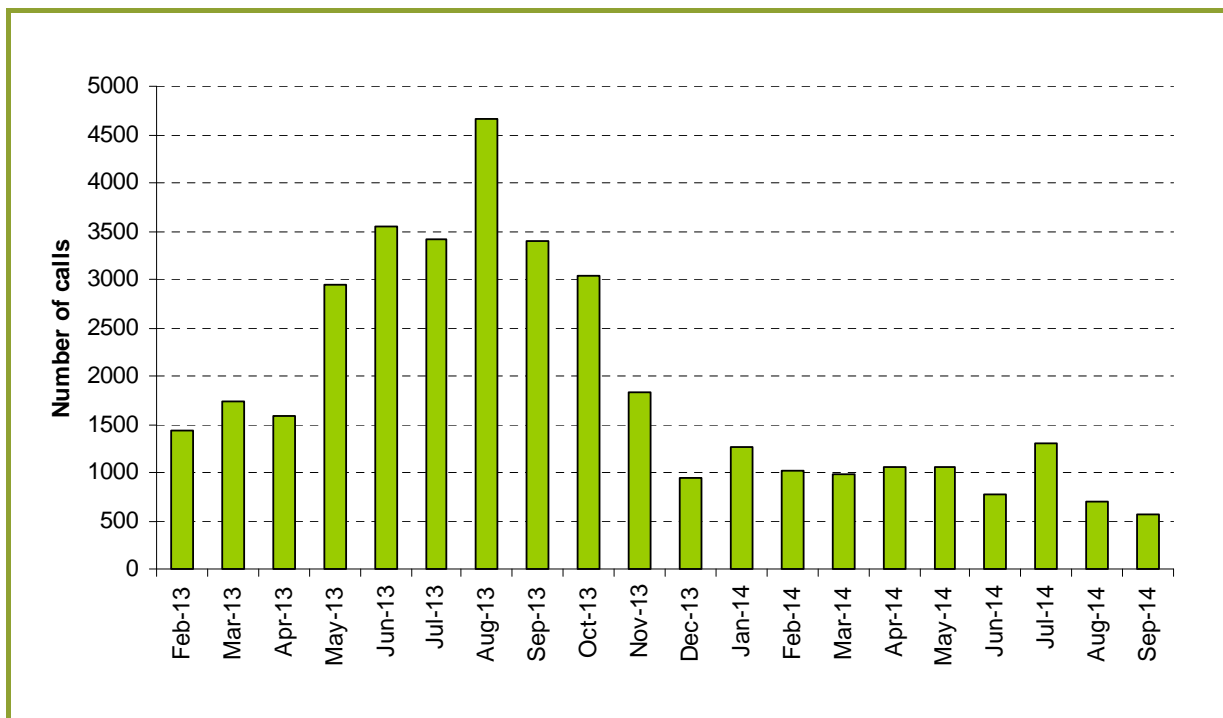
the situation in the March quarter 2014 stabilised at a little under 50 website visits each day, the June and September quarters saw diminishing website traffic, as mentioned, with average daily website visits dropping to 28 in the September quarter.

Figure 8 Visits (by day) to the FSLM website – September quarter 2014



Source: FSLM estimates and Google Analytics.

Figure 9 Visits (by month) to the FSLM website – February 2013 to September 2014



Source: FSLM estimates and Google Analytics.

THIS PAGE DELIBERATELY LEFT BLANK

6. Enquiries and complaints

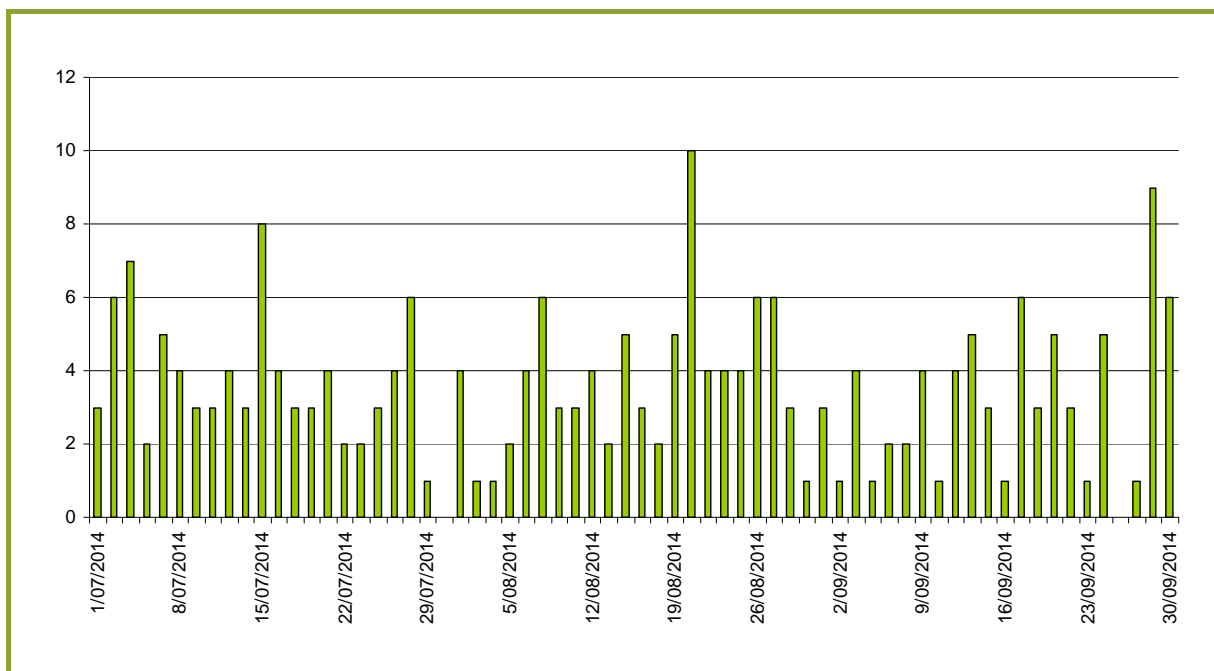
Enquiries and complaints related to FSL charges, base premium changes, representations by insurers, the relationship between the FSL and the FSPL. The complaints were received through several media and provided valuable information to support the FSLM's compliance monitoring.

6.1 Complaints and enquiries line – 1300 300 635

A dedicated enquiries line assisted policyholders with queries and complaints regarding fire service funding reform. It has received a total of 6,128 calls between its launch on 30 January 2013 and 30 September 2014, with 233 in the September quarter 2014. Figure 10 displays the number of daily calls received in the September quarter 2014. The call rates, consistent with the trend for website visits, were lower than in the June quarter 2014 and the lowest they have been since the inception of the service. The FSLM has been able to scale back the resources applied to the enquiries line, commensurate with the lower call rate.

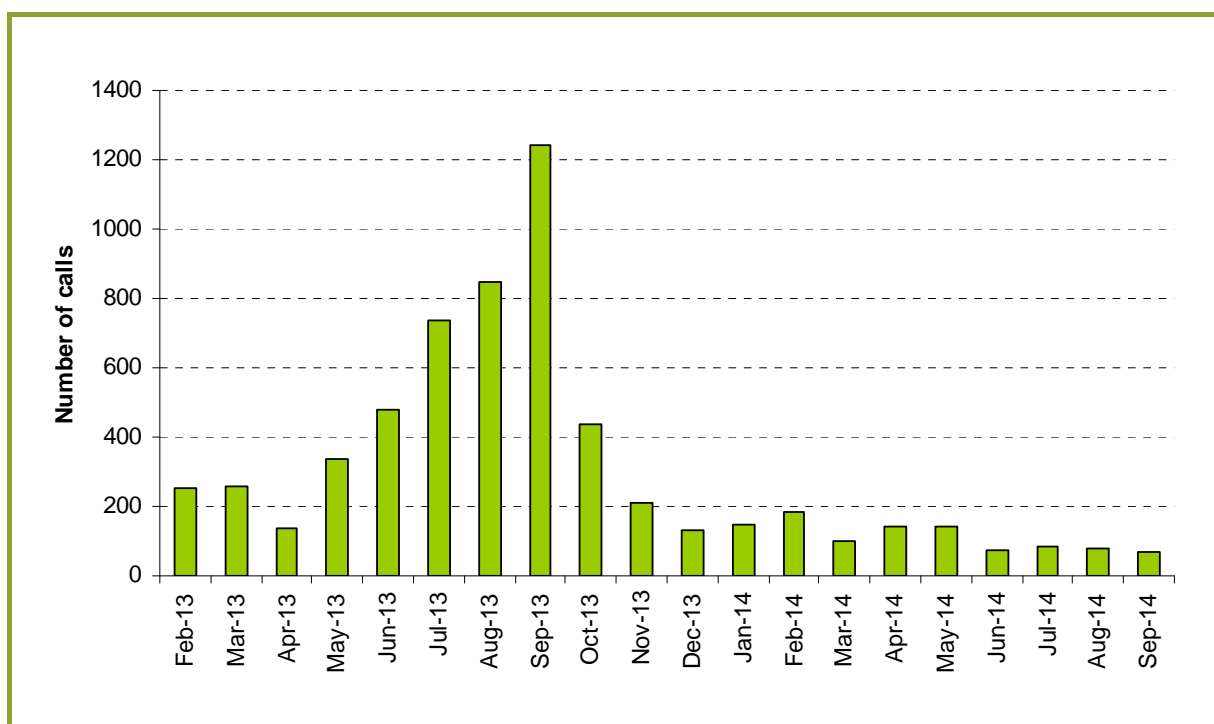
Figure 11 shows the average number of daily calls per month since February 2013. There was a steady increase across the June and September quarters of 2013, reflecting the timing of key changes in implementation of fire service funding reform. With the abolition of the FSL well over a year ago, and given that all policyholders renewing in this quarter experienced their *second* annual insurance premium free of any charge for FSL, it is not surprising that there has been such a small number of calls to the hotline, in the September quarter and this year.

Figure 10 Calls (by day) to the FSLM complaints and enquiries line – September quarter 2014



Source: FSLM estimates

Figure 11 Calls (by month) to the FSLM complaints and enquiries line – February 2013 to September 2014



Source: FSLM estimates

6.2 Sources and trends of enquiries and complaints

The level of enquiries and complaints decreased further in the September quarter 2014, to 279. The cumulative total number of enquiries and complaints received to the end of the September quarter 2014 was 7,122 as shown in Table 9.

Table 9 Enquiries/complaints to the FSLM – March quarter 2013 to September quarter 2014

Mode of contact	Mar qtr 2013	Jun qtr 2013	Sep qtr 2013	Dec qtr 2013	Mar qtr 2014	Jun qtr 2014	Sep qtr 2014	Total	% of all contacts
Telephone	544	953	2,832	781	430	355	233	6,128	86
Emails	90	45	344	108	55	43	41	726	10
Letters	0	64	110	58	27	4	5	268	4
All contacts	634	1,062	3,286	947	512	402	279	7,122	100

Source: FSLM estimates

The September quarter 2014 reflects an inevitable decrease in enquiries and complaints, given that property owners are now familiar with the FSPL as successor to the FSL and that, by definition, policyholders renewing in the September quarter 2014 have entered their second year free of FSL charges in their insurance premium. As suggested in the June quarter 2014

report, the increased understanding by policyholders and insurers of the transition from FSL to FSPL has probably played a role in the fading policyholder interest in the FSL, at the 'expense' of a heightened interest in the FSPL.

Over the entire period of operation of the FSLM, complaints about 'paying twice' and the amount of FSL or premium charged were by far the most common (see Table 10).

Table 10 Enquiries / complaints by category – August 2012 to September 2014

Issue	September quarter 2014	September quarter 2014	Cumulative: August 2012* to September 2014	Cumulative: August 2012* to September 2014
	number	%	number	%
Paying twice/double charging ¹	3	17	1,519	57
Amount of FSL or premium charged	4	22	935	35
Misleading/false representation	6	33	133	5
Undertakings and refunds	5	28	72	3
Total	18	100	2,659*	100

* Although the FSLM did not formally commence operations until January 2013, Consumer Affairs Victoria had been recording complaints since August 2012 – these complaints were then forwarded to the FSLM in January 2013.
 Note: This table is limited to enquiries/complaints where the nature of contact is more than a general enquiry and the subject matter was able to be categorised.
 Source: FSLM estimates.

Table 11 summarises the data on enquiries/complaints disaggregated by insurer brand. IMA (RACV), and the Suncorp Group brands (GIO, APIA and AAMI) together account for a little over 70 per cent of the complaints logged since the end of January 2013, though between them, the market share of IMA and Suncorp (as at 30 June 2013) was approximately 24 per cent of the total commercial and residential property insurance market.

Table 11 Complaints by insurance brand – August 2012 to September 2014

Insurer	Total from August 2012 to September 2014 [†]		Insurer 's 2012–13 market share [#]
	number	%	%
Allianz Australia Insurance Limited	22	4.7	8.9
Aon Risk Services Australia Limited	1	0.2	0.2
Australian Alliance Insurance Company Limited (APIA)	47	10.0	2.8
Australian Associated Motor Insurers Limited	48	10.2	7.1
Auto & General Insurance Company Limited	4	0.9	0.6
Calliden Insurance Company	4	0.9	0.8
CGU Insurance Limited	15	3.2	9.3
Chartis Australia Insurance Limited	2	0.4	-.*
Commonwealth Insurance Limited	12	2.6	3.4

Table 11 Complaints by insurance brand – August 2012 to September 2014 (cont'd)

Insurer	Total from August 2012 to September 2014 [†]		Insurer 's 2012–13 market share [#]
	number	%	%
Defence Service Homes Insurance	3	0.6	0.2
Elders Insurance Limited	4	0.9	0.4
GIO General Limited	52	11.1	5.4
Great Lakes Reinsurance (UK) PLC	1	0.2	1.2
Insurance Manufacturers of Australia Pty Limited (RACV brand)	185	39.4	8.5
OAMPS Insurance Brokers Limited	2	0.4	.*
QBE Insurance (Australia) Limited	19	4.1	14.2
Suncorp Metway Insurance Limited	1	0.2	0.2
The Hollard Insurance Company Pty Ltd	4	0.9	0.5
Vero Insurance Limited	10	2.1	7.2
Wesfarmers General Insurance Limited	9	1.9	5.9
Westpac General Insurance Limited	21	4.5	2.3
Youi Pty Ltd	2	0.4	0.6
Zurich Australian Insurance Limited	1	0.2	3.5
Total	469**	100.0	

Share of combined residential and commercial property insurance premiums subject to contributions to the fire services.

* Share of less than 0.1.

† Some totals for individual companies incorporate additional complaints that were not included in the March quarter 2013 report.

** The equivalent total for the June quarter 2014 was presented as 496. The June quarter figure resulted from an addition error and should have been 465. The total of 469 in this table represents just 4 additional complaints that could be linked to insurance brand.

Source: FSLM estimates

6.3 Double charging/paying twice

The most common complaint received by the FSLM, accounting for 57 per cent of complaints, related to the perception by many policyholders that they were 'paying twice' for funding of the fire services in 2012–13 or 2013–14 because they paid the insurance-based levy and then the FSPL in a period of less than 12 months. The other side of this paying twice perception was a misapprehension that the Victorian Government was 'double dipping' into policyholders' pockets to fund the fire services.

This issue was addressed at the outset in the explanatory material placed on the FSLM website from its commencement on 30 January 2013. It remained a common subject of complaints during the 2013 calendar year. The basic explanation as to why this was a misconception – and the reason there was not a double payment for the fire services – was because the FSL component of an insurance premium is tied to financial years, 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 is 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 calculation of 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, nearly all insurance companies had ceased charging an FSL amount (that is, the FSL rate equalled zero per cent) by the beginning of May 2013.

Paying twice would have arisen only if an insurer failed to remove the levy on policies inceptioned on or after 1 July 2013: a policyholder in reality would be charged twice: through the insurance premium and through the FSPL included with 2013–14 councils rates notices. However, should this have occurred, it would have raised compliance issues and insurers would have faced investigation and potential enforcement action.

Where insurers did the correct thing and removed the FSL from insurance premiums, policyholders did not pay for the fire services twice for the same year. This was still the case where a policyholder paid an FSL amount in a total premium prior to 1 July 2013 and also paid the FSPL later in 2013.

6.4 Complaints about the amount of FSL or base premium charged

The amount of FSL or base premium charged was the subject of the second most common complaint received (see Table 10). Complaints about the amount of FSL or premium charged to policyholders were received in two 'waves' during 2012–13.

The first wave of complaints related to increased amounts of FSL charged in the first half of 2012–13 which reflected most insurers' practice of 'tapering' FSL rates. This involved initially increasing FSL rates in that period. Many of these complaints were received by Consumer Affairs Victoria prior to the operation of the FSLM and were passed to the FSLM for examination.

The second wave of complaints related to large increases in base premiums coinciding with some insurers removing FSL from their total premiums. These were received in the second half of 2012–13 and most were from IMA policyholders.

THIS PAGE DELIBERATELY LEFT BLANK

7. Price monitoring of individual insurers

Under s.6 of the FSLM Act, premiums have been monitored to assess industry compliance with the prohibition on price exploitation and the prohibition on conduct which falsely represents or misleads or deceives, regarding the effect of the abolition of the FSL.

Sections 18 and 19 of the FSLM Act provide power to require the provision of information that may assist in monitoring compliance with the FSLM Act. Section 30 specifically allows the monitoring of 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 established monitoring program continued during the September quarter 2014, drawing on a range of sources, including information obtained under s.19 and s.30. Table 3 sets out the number of notices issued in the September quarter. The notices issued under s.30 were issued once in late 2013, and contain a repeat requirement, monthly, to supply data. This obviates the need for the FSLM to serve new notices each month and gives the insurers certainty in advance, as to what information they are required to provide.

Table 12 Statutory notices issued under monitoring and investigation power – September quarter 2014

Statutory notice	Number
Section 18	0
Section 19	1
Section 30*	11
Section 57	0

*The s.30 notice reflects a recurring notice issued in late 2013 requiring monthly data.
Source: FSLM estimates

7.1 Ongoing premium quotes

Analysis of monthly data representing 11 insurance brands continued up to the end of the September quarter 2014, consistent with previous quarters. The data was used to:

- cross-reference movements in insurance premiums against information provided by insurers in 2013
- cross-reference movements in insurance premiums against quotes obtained from insurers' internet-based quotation facilities
- cross-reference movements in insurance premiums against quotes provided from an external actuary.

Analysis of this data is provided in section 9.3.2 of this report.

7.2 Developments in premiums

The evidence to date has demonstrated that policyholders have benefited and continue to benefit from the abolition of the FSL. This section draws on the continuous monitoring of price

data to assess the ongoing impact of fire service funding reform on policyholders. It confirms that movements in total premium, on the whole, continue to be very moderate, following the abolition of the FSL.

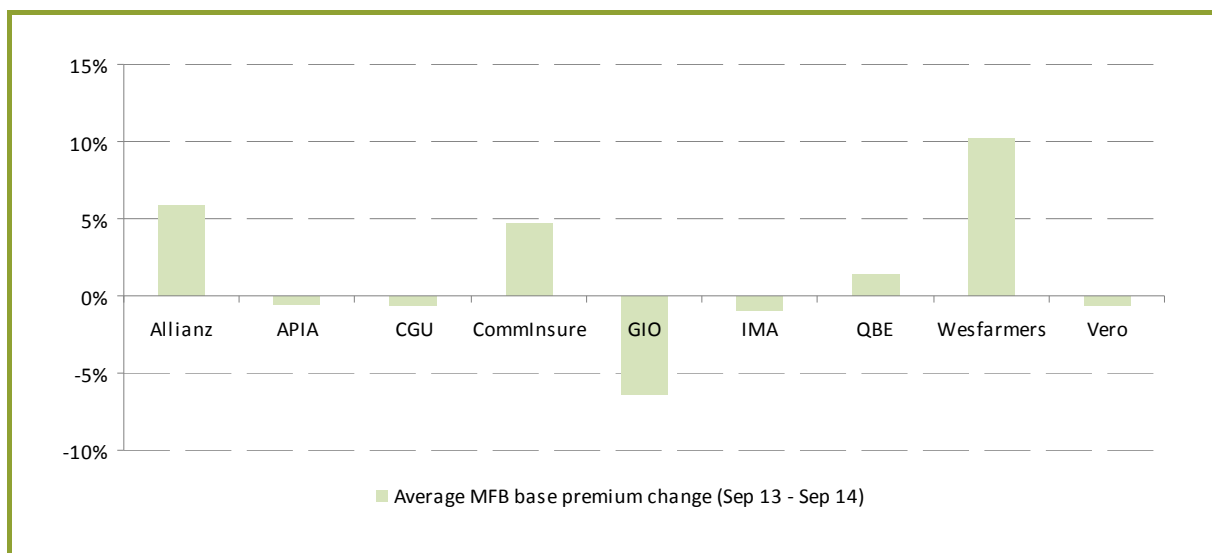
As it is now more than 12 months since the abolition data (30 June 2013), policyholders will not discern a direct impact of the removed FSL on their annual renewal notices. As such, this section focuses solely on premium movements.

7.3 Premium data supplied by insurers – 12 months ending September 2014

As FSL is no longer a component of premiums, percentage changes in base premium can be equated with percentage changes in total premium (base premium plus government charges). Base premium continues to be used so as to be consistent with previous reports.

The September 2013 quarter report noted that in the years prior to the transition year, base premiums have tended to rise by 7 to 10 per cent annually. This was reinforced by insurers in the June 2013 public hearing convened by the FSLM, the insurers stating that base premiums were expected to rise by between 8 and 10 per cent for the 2012–13 financial year. The following figures show the average change in base premiums over the past 12 months for a series of insurers who provide monthly quotes to the FSLM on a constant sample of properties. The average increase shown in the figures include the effects of price changes impacting on particular properties in the sample.

Figure 12 Residential building insurance base premium, average change in insurers' quotes in MFESB region – September 2013 to September 2014

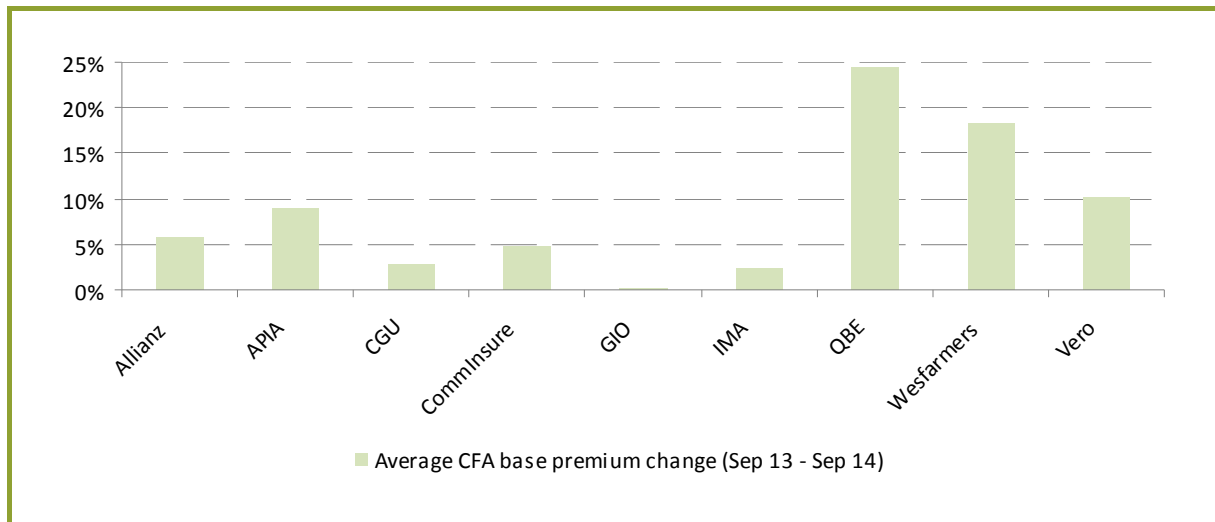


Source: FSLM estimates

For the MFESB region, all insurers shown in Figure 12 had base premium movements for the year ending September 2014 that where they rose at all, were equal to or below an increase of 10 per cent. The largest increase observed was Wesfarmers with 10 per cent. Much of this increase was due to a state-wide risk re-rating in July 2014 which was the insurer's response

to high loss ratios in particular regions. It is noteworthy that five of the insurers' base premiums decreased.

Figure 13 Residential building insurance base premium, average change in insurers' quotes in CFA region – September 2013 to September 2014



* Average quotes for one of the sample properties were heavily affected by QBE December 2013 introduction of flood cover into their intermediary line of business .
Source: FSLM estimates

For the CFA region, most insurers shown in Figure 13 had base premium increases for the year ending September 2014 that were less than 10 per cent. The exceptions were QBE and Wesfarmers. Some QBE quotes in the sample were significantly affected by the inclusion of flood cover in December 2013. As for the MFB region, Wesfarmer's premium levels rose due to a state-wide risk re-rating.

7.4 Premium data supplied by insurers – September quarter 2014

Based on the data provided by insurers as part of the ongoing price monitoring under s.30 of the FSLM Act, movements in total premiums observed in the September quarter 2014 have, on the whole, been negligible. Table 13 lists the average total premium change across the sample of scenarios/suburbs monitored, for the five quarters from September quarter 2013 to September quarter 2014, inclusive.

Table 13 Total premium for residential insurance by brand, per cent change from previous quarter – September quarter 2013 to June quarter 2014

Insurer	Sep qtr 2013	Dec qtr 2013	Mar qtr 2014	Jun qtr 2014	Sep qtr 2014
AAMI	3.1	0.8	-8.7	-2.1	3.6
APIA	0.8	0.8	2.9	0.2	0.2
Vero	0.5	0.6	3.4	0.3	0.3
IMA	0.0	1.7	-0.9	0.0	0.0
QBE	0.0	12.8	0.0	0.0	0.0
CommInsure	0.0	0.0	3.5	0.0	0.0
Allianz	0.0	5.0	0.0	2.0	-1.2
CGU	0.0	0.0	1.1	0.0	0.0
GIO	0.2	0.7	-1.0	-7.8	5.5
Wesfarmers	-2.2	-3.2	0.0	-0.3	18.1

Source: FSLM estimates

In the September quarter 2014, seven of the ten residential property insurance brands implemented price changes of less than one per cent. This included four brands that had no change in total premium at all, and Allianz, which decreased prices.

The largest increases were observed for Wesfarmers, which averaged a total premium increase of 18.1 per cent for the quarter, as mentioned earlier. This is largely attributable to a state-wide recalibration of risk ratings impacting premiums of particular properties in the sample.

The average premium change across the ten residential insurers was an increase of 2.7 per cent for the September quarter 2014, compared with a 0.6 per cent reduction for the June quarter 2014. However, if the effect of the Wesfarmers one-off risk re-rating is excluded, the average increase is 0.9 per cent.

7.5 Premium quotes obtained from insurers' websites

Capturing online quotations from major insurers' websites since March 2013 has assisted the FSLM in understanding general base premium increases. The monitoring encompasses the period in which most insurers ceased to charge FSL on their policies.

The percentage change in base premium between March 2013 and September 2014, for each of the sample properties, was calculated for the eight insurance brands monitored. By averaging the base premium change across the sample properties, a single average percentage increase for this period was obtained. These figures are provided below in Table 14.

Table 14 Indicative base premium by brand – March quarter 2013 to September quarter 2014

Insurer	Indicative base premium Mar qtr 2013 (\$)	Indicative base premium Sep qtr 2014 (\$)	Change in indicative base premium*** (%)
AAMI	301	318	6.0
Allianz	356	363	2.0
APIA	359	382	6.5
CommInsure*	306	361	18.0
IMA (RACV)	521	632	21.4
QBE**	522	600	14.8
Vero (Bankwest)	476	522	9.6
Wesfarmers (Coles)	562	612	8.8

* CommInsure introduced flood cover to their home insurance policies during this period. The impacts of this are not observed in the s.30 data analysed above as these relate to policies without flood cover.

** QBE introduced flood cover to their 'direct' line of home insurance business in February 2014.

*** Average premiums in the first two columns are rounded. Percentage changes were calculated using the exact amounts. Source: FSLM estimates

Five insurers registered increases below 10 per cent in the six quarters following the March quarter 2013, while QBE, CommInsure and IMA, in ascending order, registered the highest increases. CommInsure and QBE added flood cover to their policy coverage during this period, which contributed significantly to these increases. IMA's three base premium increases over this period were the subject of investigation, with the last of these increases being the subject of the IMA undertaking.²⁶

7.6 Price variations across the major insurers

Ongoing monitoring of residential insurance premiums has continued to highlight the substantial price differences between insurance brands. Total premium values were obtained from online quotes gathered at the end of September 2014 for a sample of properties using standardised policy specifications (see Table 15). The range of premiums quoted for the same property can be quite large – for example, in the case of an Echuca property, the lowest on-line quote for an annual building only insurance policy was \$332 and the highest on-line quote \$1,036, a range of \$704.

The message for consumers remains very clear. It pays to shop around by comparing the price of different insurers before purchasing or renewing policies. In this regard, one of the potential projects to be undertaken from the disbursement of over-collected FSL to consumer organisations involves the establishment of an online price comparison facility.

²⁶ The enforceable undertaking is discussed in detail in the March quarter 2014 report and is also available on the website.

Table 15 On-line building only insurance premium quote for FSLM specified properties (\$300,000 sum insured) – 1 October 2014

Property location	Bendigo	Glen Iris	Echuca	Surrey Hills
AAMI	\$353	\$412	\$332	\$380
Allianz	\$423	\$451	\$410	\$446
APIA	\$424	\$484	\$403	\$425
CommInsure	\$453	\$443	\$422	\$453
QBE	\$736	\$551	\$719	\$551
RACV	\$466	\$681	\$1,036	\$510
Bankwest	\$573	\$629	\$564	\$576
Coles	\$574	\$634	\$941	\$568
<i>Range</i>	\$383	\$269	\$704	\$196
<i>Low as % of high</i>	48	60	32	66

8. Investigation and enforcement

Four major areas of investigation and enforcement activity occurred during the operations of the FSLM:

- two of these areas related to pricing by individual companies in the lead-up to the abolition of the FSL
- one area was the almost industry-wide occurrence of over-collection of FSL due to insurers having to estimate their contributions for 2012–13
- one area was the charging of FSL after 1 July by some brokers.

There were developments in respect of the last two in the September quarter 2014.

Previous quarterly reports provided details of two investigations and enforcement outcomes involving individual insurers. One related to a pricing error by QBE Insurance (Australia) Limited. The most significant investigation and enforcement outcome related to large increases in base premiums by IMA immediately prior to the FSL abolition date of 1 July 2013.

The December quarter 2013 report included a table setting out the amount of revenues relating to non-compliance issues that would have otherwise been retained by insurers but for FSLM's oversight of the fire service funding reform. Table 16 updates that table to provide an aggregate figure for the outcomes of enforcement activities as at 30 September 2014. Table 16 shows that nearly \$27 million in revenues received by insurers in 2012–13, has been returned to policyholders or otherwise disbursed.

Table 16 Aggregate outcome of FSLM oversight: revenue not retained by insurers

Compliance issue	No. of policyholders where refunds made	Amount disbursed (\$ million)
Pricing error on reducing FSL rates	11,500	1.3
Charging FSL after planned cessation	1,051	0.1
Price increase just before abolition of FSL	206,000	11.3
Over-collection of FSL in 2012–13	40,538	8.1
Over-collection of FSL in 2012–13	Refunds paid to consumer organisations	4.4
CGU payment to CFA		1.2
Brokers and insurers charging FSL after 30 June 2013	120*	0.5*
Total not retained by insurers		26.9

* Includes \$314,000 identified as a result of the amnesty that ran through October 2014.

8.1 Over-collection of FSL by insurers in 2012–13

It was anticipated that at least some insurers would collect more FSL, and some less, than was ultimately required to meet their statutory contribution in 2012–13. This outcome was almost inevitable given that the final determination of the amount of statutory contribution for 2012–13 would not be made until October 2013. Insurers were required to estimate in advance how much they would be required to contribute. Accordingly, the FSLM May 2013

guidelines on price exploitation provided that where an insurance company over-collected FSL, it should directly refund the excess to affected policyholders.

In the FSLM's report to the Minister for the June quarter 2014 report, it was noted that as at 30 June 2014, 55 of the 56 affected insurance companies had participated in a process consistent with FSLM March 2014 guidelines on resolution of over-collection to resolve their over-collection. Resolution was effected either by way of concise pro-forma agreement or for 15 insurers, formal undertakings pursuant to s.92 of the FSLM Act. The final insurer, which did not accept the voluntary approach of the guidelines, to resolve its over-collection was CGU. After a detailed investigation CGU concluded an enforceable undertaking, full details of which are available in the register of undertakings on the FSLM website. Further detail on the conclusion of this matter in the September quarter is provided in section 8.1.2.

A list of the 56 insurance companies required to disburse their net over-collected FSL, along with their disbursement to either policyholders or consumer organisations, is at *Appendix B: Total disbursement of over-collected FSL by insurer.*

8.1.1 Policyholder refunds

The FSLM advised insurers to resolve their over-collection of FSL by making refunds to those policyholders who paid FSL on policies incepted in the 2012–13 financial year. This was made clear in the FSLM May 2013 guidelines on price exploitation, consistent with the FSLM's view that over-collected FSL should be disbursed by insurers, rather than retained and treated as income.

The May 2013 guidelines on price exploitation acknowledged, in response to representations by insurers, that it may not always be practicable for insurers to make refunds to affected policyholders, or the cost of administering refunds may be disproportionate to the amount of the refund. The complexity of intermediated customer relationships was a major reason that a number of insurers sought to aggregate FSL over-collection monies. As a general rule, the FSLM considered that policyholder refunds that would be less than \$20 for residential policies or \$100 for commercial policies could reasonably be aggregated. In the result, insurers agreed to make refunds totalling \$6,674,681. In accordance with guidance issued in May 2014, insurers also paid the GST and stamp duty applicable to the amount of the refund, in addition to the refund itself. This increased the size of the total amount of refunds by \$1,401,683 (comprising \$667,468. in GST and \$734,214. in stamp duty) to \$8,076,364.

The FSLM March 2014 guidelines on resolution of over-collection referred to the need for verification of payments by insurance companies. A guidance note issued on 16 May 2014 offered insurers the choice of retaining independent auditors to vouch for the processes followed by the insurer, or alternatively, the CEO could make a declaration to the effect that the company complied with the FSLM March 2014 guidelines on resolution of over-collection and followed the verification processes set out in the May 2014 guidance note. As at 30 September 2014, the FSLM had received verification from all but one insurer in relation to the payment of refunds to policyholders.

8.1.2 *Payments to consumer organisations*

Enforceable undertaking with CGU

On 29 August 2014, the CGU undertaking was accepted. This followed an investigation into aspects of CGU's over-collection of FSL in relation to the 2012–13 financial year. Under the terms of the undertaking, CGU undertook to make a payment of \$210,000 to the Consumer Action Law Centre, a major Victorian organisation representing the interests of consumers, including the interests of Victorian consumers of insurance. The undertaking notes that CGU had already paid \$1.184 million to the CFA, as a disbursement of a large proportion of the total amount of FSL it over-collected. The following quote from the media release summarises the CGU undertaking:

While the Monitor's preference with all insurers was for over-collected FSL to be returned to customers, we have accepted payments to organisations representing the interests of Victorian consumers by insurers where they could demonstrate that refunds were impractical.

The Monitor has acknowledged CGU's claim that its average over-collection of FSL was approximately \$8.80, the majority of which was collected through brokers, and accepts that it was uncommercial and infeasible for CGU to return these small sums of over-collected FSL to its customers.

Given that refunds were impractical and the payment to the CFA had already been made, we accepted that the payment made to the CFA should stand.

The Undertaking also requires CGU to withdraw a media release it issued on 3 March 2014 announcing that it had donated \$1.184 million in surplus FSL collections to the CFA, and to refrain from referring to the payment of \$1.184 million it made to the CFA as a donation. CGU has provided the Monitor with an independent report confirming the amounts involved are accurate.

Aggregation of over-collected FSL unable to be returned to policy holders

Where other insurance companies satisfied the preconditions for aggregating some or all of the refund amounts into a single sum, they agreed to disburse those monies to approved consumer organisations representing the interests of Victorian insurance consumers. The range of activities these organisations intend to undertake as a result of these funds includes a free telephone advice and assistance service in connection with residential property and other forms of personal insurance, training the financial counselling community to improve their facility with insurance, rolling out insurance education programs to culturally and linguistically diverse communities, developing new insurance products targeting the needs of low income consumers, and advocating for improvements to the regulatory framework.

Verification of aggregated refund payments made to the recipient organisations referred to below was a straightforward exercise. Each organisation compiled a list of payments received from insurers. These were then cross-checked against the undertaking or resolution agreement (as the case may be) entered into by all of the insurers who were to pay some or all of their over-collected FSL to one or more of the seven organisations.

The total amount of aggregated FSL payments disbursed by relevant insurers among the seven recipient organisations was \$4.372 m. The seven organisations and the amounts received are listed in Table 17.

Table 17 FSL payments disbursed by relevant insurers to recipient organisations

Organisation	Total received from insurers
Brotherhood of St Laurence	\$437,000
Community Information & Support Victoria	\$130,000
Consumer Action Law Centre	\$1,597,000
Financial Rights Legal Centre	\$957,000
Footscray Community Legal Centre	\$206,000
Good Shepherd Microfinance	\$578,000
Kildonan Uniting Care	\$467,000
<i>Total</i>	<i>\$4,372,000*</i>

*The figures in this table have been rounded.

8.1.3 Application of funds disbursed to consumer organisations

Each of the seven organisations to whom aggregated FSL payments were disbursed signed a memorandum of understanding (MoU) with the FSLM stipulating that monies received from insurers would be applied to projects relevant to issues affecting Victorian insurance consumers. The organisations also were subjected to a due diligence process by the FSLM. This process examined their governance arrangements, experience and their capacity to engage in research, education, public advocacy, advice or casework in connection with consumer insurance issues.

Activities that will be undertaken by relevant organisations with the additional funding they have received include:

- provision of telephone advice and insurance casework assistance
- provision of insurance advice helpline specifically for indigenous consumers and policyholders
- develop and roll out training modules that will improve the competence of financial counsellors to advise on insurance issues
- development of insurance products that better meet the requirements of low income consumers or non-insured consumers and under-insured policyholders
- casework and advocacy designed to protect insurance consumers from exploitative behaviour, such as pressure selling of 'add-on' insurance products of dubious value or utility
- examining the need for and feasibility of applying the unfair contract terms provisions of the Australian Consumer Law to insurance contracts
- examine and test the benefits (or putative benefits) of clear disclosure of insurance contract terms, such as in statutory insurer product disclosure statements

- promote and encourage insurance consumers and policyholders to look wider than price, when they shop around
- development of tailored educational materials on insurance for culturally and linguistically diverse communities

8.2 Continuing investigations as at 30 September 2014

The complexities involved in determining the nature and extent of observed FSL irregularities that occurred across complex broker networks have been referred to in previous quarterly reports. The rigorous and extended FSLM investigation has confirmed that these all relate to FSL having been charged after 30 June 2013, by at least 20 brokers and 6 insurers and intermediaries.

In Guideline 3 of the FSLM May 2013 guidelines on price exploitation, industry and consumers were reminded that ‘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.’ The FSLM May 2013 guidelines on misleading / deceptive conduct also make reference to this issue, by stating that such conduct (charging FSL after 30 June 2013) may contravene s.31 of the FSLM Act.

By the end of the September quarter 2014, the FSLM investigation provided an informed understanding of the structure and extent of the broker networks across which the conduct of concern had occurred. Most policies affected by the contravention are construction or building insurance contracts. The policies were incepted on or before 30 June 2013 with adjustments made after 30 June 2013. The FSLM May 2013 guidelines on misleading / deceptive conduct expressly addressed this issue, stating clearly that such adjustments did not alter the insurer’s FSL liability for the 2012–13 financial year, and therefore, had no consequences for FSL collection.

The extent of post-30 June 2013 charging of FSL established so far is limited in terms of the number of policies and the amount of FSL paid by policyholders. The policies in question were underwritten by a small number of insurance companies. While the known extent of the issue is relatively small, consumers are entitled to expect that insurance brokers will be completely knowledgeable about the statutory charges they invoice for and that invoices will be compliant with all statutory requirements.

A significant proportion of the intermediated policies in respect of which it is alleged FSL was improperly charged after 30 June 2013 were attributable to an insurance broker called Allrisk Pty Ltd. Allrisk mistakenly charged FSL on ‘endorsements’ occurring after the abolition of FSL in connection with insurance policies that had been incepted before the abolition of FSL. Allrisk did not itself retain the FSL, but rather remitted it to the relevant underwriter. Refunds have since been made to each affected policyholder. Allrisk offered an enforceable undertaking to the FSLM on 29 September 2014, which was subsequently accepted, to resolve the matter.

8.2.1 Insurers

During the quarter, the FSLM issued letters to five of the insurers seeking explanations for various FSL charges apparently occurring after 30 June 2013. One insurer’s response was unsatisfactory, and consequently the FSLM issued a notice under s.19(1)(a) and (b) of the

FSLM Act seeking further information and documents. The insurer subsequently identified a number of instances where it, one of the insurer's underwriting agents and one broker appointed by the insurer to issue insurance on its behalf, charged FSL after 30 June 2013. The insurer promptly refunded the FSL, plus commensurate GST and stamp duty, directly to affected policyholders and has taken steps to ensure that its associated third party entities comply with the FSLM Act.

The FSLM has been working with another insurer that indicated that it had mistakenly charged FSL after 30 June 2013. The insurer is in the process of making arrangements with intermediaries to pay refunds to a small number of policyholders who were charged FSL after 30 June 2013, contrary to the FSLM Act, in relation to construction insurance contracts. The total amount to be refunded is expected to be in the order of \$100,000.

8.2.2 Amnesty for brokers and insurers

Given the imminent repeal of the FSLM Act on 31 December 2014 and the costs associated with a continuing widespread investigation by the Director of Consumer Affairs Victoria following the repeal of the FSLM Act, the FSLM instituted an 'amnesty' period from 1 October to 31 October 2014. The amnesty allowed for brokers and insurers to advise the FSLM that they charged FSL on or after 1 July 2013 in connection with adjustments to policies incepted before that date. As a result of the amnesty, six brokers and two insurers advised that they had improperly charged a total of \$314,000 of FSL after 30 June 2013, in connection with 457 mostly commercial property insurance policies. Each of the brokers and insurers concerned has confirmed that the FSL has been refunded to the relevant policyholders as required by the FSLM.

As a result of activities conducted prior to the end of September 2014 and the amnesty conducted through October 2014, a total of approximately \$500,000 of FSL charged on or after 1 July 2013 has been identified and returned to policyholders.

9. Did the FSLM achieve its regulatory objectives?

A key measure of the success of the FSLM is whether it achieved its regulatory objectives as outlined in section 2.3 – that is:

- the benefits of abolition of FSL should be passed on to consumers
- consumers of insurance were protected in the transition from an insurance-based levy to a property-based levy.

Objective 1: Benefits of abolition of FSL passed on to consumers

This section focuses on whether pricing outcomes arising from fire service funding reform could be considered to have achieved the Government's objective of ensuring that the benefit of abolition of FSL was passed on to consumers.

9.1 Criteria for a successful transition

Discussion of pricing outcomes focuses on the timing of changes in the elements of total premium as previously outlined in Box 1 (section 2.2, page 6).

In an ideal public policy environment, an ex-post assessment of the pricing effects of transition from an insurance-based levy for fire service funding would reveal:

- during the transition year, each insurer managed their fire service funding obligations such that aggregate FSL collected by insurers from all relevant property insurance policies was neither no more nor no less than was required to meet their required statutory contributions for funding fire services
- changes in premium were reasonable:
 - changes in base premium before, during and after transition reflect reasonable changes in the costs of delivering insurance services
 - total premiums for policies incepted on or after 1 July 2013 reflect reasonable changes in base premium and the full removal of the previous year's FSL charge.

The remainder of section 9 discusses the performance of Victoria's property insurance market with respect to the above criteria.

9.2 Consumers were refunded over-collected FSL

For any given financial year, to ensure aggregate FSL collected from all relevant property insurance policies was neither more nor less than was required to meet required statutory contributions for funding fire services, each insurer would have to:

- estimate their market share of premium written in the relevant financial year for policies covering each of:
 - residential property in the MFESB region
 - residential property in the CFA region

- commercial property in the MFESB region
- commercial property in the CFA region
- set FSL rates for each type of policy consistent with collecting FSL revenue matching their required statutory contributions for funding each of the MFESB and CFA.

Final reconciliation of market shares and establishment of the final statutory contribution for funding fire services by each insurer could only be determined after the end of the relevant financial year. Accordingly, it is almost inevitable that each insurer would either over-collect or under-collect FSL to some degree in any given financial year.

The range of over- and under-collection of FSL in each of the MFESB and CFA regions of Victoria in the 2012–13 financial year (the last year in which insurer funding of fire services applied) is outlined in Table 18.

Table 18 Range of over-collection of FSL by insurers in Victoria’s MFESB and CFA regions – 2012–13

	MFESB region	CFA region
<i>... by \$'000s</i>		
● Largest over-collection by an insurer	350	1,467
● Largest under-collection by an insurer	1,610	1,884
<i>... by proportion of total FSL collected from policyholder base</i>		
● Largest over-collection by an insurer	136.8%*	146.6%*
● Largest under-collection by an insurer	-64.8	-73.5

* Large over-collection due to a 's.45 adjustment' resulting from spot audits on insurers that would have significantly affected the relevant insurer's FSL collection targeting process. Under s.45 of the MFB Act, if the MFESB is satisfied that the amount of premium returned by an insurance company is incorrect, they can require the company to submit an amended return – this most heavily influences the liability of the insurer that provided the incorrect return, but also has impacts on all other contributing insurers as market shares are re-adjusted.

In resolving the instances of over-collection of FSL, some offsetting was allowed.²⁷ The collection of FSL and statutory contributions to the fire services was considered as whole, rather than treating collections and contributions for the two fire services as separate entities. Thus, an under-collection of FSL for one fire service may be offset against an over-collection of FSL for the other fire service. Also, an adjustment could be made to the amount of FSL collected as at 30 June 2013 and set out in the FSL declaration to the FSLM on account of either:

- any refund of FSL to policyholders on 2012–13 policies cancelled after 30 June 2013 that was refunded to policyholders prior to 1 March 2014

or

- the amount of FSL not recovered due to the cancellation of 2012–13 instalment-paid policies after 1 July 2013 and prior to 1 March 2014.

²⁷ For detail of how the offsetting process was applied refer to FSLM 2014a, section 4.3.2, pp.19-20

After all offsetting was taken into account, there was a relatively small amount of FSL collected that the FSLM deemed as needing to be returned to policyholders or otherwise disbursed. As a result of the FSLM's actions on over-collection, \$12.3 million²⁸ representing 2.2 per cent of all required statutory contributions for funding fire services in 2012–13 was not retained by insurers.

9.3 Were premium movements reasonable?

Transition from an insurance-based levy for funding fire services to a property-based levy for funding fire services has many steps. Before assessment can be made of the success or otherwise of that transition from a pricing perspective, consideration needs to be given to pricing behaviour of insurers in the period leading up to FSL reform and the period following FSL reform.

The policy decision to engage in fire service funding reform was announced in May 2011, more than two years prior to the formal abolition of the insurance-based levy. As discussed in section 2.1.2, the announcement of the policy decision included a reference to a 12 month transition period starting in July 2012. With this degree of forewarning, insurers had the opportunity to establish pricing strategies with respect to the combination of base premium and FSL rates, even though some of the detail around transition arrangements was not clear until after the transition period had commenced.

9.3.1 *The role of FSL rate tapering*

The nature of tapering

As discussed in section 9.2, insurers set FSL rates for each type of policy in order to collect FSL revenue to meet their required statutory contributions for funding each of the MFESB and CFA. Accordingly, changes in fire services budgets and consequent changes in the fire services funding liability of insurers could be expected to result in changes to FSL rates. FSL rates have tended to be lower in the MFESB region than the CFA region – this is because for the MFESB region, the fire service budget was lower relatively, and the number of insured properties from which the required levy had to be raised was higher relatively.

In the three years to 2012–13, the budget for the MFESB was quite stable, as were average FSL rates in the MFESB region. However, the budget for the CFA was notably higher in the 2011–12 financial year than in the years either side, necessitating a higher average FSL rate for 2011–12 in the CFA region (see Table 19).

²⁸ FSL only – does not include relevant GST and stamp duty.

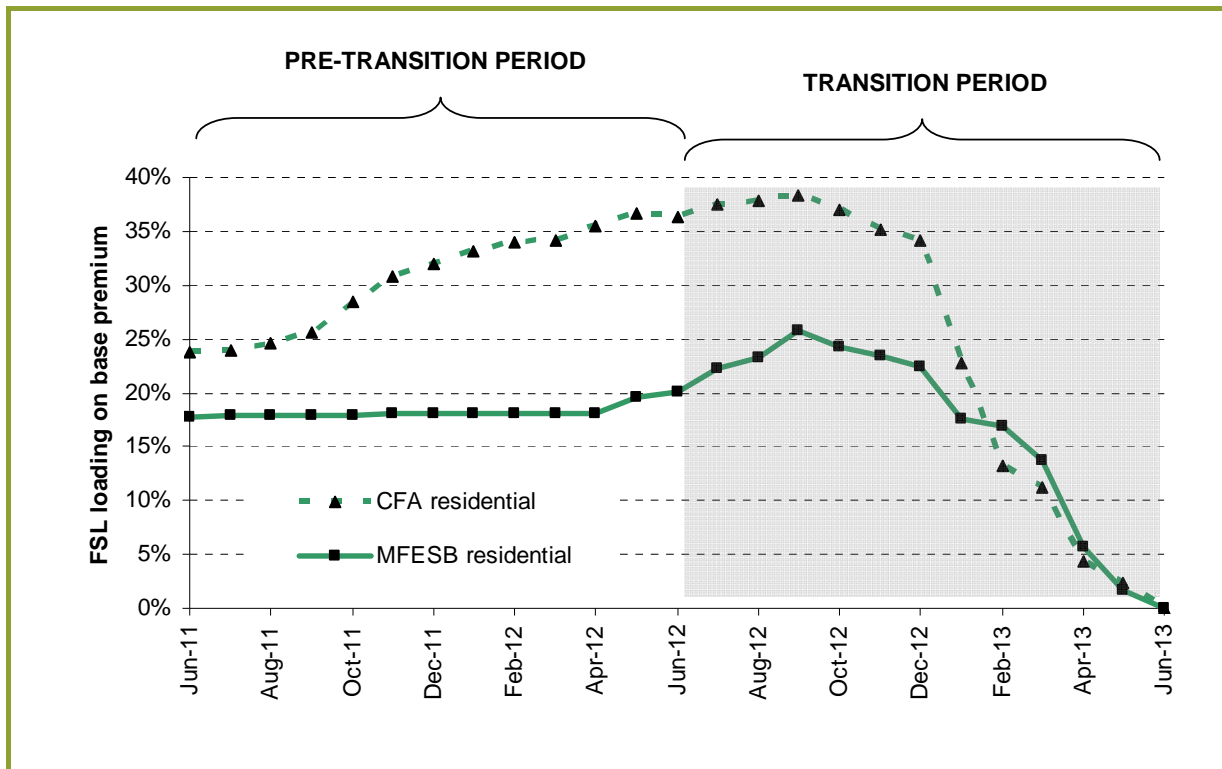
Table 19 Average FSL rates applied to property insurance in the MFESB and CFA regions – 2010-11 to 2012-13

	MFESB region residential	CFA region residential	MFESB region commercial	CFA region commercial
2010-11	17.8%	24.4%	44.7%	65.7%
2011-12	18.3%	30.7%	44.3%	78.7%
2012-13	16.7%	23.8%	37.2%	55.9%

Source: FSLM estimates

Figure 14 shows the market weighted month-by-month FSL rates applied to residential property insurance in Victoria for both the pre-transition and transition periods in each of the MFESB and CFA regions.

Figure 14 FSL rates applied to residential property insurance in Victoria – June 2011 to June 2013



Source: FSLM estimates

In the pre-transition year (2011-12) FSL rates for the MFESB region were stable, but FSL rates for the CFA region increased through 2011-12 in response to the announcement of a substantially increased budget for the CFA. The month-to-month setting of FSL rates during the 2012-13 transition year was affected by the timing of announcements of budgets for each fire service and insurer interpretation of compliance requirements in the last half of the 2012-13 financial year consistent with the FSLM Act associated with transition.

The primary objective of tapering FSL rates during the 2012-13 transition year was to discourage owners of property from engaging in self-insurance for at least part of the transition

year (see Box 2), with a further objective of delivering an average FSL rate consistent with matching FSL collections and fire services funding liability.

Box 2 Transition out (tapering) of insurance-based levies

In the transition from an insurance-based levy to a property-based levy, the FSL rate attributed by an insurer to an individual policy was systematically reduced over the course of the final year of the insurance-based levy in each of South Australia (1998-99), Western Australia (2003) and Victoria (2012-13).

Tapering of FSL rates was adopted to avoid providing insured persons with an incentive to forego insurance for a short period in an effort to avoid a full year's worth of fire levy on that short period.

Consider the following example.

The insurance-based FSL is due to be replaced by a property-based levy on 1 July 2013.

In past years, the FSL rate charged to residential building properties was 20 per cent of base premiums.

Person A insures her property on an annual basis with renewal due each year in August. FSL is charged at 20 per cent for the renewal due in August 2012. Provided Person A was unaware of any better insurance deals, she is likely to renew her policy and wear the fact that although her insurance expires at least one month after the insurance-based levy is abolished and she is paying a full year's FSL, the risk of foregoing insurance to avoid the 'extra' levy is not worth it.

Person B insures his property on an annual basis with renewal due each year at the end of May. If FSL were charged at 20 per cent for the renewal due in May 2013, and provided Person B was unaware of any better insurance deals, he has an incentive to allow his insurance to lapse for a month or so (self-insure) to avoid paying a full year's FSL. Insurers would be conscious of Person B's incentive to self-insure and offer an insurance policy with a much reduced FSL rate, to encourage him to continue his policy without allowing it to lapse.

In the circumstances described above, insurers will claim that it would be reasonable to deploy some form of gradual reduction in FSL rates through the course of the 2012-13 financial year (tapering) to manage the incentives for insured persons to otherwise allow their policies to lapse in order to avoid (effectively) paying FSL for a period beyond which FSL did not otherwise apply.

Different forms of tapering have been applied in different jurisdictions – the common element of tapering is that at the beginning of the transition year, the FSL rate is around the 'normal' rate, and reduces to zero per cent by the end of the transition year.

Implications of tapering assuming no change in base premium

Given the known changes in FSL rates outlined in Table 19 and Figure 14, *potential* changes in total premium can be determined on the assumption that base premiums did not change. In such circumstances, the annual average total premium for:

- insurance on property located in the MFESB region would be 14.3 per cent lower in 2013-14 than 2012-13
- insurance on property located in the CFA region would be 19.3 per cent lower in 2013-14 than 2012-13.

However, as FSL rates were tapered through 2012-13 and provided base premium did not change, different year-to-year change in premium would occur depending on:

- the time of year the renewal falls and the FSL rate applying at that time
- region in which the property is located (MFESB or CFA)

- the nature of the property (commercial or residential).

For example, for a residential property located in the CFA region with a renewals in September each year, the expected reduction in the *total* premium following the abolition of the FSL would be 27.7 per cent. However, for a similar policy with renewal in February of each year, the expected reduction in the *total* premium following the abolition of the FSL would be just 11.7 per cent (see Table 20).

Table 20 Change to total premium following FSL reform

Renewal cycle	MFESB region (% change from year earlier*)	CFA region (% change from year earlier*)
<i>Residential property policy</i>		
• taken out September 2012, renewed September 2013	-20.5%	-27.7%
• taken out February 2013, renewed February 2014	-14.4%	-11.7%
<i>Commercial property policy</i>		
• taken out September 2012, renewed September 2013	-34.2%	-47.7%
• taken out February 2013, renewed February 2014	-27.6%	-27.2%

* Assuming no change in base premium

9.3.2 How did residential property insurance premiums change?

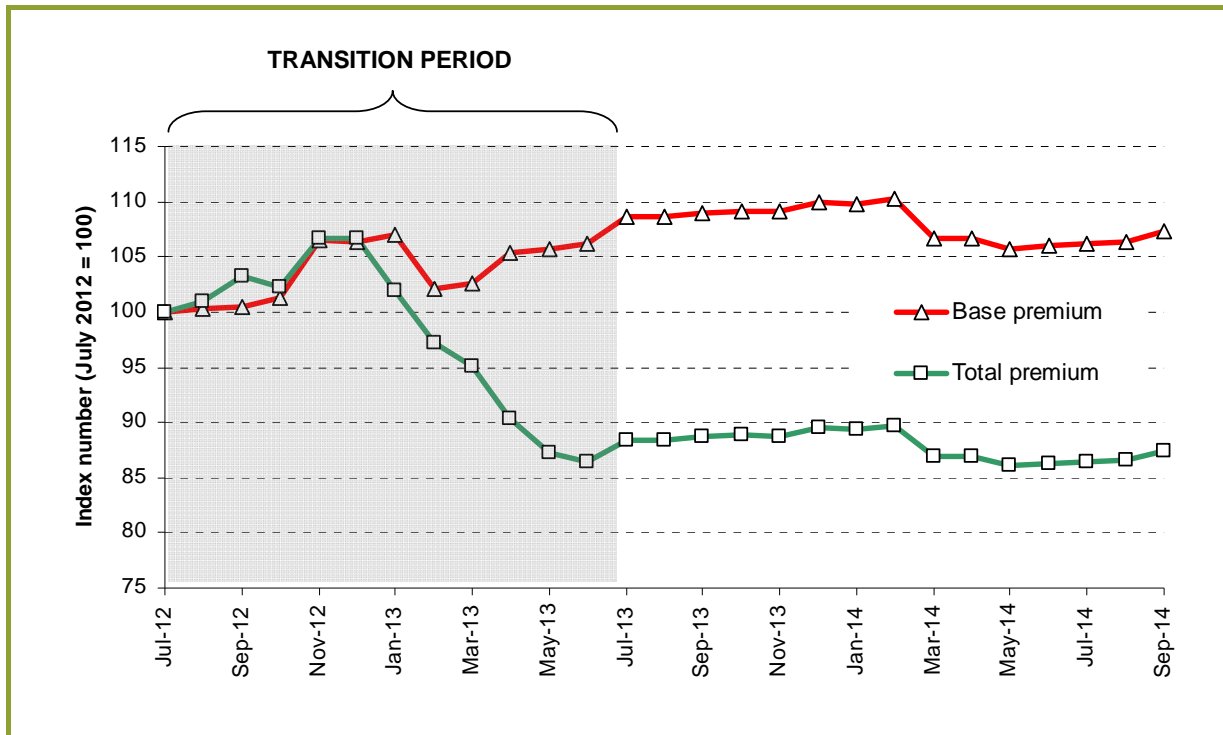
Data from FSLM industry monitoring

The results of the FSLM's own monitoring of actual movements in total and base premiums in each of the MFESB and CFA regions both during and after the FSL transition period is shown in Figure 15 and Figure 16. The data used to construct these figures is drawn from insurers' advice to the FSLM of premiums applied to a small sample of properties as defined by the FSLM, with each insurer's data then weighted by insurer market share. As discussed in section 4.3, this data was used by the FSLM to assist the assessment of where further investigation might be required.

As the transition progressed through the first half of the 2013 calendar year, the FSLM observed some reductions in total premiums in each of the MFESB and CFA regions as the FSL was being progressively removed, notwithstanding a relatively mild upward trend in base premiums that was a little more pronounced in the CFA region.

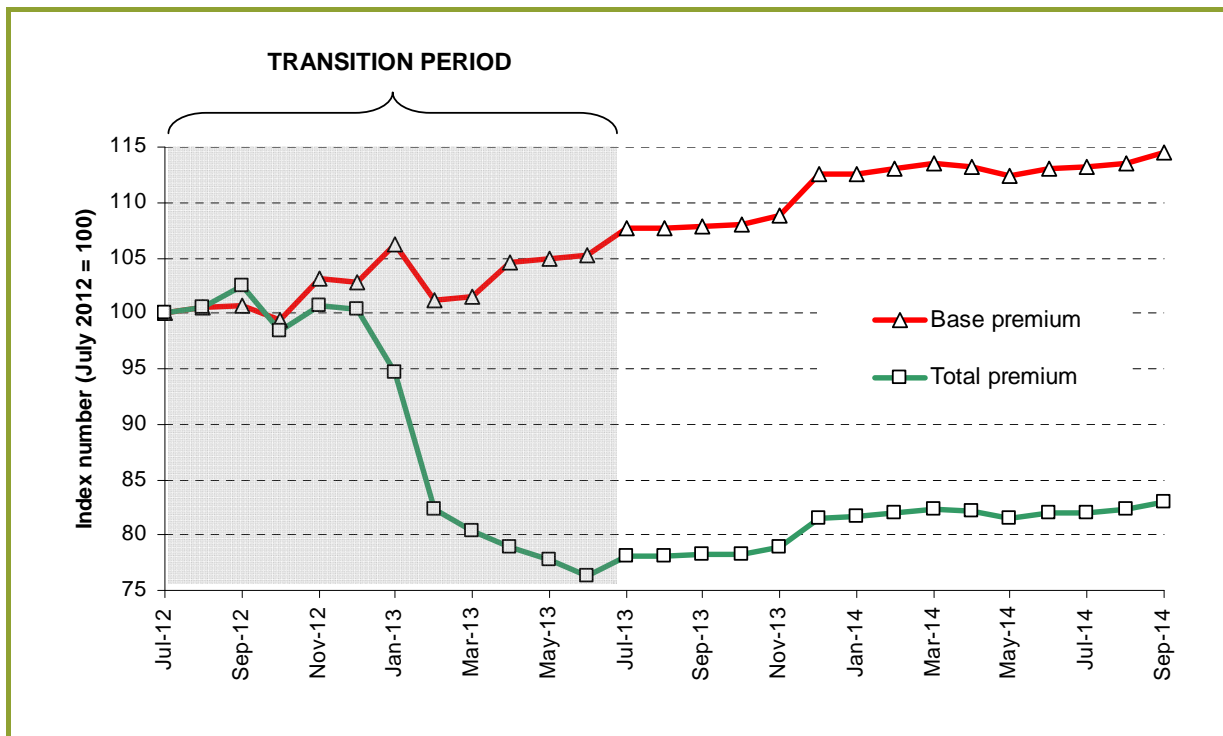
It can be seen from Figure 15 and Figure 16 that size of the relative gap that emerged between base and total premiums was larger in the CFA region than in the MFESB region, reflecting the fact that in the CFA region FSL rates were higher and thus a larger proportion of total premium was to be removed. Nevertheless, the gap that did emerge between base and total premiums in each of the MFESB and CFA regions was of a size sufficient to provide confidence that, in general, savings attributable to elimination of the FSL was being passed on to consumers.

Figure 15 Total premium and base premium for the MFESB region – July 2012 to September 2014



Source: FSLM estimates

Figure 16 Total premium and base premium for the CFA region – July 2012 to September 2014



Source: FSLM estimates

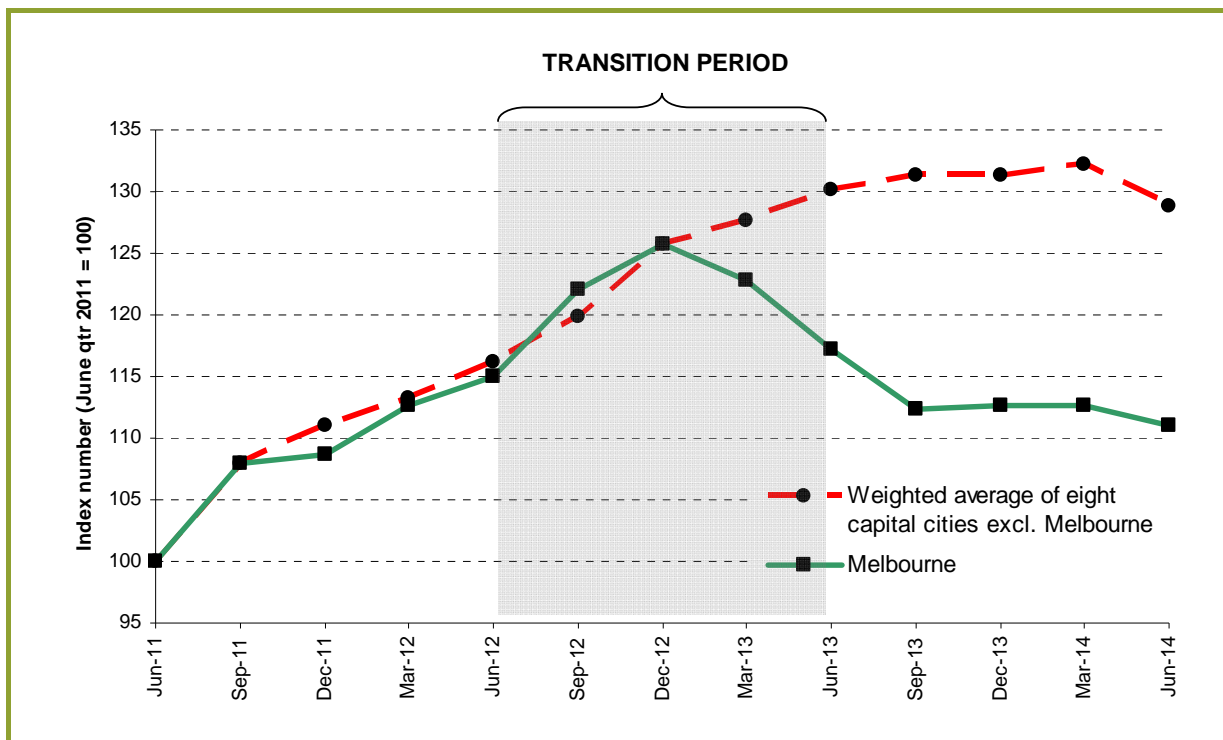
Data from the Australian Bureau of Statistics

In order to assess whether the pricing behaviour of insurers in Victoria before during and after transition was appropriate, it is necessary to establish some sense of how base premiums for residential property insurance moved:

- locally
- relative to movements in other jurisdictions where fire service funding reform was not occurring.

The path of quarter-by-quarter relative movements in average total premiums in each of Melbourne and a 'weighted average of the other Australian capital cities' is depicted in Figure 17. Note that the following analysis is based on unpublished data compiled by the Australian Bureau of Statistics for constructing the consumer price index (CPI). The CPI relates to prices only in the areas of the capital cities in the six Australian states and the two mainland territories – equivalent data for non-metropolitan areas is *not* available.

Figure 17 Average total premium for residential property insurance in Melbourne vs other Australian capital cities – June quarter 2011 to June quarter 2014



Source: Australian Bureau of Statistics

Conclusions regarding relative movements in *base* premiums can be informed using this data and knowledge that:

- for each of the Australian jurisdictions outside Victoria, in the period from the June quarter 2011 to the June quarter 2014 statutory arrangements that might otherwise affect property insurance premiums were *not* subject to any material change.
- for Victoria:

- during the course of 2011–12 FSL rates and other statutory imposts (GST plus stamp duty) that might otherwise affect property insurance premiums were *not* subject to any material change
- during the course of 2012–13 FSL rates affecting property insurance premiums were subject to tapering but other statutory imposts did not change.

Accordingly, at least in metropolitan areas, it can be surmised that for residential property insurance during the pre-transition period:

- in Victoria, base premium movements generally matched total premium movements – similar to the outcome that occurred in jurisdictions outside Victoria
- insurers' pricing strategies for the Victorian market did not differ to any substantial degree to strategies adopted in other Australian markets.

During the transition period – as a result of the FSL rate tapering adopted in Victoria and the absence of changes to statutory arrangements that might otherwise materially affect property insurance premiums in jurisdictions *outside* Victoria – there was a divergence in the relative path of total premiums in each of Melbourne and a 'weighted average of the other Australian capital cities'. In the post-transition period (2013–14), quarterly premium movements in Melbourne seem to have broadly tracked those in other capital cities.

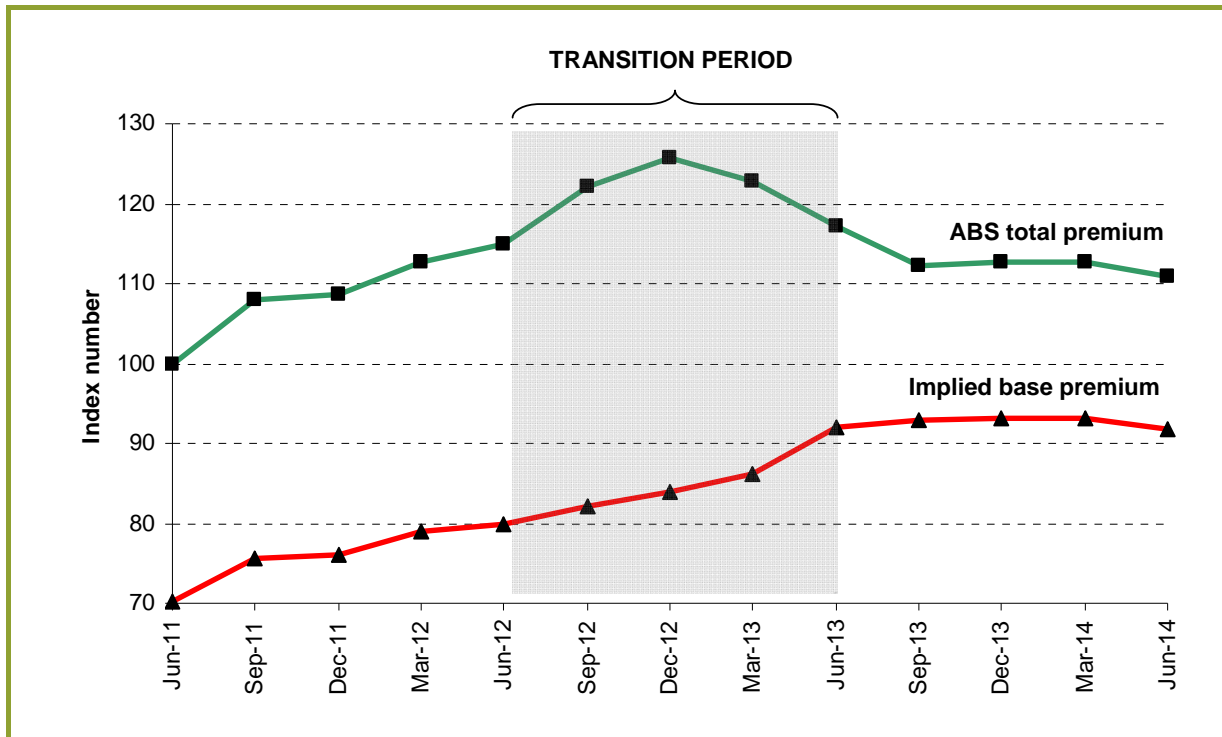
An implied path for average *base* premiums in Victoria's MFESB region can be derived by taking the ABS total premium data and removing the known effect of FSL,²⁹ GST and stamp duty (see Figure 18).

Although Figure 15 and Figure 18 each represent a perspective of premium movements in metropolitan Melbourne, the respective data underlying the figures is compiled using different samples and techniques. Nevertheless, the two data sets provide similar messages regarding premium movements for residential property insurance:

- a rise and subsequent fall in total premium through the transition period
- a gentle rise in base premium through both 2012–13 and 2013–14.

²⁹ Using FSLM estimates of quarterly market weighted FSL rates

Figure 18 Total premium and implied base premium for residential property insurance in Melbourne – June quarter 2011 to June quarter 2014



Source: Australian Bureau of Statistics

Analysis of average movements from 2012–13 to 2013–14 in *total* premium for residential property insurance in Melbourne indicates a reduction by an average of 8.1 per cent (see Table 21), rather the 14.3 per cent that might have been expected if *base* premiums did not rise (see section 9.3.1). The average change in total premiums over the same period for the other seven capital cities was an increase of 4.0 per cent.

Table 21 Changes to total and base premium for residential property insurance in Melbourne

	Change in ABS total premium	Change in implied base premium
2011–12 average compared to 2012–13 average	9.8%	10.8%
2012–13 average compared to 2013–14 average	-8.1%	7.7%

However, the estimated 7.7 per cent increase from 2012–13 to 2013–14 in average base premium is within the range of previous years’ premium increases in Victoria and gives confidence that, in general, savings attributable to elimination of the FSL have been passed on to consumers.

The existence of ‘cycles’ in the movement of premiums seems likely as the rate of increase varies substantially over time. It may be that the range of 7 to 10 per cent observed in the years leading up to FSL reform was in the ‘upcycle’ phase of premium movements as insurers endeavoured to return their profitability to target levels following

cost pressures from a run of natural disasters. The commencement of the FSLM role may have coincided with the latter stage of that phase. The relatively flat trend in premiums on average across all capital cities, as indicated by ABS data since the September quarter 2013, may indicate that the cycle of premium rises has turned down

9.3.3 Will the premium reductions due to the elimination of the FSL be sustained into the future?

The FSLM has closely monitored premiums both before and after FSL reform. The FSLM has no doubt that during this time insurers have exercised a degree of restraint in their pricing that may not have otherwise been there. This does raise a potential concern as to whether premiums may rise faster than otherwise after the FSLM's role ceases. The FSLM considers this to be a possibility. The main safeguard against this happening is the operation of competitive market forces and, in particular in this regard, the role that empowered consumers can play in shopping around and switching suppliers to get a better deal. The FSLM has considered a number of initiatives that may help to promote consumer empowerment and competition in the longer term. These include improvements to mandatory information disclosure and the introduction of price comparators to the market.

Objective 2: Insurance consumers protected

In addition to ensuring that the benefit of the abolition of the FSL in prices was passed on to consumers, statements by the Government at the time of the introduction of the legislation establishing the FSLM and the provisions of the legislative scheme, indicate that 'protecting consumers' meant:

- consumers have access to information from a source independent of insurers about the abolition of the FSL and what it means for their premiums
- there is an independent body to whom insurance consumers can make enquiries or complaints about insurers' pricing and conduct related to the abolition of the FSL
- there are remedies available to address detriment to insurance consumers arising from the actions of insurers' associated with the abolition of the FSL.

The three requirements for protecting consumers were met through the operations of the FSLM. The following are key indicators of the protection afforded consumers.

- Consumers have access to independent information about the abolition of the FSL, demonstrated by:
 - 37,117 visits to the FSLM website
 - two State-wide advertising campaigns in the print and online news media alerting the public that the FSL was about to be abolished, the FSLM existed to assist consumers and warning policyholders to check that their total premiums fell
 - two 'public warnings' placed in Victoria's major newspapers
 - 20 media releases issued on various subjects in the abolition of the FSL and the outcomes of FSLM activities.

- Consumers can make enquiries or complaints about insurers and the abolition of the FSL, demonstrated by:
 - 6,128 calls by consumers to the FSLM enquiries and complaints line
 - 726 emails and 268 letters from policyholders setting out complaints
 - a total of 7,122 enquiries and complaints across all sources.
- Remedies are available to consumers, demonstrated by:
 - 52 notices requiring information and documents issued as part of investigations into potential price exploitation and false representations or misleading or deceptive conduct
 - refunds of \$0.6 million following investigations and enforcement activity related to pricing by individual companies, over-collection of FSL and the charging of FSL after 30 June 2013
 - refunds of \$1.3 million to customers of QBE [name in full] due to QBE's pricing error that led to excess FSL being charged
 - refunds of \$11.3 million to customers of IMA who were charged a price increase implemented days before the statutory abolition of the FSL
 - refunds of \$8.1 million to individual policyholders of 55 insurers and \$4.4 million disbursed to consumer organisations representing the interests of Victorian insurance consumers due to the over-collection of FSL in 2012–13 and \$1.2 million to the CFA
 - a total of \$26.9 million in excess revenues obtained by insurers in the reform transition disbursed to Victorian residential and commercial insurance customers or organisations representing the interests of consumer.

The information provided to consumers, the processes put in place to address issues raised by insurance consumers and the remedial outcomes above, together with the observed reductions in total premiums, substantiate a conclusion that the Government's objectives in establishing the FSLM were achieved.

South Australia in 1999 and Western Australia in 2003 have each undergone transitions from insurer-based to property-based funding of fire services. The policy implementations in those jurisdictions were examined to provide further context for Victoria's experience. The fundamental difference between Victoria on the one hand, and South Australia and Western Australia on the other, was the absence of independent regulatory oversight of the abolition of the FSL in the latter States. While there was an *ex post* review of implementation of reform in each of those States, there was no independent oversight of insurers' responses as the transition unfolded.

The Victorian experience demonstrates that:

- pricing errors by insurers can occur
- some insurers may even take opportunistic advantage of the abolition of FSL and simultaneously increase base premiums
- too much FSL revenue may be collected and retained by insurers
- some policyholders may be charged FSL despite it being abolished by law.

In South Australia and Western Australia, there were no mechanisms in place to detect such transition problems. Unlike in Victoria, in South Australia and Western Australia there were no specific measures to protect the interests of consumers. The fire service funding reform outcome for Victorian consumers comprised lower total premiums *and* recovery from insurers of the proceeds of inappropriate FSL charges, price increases, and excess collection of FSL.

The Insurance Council of Australia (ICA) is the peak body for general insurers and the entity the Victorian Government consulted regarding fire service funding reform policy arrangements. ICA members were also regulated entities under the FSLM Act. The FSLM also consulted the ICA prior to commencing, and during, the operations of the FSLM.

The ICA was invited to comment on the regulatory scheme and its administration as part of the FSLM's evaluation review. The ICA's comments are reproduced in full in *Appendix C: ICA comments on the regulatory scheme for the fire services levy reform*. Some of the comments made relate to matters for the Government and outside the scope of the FSLM. The FSLM does not comment on these matters and others raised by the ICA.

THIS PAGE DELIBERATELY LEFT BLANK

10. Lessons relating to abolition of insurance-based funding of fire services

This section draws on the experience of the FSLM in administering the regulatory scheme. It identifies those aspects of the regulatory scheme that contributed to the achievement of the Government's consumer protection objective and those aspects that encountered some difficulties. It ends with a suggested model approach to supporting implementation of a policy involving removing a tax from a consumer product.

10.1 What worked well

10.1.1 *Engagement with consumers*

One key success in the operation of the FSLM was the gathering and use of information regarding insurers' prices yielded from the FSLM's engagement with consumers via:

- enquiries and complaints making facilities through the FSLM's website and a 1300 consumer 'hotline'
- two advertising campaigns alerting consumers to the nature of fire service funding reform
- two public warnings about particular pricing practices of underwriters and brokers.

As a consequence of this engagement, the FSLM was made aware of potential breaches of the FSLM Act with respect to price exploitation³⁰ and misleading/deceptive conduct.³¹ As noted previously, investigations triggered by consumers' complaints led to the return to policyholders of IMA's excessive price increase and refunds of FSL charged after 30 June 2013.

10.1.2 *Formal industry monitoring*

A formal industry price monitoring program assisted the FSLM to better understand industry pricing patterns and highlighted anomalous pricing behaviour within the insurance industry. As a consequence, the FSLM was able to:

- assess whether the removal of the FSL had been passed on to policyholders
- effectively target investigations into price exploitation and misleading/deceptive conduct.

10.1.3 *Strong regulatory regime*

The legislation that established the FSLM supported the definitions of price exploitation and misleading or deceptive conduct with effective powers for the FSLM to conduct investigations and high penalties available to the courts for contraventions.³² It was in this context that the

³⁰ For example, exceptionally large increases in base premium around the time of removal of the FSL

³¹ For example, charging of FSL after 30 June 2013

³² Through responses to statutory notices and examinations

total amount of money insurers were unable to retain as a result of the activities of the FSLM was \$26.9 million (see Table 16). Such an outcome would not have been likely with a more light-handed regulatory approach.

10.2 What difficulties were encountered

As already observed, because of FSL tapering, policyholders' experience of total premium reductions when renewing policies was directly related to the time of year renewals fell in. As soon as was practicable, guidance was provided to insurers regarding the form of communication insurers should provide to policyholders to enable them to readily understand changes in FSL and base premiums.³³

Notwithstanding the issuing of FSLM guidelines, insurers generally still failed to provide clear advice to policyholders with respect to how tapering of FSL rates and the abolition of the FSL affected the components of the total premium they were charged. The FSLM's experience with policyholders' enquiries and complaints indicates that insurers' responses to policyholders, through their customer call centres and intermediaries, were not always accurate and sometimes were perfunctory.

10.2.1 *Lack of historical requirement for clear declaration to policyholders of FSL collection by insurers*

Throughout the course of the administration of the insurance-based levy there was no requirement on the part of insurers to *clearly and consistently* declare to each policyholder the amount of FSL charged on each insurance policy.

In pre-transition times (2011–12 and earlier), some (but not all) insurers identified an 'estimated amount of FSL' as part of their declaration of statutory or government charges. However, this declaration was often not prominent in an insurance renewal notice and, as such, the FSLM considers that many policyholders would have been unaware of the important distinction to be made between *base* premium, statutory charges (FSL, GST and stamp duty) and *total* premium (see section 2.2, page 6, Box 1).

Given the historical lack of clear and consistent disclosure of FSL and the extent to which premium was affected leading up to FSL reform, consumers of residential property insurance were placed at some disadvantage in being able to understand the consequences of removal of FSL when it occurred.

10.2.2 *Communications between insurers and their customers during transition*

Another related difficulty was the lack of communication from insurers about the effects of the abolition of the FSL, particularly the effects of applying FSL rate tapering during 2012–13. More than two years prior to the formal abolition of the FSL, insurers were aware that fire service funding reform would occur and had the opportunity to develop FSL rate tapering strategies and base premium adjustment strategies to apply during the transition period (2012–13).

³³ Draft guidelines were issued for consultation in April 2013 and published in final form in May 2013.

A circumstance perhaps contributing to this situation was that the FSLM's focus on individual insurers' compliance with the law was a contrast to the industry level engagement with the Government in the formulation of the policy detail of the fire service funding reform and the previous role of the ICA in the setting of 'advisory' industry-wide FSL rates.

Also, the arrangements surrounding previous similar reforms in South Australia (1999) and Western Australia (2004), were based more on an 'industry' approach agreed between the industry association and the Government. In Victoria, there was more uncertainty for the companies as they had to apply an individual company approach to rate setting. The previous practice of the ICA publishing 'advisory' FSL rates was discontinued in early 2012. There was no guidance provided to individual insurers as to FSL rate tapering, nor any requirement to inform policyholders that FSL rate tapering was actually taking place.

It was only when the FSLM began formal operations in early 2013 – more than half-way through the transition year – that any formal notice was given to policyholders that FSL rate tapering was occurring and that policyholders should give separate attention to changes in each of FSL and base premium. As soon as was practicable, the FSLM issued guidance to the industry regarding the form of communication insurers should provide to policyholders of premium change.³⁴ Notwithstanding the content of the FSLM's guidelines, insurers generally still failed to provide clear advice to policyholders with respect to how tapering of FSL rates affected the composition of the total premium they charged during and after transition. Consequently, it was only those policyholders who committed some effort to reviewing the information provided, and calculating changes in FSL and base premium, that were in a position to alert the FSLM to potential instances of price exploitation or misleading or deceptive conduct on the part of insurers.

10.2.3 Insurers' preparation for compliance

A third difficulty arose from the constrained timetable for the preparation of detailed guidance for insurers on appropriate conduct leading up to and after the abolition of the FSL. This meant that there was a very tight timeframe for insurers to prepare their compliance regime on matters in the transition before those matters arose in practice. Some insurers managed their compliance effort within that constraint better than others.

The constrained timelines for preparation of billing systems and notification to policyholders were emphasised by insurers during consultations on the FSLM guidelines. The legislation outlining the role of the FSLM was not approved by Parliament until 11 December 2012. However, it seems highly unlikely that insurers were ever in any doubt, from the announcement of the reform in May 2011, that there would be a community expectation that the benefits of the removal of the FSL should be passed on to policyholders and be seen to be passed on.

10.2.4 Resolving over-collection of FSL

The resolution of over-collection was complicated by: the lack of recognition that some over-collection of FSL was inevitable, given the requirement on insurers to estimate their contributions for 2012–13; and the absence of legislative provisions on the status of over-

³⁴ Draft guidelines were issued for consultation in April 2013 and published in final form in May 2013.

collected FSL and for addressing over-collection. The process would have been much more straightforward if the FSLM Act had required those amounts to be refunded directly to them.

10.3 Elements of regulatory oversight of a policy transition

The Victorian experience of fire service funding reform suggests that appropriate regulatory oversight can contribute to equitable outcomes for the community where a tax of some sort is removed but there is market failure and constrained price competition, even where the affected industry broadly supports the originating policy change. The likely success of reform, and public confidence in the merits of the originating policy change, are enhanced by regulatory oversight to protect consumer interests in the consequences of the policy change.

Based on the FSLM's experience in the abolition of the insurance-based levy, the following highlights elements of regulatory oversight of the implementation of a policy change that affect the prices of a consumer product, and where there is market failure and/or constrained price competition:

- There should be timely establishment of transition arrangements co-coordinating the initiating policy change and any associated regulatory oversight. This would allow suppliers and the regulator to have an early common understanding of what would constitute acceptable and unacceptable conduct on the part of suppliers during the course of transition.
- The key elements of a supporting framework for reform should be specified in legislation, encompassing measures such as:
 - prominent disclosure by suppliers of the components of prices, reconciliation of the tax actually collected from consumers and amounts remitted to government
 - specification of the treatment of any over- and under-collection of tax in the final period by a supplier
 - specified constraints on any mechanisms to adjust the charging of the tax in the final period.
- There should be legislatively-based oversight with appropriate powers and resources reflecting the Government's assessment of market failures, price competition and community concerns about equity outcomes in the transition.

10.3.1 *Timely establishment of transition arrangements*

The definition of 'timely' will be a function of the significance of the product's prices in consumer budgets, the pricing cycle for the product and businesses' billing processes for the product affected by the policy change. Timely establishment of effective systems provides an opportunity for industry and the regulator to anticipate emerging issues before they become significant problems, rather than having to respond after the event and effect some repair.

What is timely should also take into account a balance between:

- providing sufficient notice to industry of the policy change implementation date, so that necessary changes to businesses' billing can be made and notice to customers provided

and

- limiting the scope for industry to opportunistically 'game' the consequences for prices caused by the policy change.

A factor critical in this balance is the coordination of the implementation of the originating policy change and the regulatory oversight regime. If the policy change implementation is too far in advance of the regulatory regime, there may be an opportunity for industry players to take some advantage before oversight commences.

In the case of the abolition of the FSL, insurers claimed that significant lead times were required for policy renewal notices to incorporate specific changes, such as more than three months necessary to design, approve and implement changes within software, billing and mail house systems. As insurers tend to send out renewal notices up to six weeks ahead of the actual renewal date, close to six months can elapse between: a decision being made to change the renewal notice; and the policy renewal date of the first customer to receive amended information within their renewal notice.

With an early common understanding of acceptable and unacceptable pricing practices and associated conduct on the part of insurers, there is likely to be diminished incentive for insurers to strategically manage the transition process for commercial gain. There will be an opportunity for industry and the regulator to negotiate details of compliance regimes to the benefit of all.

10.3.2 Supporting framework for fire service funding reform

In the lead up to implementation of a reform to insurance-based levy funding of fire services (the transition year), ideally the legislative framework supporting the reform should provide for:

- compulsory prominent disclosure by insurers of all elements of total premium (base premium, levy, GST and stamp duty) on all new business and renewals policies issued during both the transition year and the year following transition
- a specified process to reconcile:
 - levy collections from policies incepted during the course of the transition year by each insurer from all policyholders
 - 'provisional' contributions paid by insurers to the fire services for the transition year
 - each insurer's fire services funding liability for the transition year
- specification of the treatment of any over- and under-collection of FSL by an insurer for the transition year
- parameters for any levy rate tapering applied by insurers in the transition year, consistent with the requirement for insurers to collect sufficient revenue to meet their fire services funding obligations

In order to maximise transparency for consumers affected by the policy-induced price change, each of the above requirements – except those relating to FSL tapering – arguably, should also apply to pre-transition years.

In the absence of verifiable reconciliations of each insurer's annual levy collections with the annual funding liability, it is not possible to identify the extent of over- or under-collection and to subsequently ensure that over-collections are refunded to policyholders, after appropriate offsets.

As discussed in section 9.2, it is inevitable that each insurer would either over-collect or under-collect FSL to some degree in any given financial year. Therefore clear provisions for dealing with over-collected amounts is desirable to avoid insurers increasing revenue at the expense of consumers, or the perception that that may have occurred.

Parameters for any levy rate tapering applied by insurers are necessary to ensure equitable treatment of policyholders during the process of reform. The unregulated FSL rate tapering applied by nearly all insurers during Victoria's transition resulted in some inequity among policyholders that the FSLM could not mitigate.

10.3.3 Effective regulatory oversight of levy transition

The Victorian experience indicates that effective monitoring of the insurance industry contributed to the overall management of fire service funding reform. Depending on the assessment of risks from market failure and constrained price competition, and community concerns about equity, effective regulatory oversight of fire service funding reform requires a legislated scheme incorporating:

- prohibitions on inappropriate insurer pricing and other conduct during the course of reform, including price exploitation, false representations or misleading or deceptive conduct
- power to prescribe reasonable consumer protection measures to be taken suppliers
- strong investigative and enforcement powers
- meaningful penalties for engagement in proscribed conduct
- a requirement for comprehensive reporting by the regulator to government.

Clearly defining proscribed behaviour and setting meaningful penalties for contraventions of the law provides a strong incentive for insurers to avoid inappropriate behaviour and promote alignment with the objectives of the regulatory scheme.

Where potentially inappropriate behaviour is detected, an ability to properly investigate – in a manner proportionate to the seriousness of the alleged contravention – is required to ensure the circumstances of any contravention is fully understood and appropriate remedial action is undertaken. Investigative powers need to incorporate a capability to issue legally binding requests by the regulator of insurers to deliver relevant information in a timely manner. Comprehensive reporting by the regulator is necessary to deliver transparency in regulatory processes and outcomes.

In addition to the legislative framework, effective regulatory oversight requires appropriate resourcing of the regulator. Skill sets available to the regulator should draw on economics, accounting and legal disciplines. An understanding of and experience in competition analysis is also necessary, as is experience in investigations and enforcement. Access to expertise specific to the industry in question, in the case of the abolition of the insurance-based levy actuarial expertise, is essential.

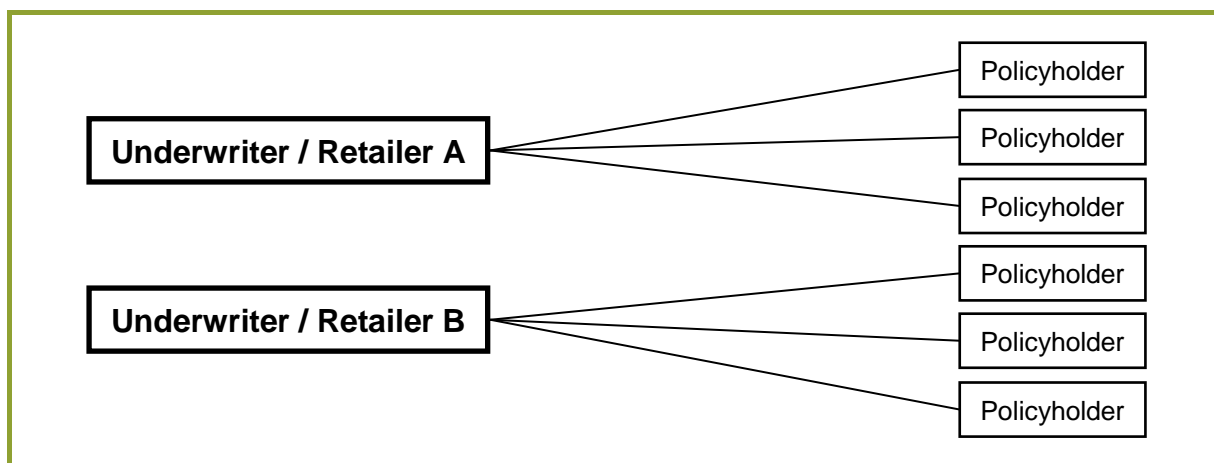
Appendix A: Insurance market relationships

An underwriter is the party responsible for paying a claim should the person insured be able to demonstrate the loss suffered is covered by his or her contract of insurance. For any given type of insurance policy, there are several possible forms of the relationship between underwriter and policyholder, either via a direct relationship or through some form of intermediation using a third-party (distributor, agent or broker).

Underwriter / retailer direct relationship with policyholders

An underwriter can have a direct relationship with their customers through their own retail outlet, with the same entity responsible for managing sales, customer relationships and claims (Figure 19).

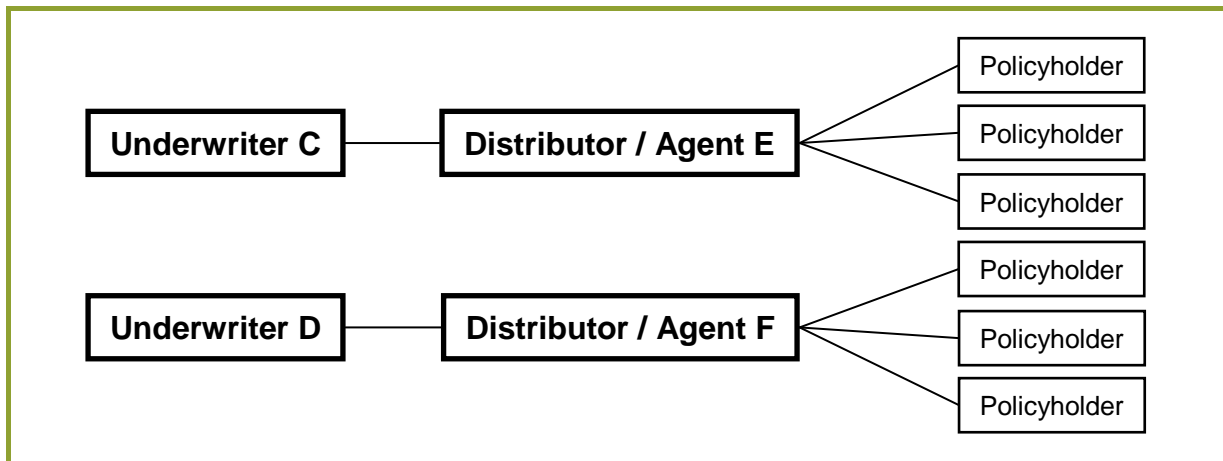
Figure 19 Underwriter / retailer relationship with policyholders



Distributor / agent relationship with policyholders

An underwriter can have an exclusive relationship with a distributor / agent for the sale of particular types of insurance policy for which the distributor / agent would earn a commission (Figure 20). In these circumstances the underwriter and the distributor / agent could share policyholder information but the distributor / agent would be responsible for managing ongoing customer relationships and claims handling (where required) could revert directly to the underwriter.

Figure 20 Distributor / agent relationship with underwriters and policyholders

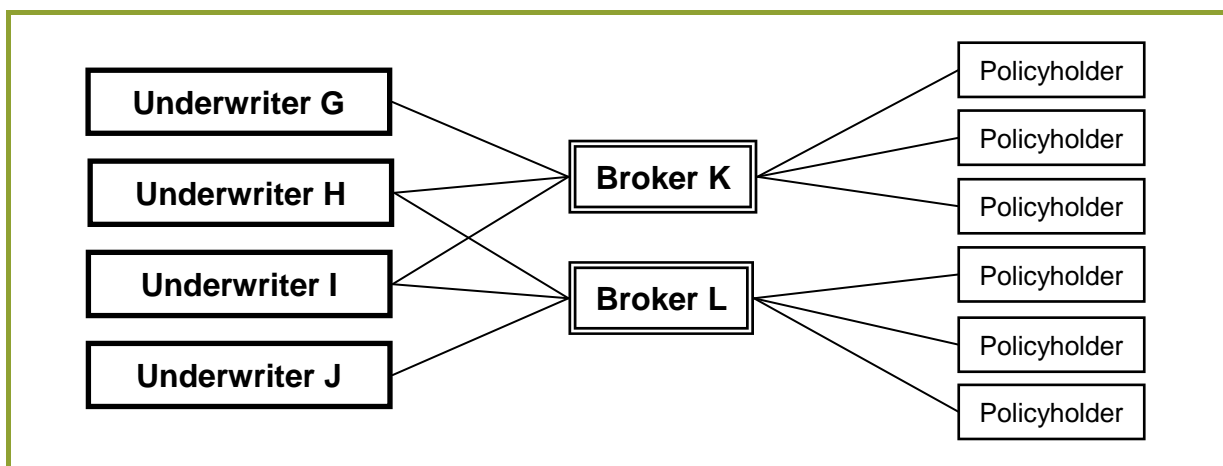


Broker relationship with policyholders

There are several variations on the nature of relationships that brokers can have within the insurance industry

An underwriter can have non-exclusive relationships with brokers for the sale of particular types of insurance policies for which the broker is likely to earn a commission from the underwriter (Figure 21). The basis of this model is that the broker can claim to be acting in the interests of the customer by facilitating competition and doing the hard work of identifying the best insurance deal for the customer’s specific circumstances. In return, the broker earns a fee from that customer and likely, also, a commission from the underwriter. In these circumstances, the broker would be responsible for managing both ongoing customer relationships and claims handling.

Figure 21 Straightforward broker relationships with underwriters and policyholders



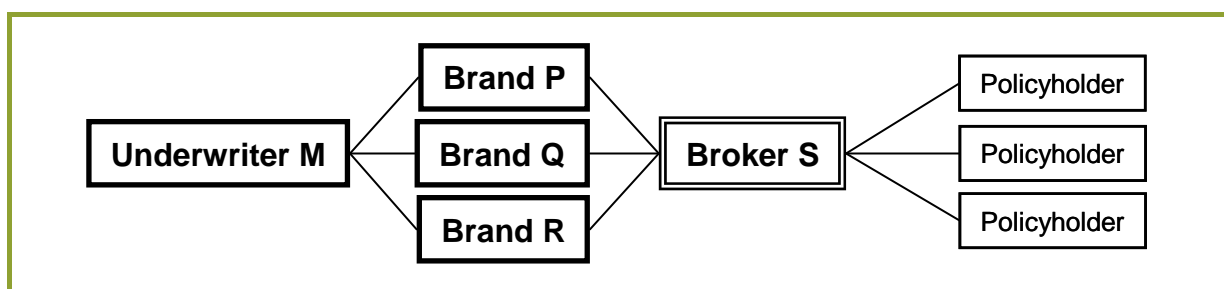
As depicted in Figure 21, Broker K and Broker L each have non-exclusive relationships with three different underwriters – for example, Broker K has a relationship with Underwriter G,

Underwriter H and Underwriter I – and are in a position to provide their customers with real choice of underwriter.

Not all brokers operate through the straightforward broker model as depicted in Figure 21.

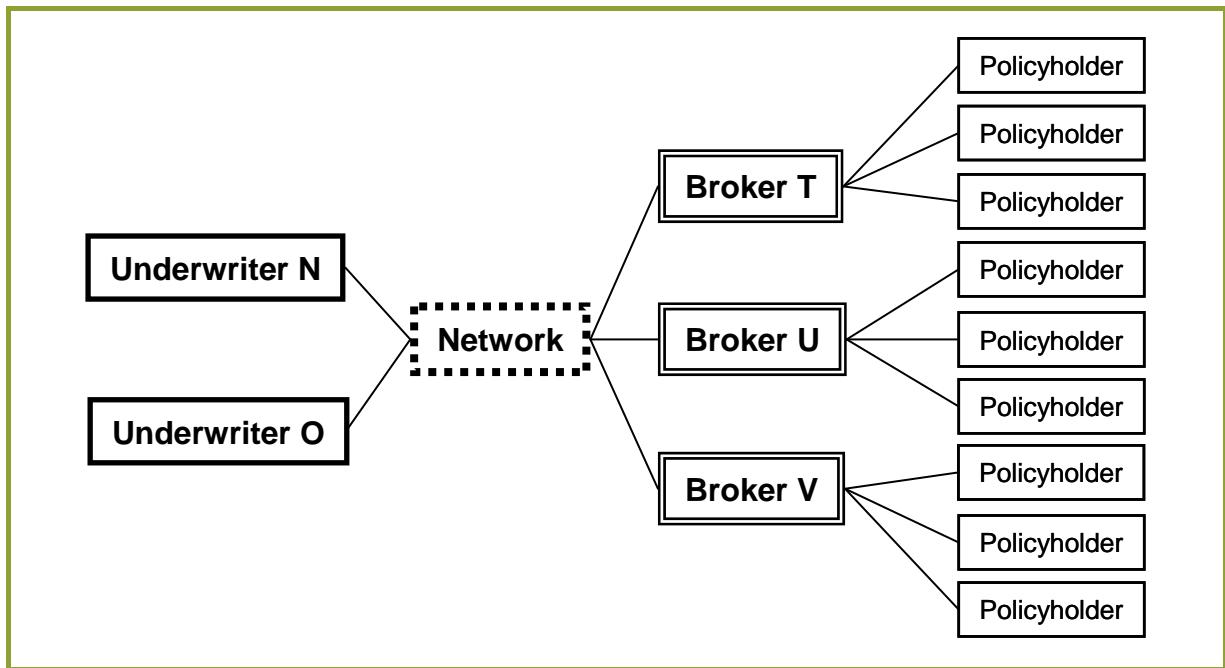
The first variation on the straightforward broker model is depicted in Figure 22 where Broker S nominally purports to represent a choice of policies from among three different brands – Brand P, Brand Q and Brand R. In this case, Broker S would still claim a commission from the relevant underwriter / brand and a broking fee for ‘identifying’ the best policy from the choice of available brands, but the fact that all brands are supported by a single underwriter suggests that Broker S could be more accurately deemed to be a distributor / agent rather than a true broker.

Figure 22 Broker really a distributor / agent



The second variation on the straightforward broker model is where multiple brokers operate through a network to sell policies constructed through a joint underwriting arrangement. For example, Figure 23 depicts a network of three brokers (T, U and V) that distributes policies jointly underwritten by Underwriter N and Underwriter O.

Figure 23 Broker operating through a network



Appendix B: Total disbursement of over-collected FSL by insurer

Company	Refunds to policyholders (\$)	Aggregated refunds to organisations (\$)	Total disbursement of over-collected FSL (\$)
A.I.S. Insurance Brokers Pty Ltd	-	2,646	2,646
ACE Insurance Limited	292,645	34,779	327,424
AIG Australia Limited	-	454,211	454,211
Aioi Nissay Dowa Insurance Company Ltd	-	1,523	1,523
Ansvar Insurance Limited	47,419	14,164	61,583
Aon Risk Services Australia Limited	387,487	4,148	391,635
Arthur J Gallagher (Aust) Pty Ltd	25,925	-	25,925
ATC Insurance Solutions Pty Ltd	3,070	24,619	27,690
Australian Alliance Insurance Company Limited	-	277,270	277,270
Axis Specialty Europe Ltd	40,655	-	40,655
Axis Underwriting Services Pty Ltd	173,314	94,246	267,560
Berkley Insurance Company	-	5,803	5,803
Calliden Agency Services Limited	99,958	327,680	427,638
Calliden Insurance Limited	-	82,964	82,964
Catlin Australia Pty Ltd	3,793	8,754	12,547
CGU	-	210,000	210,000
Chubb Insurance Company of Australia Limited	-	130,258	130,258
Elders Insurance Limited	191,466	557,843	749,309
FM Insurance Company Limited	443,809	149,952	593,760
Great Lakes Australia	-	224,553	224,553
Guardian Underwriting Services P/L	1,747	43,116	44,864
H. W. Wood Australia Pty Ltd	-	1,635	1,635
HDI-Gerling Industrie Verischerung AG	-	391,076	391,076
Honan Insurance Group	-	7,453	7,453
International Insurance Company of Hannover Ltd	-	3,476	3,476
Jardine Lloyd Thompson Pty Ltd	94,655	-	94,655
Liberty Mutual Insurance Company	544,286	-	544,286
Lundie Insurance Brokers Pty Ltd	444	-	444
MA Risk Solutions Pty Ltd (Coverforce)	242,531	4,726	247,257
Manufactured Homes Insurance Agency Limited	-	4,525	4,525

Company	Refunds to policyholders (\$)	Aggregated refunds to organisations (\$)	Total disbursement of over-collected FSL (\$)
Marsh Pty Ltd (Australia)	504,917	10,559	515,476
Mecon Winsure Insurance Group Pty Ltd	-	444	444
Millennium Underwriting Agencies PL	8,071	52,909	60,980
Miramar Underwriting Agency Pty Ltd	281,807	221,921	503,728
Mitsui Sumitomo Insurance Company, Ltd	104,963	-	104,963
NM Insurance Pty Ltd	1,531	7,366	8,897
OAMPS Insurance Brokers Ltd	-	3,352	3,352
Pacific Underwriting Corporation	79,475	15,039	94,514
QBE Insurance (International) Limited	6,967	-	6,967
Savannah Insurance Agency Pty Ltd	-	9,969	9,969
Sirius International Corporation	-	13,344	13,344
SLE Worldwide Australia Pty Ltd	170,342	44,181	214,523
Sompo Japan Insurance Inc	45,469	-	45,469
Sportscover Australia Pty Ltd	21,972	47,290	69,262
SRS Underwriting Agency Pty Ltd	49,932	60,766	110,698
Starr Underwriting Agents	771	-	771
Swiss Re International	-	315,614	315,614
Territory Insurance Office	-	110	110
The Hollard Insurance Company Pty Ltd	430,426	133,197	563,623
Tokio Marine & Fire Nichido Fire Insurance Co Ltd	245,804	14,263	260,067
Trinity Pacific Underwriting Agencies Pty Ltd	1,453	21,101	22,554
Victorian Managed Insurance Authority	558,996	-	558,996
Wesfarmers General Insurance Ltd	566,287	170,718	737,005
Willis Australia Limited	-	6,862	6,862
Youi Pty Ltd	637,553	627	638,180
Zurich Australian Insurance Limited	1,766,423	160,058	1,926,481
Totals	8,076,364	4,371,111	12,447,475

* Pursuant to an enforceable undertaking, CGU made a payment of \$210,000 to CALC and received acknowledgment of a payment to the Country Fire Authority of \$1,184,000.

Appendix C: ICA comments on the regulatory scheme for the fire services levy reform



Professor Allan Fels AO
Fire Services Levy Monitor
PO Box 24374
Melbourne Victoria 3001

21st September 2014

Dear Professor Fels

The Insurance Council of Australia (ICA) welcomes the invitation to submit industry views on the regulatory regime established by the Victorian *Fire Services Levy Monitor Act 1982* (the Act) and the administration of the Act in practice. The ICA notes that the views of the industry will be taken into account as the Monitor reports to the Victorian government on the efficacy of the regulatory settings during the course of reform of the fire services statutory contributions system.

The outline of the response by the ICA will follow the following themes.

- (1) The legislative & regulatory settings applicable, including the development of guidelines and the timing of these instruments and their impact on industry decision making.
- (2) Compliance issues associated with managing the regulatory regime imposed by the Act, including the exercise of powers under the Act.
- (3) Capability and resourcing issues, including reflections on the understanding of insurance specific industry settings within the Monitor Office.

The Legislative & Regulatory Settings

Overall, the industry fundamentally welcomes the abolition of the statutory contributions system in Victoria. However, the abolition of FSL in Victoria was by its very nature a difficult process that required consultation in order to avoid unnecessary risks and issues in implementation. Moreover, given that FSL was levied on insurance premiums that typically run for a period of twelve months, reasonable lead times were needed to accommodate adjustments and for the industry to respond appropriately.

Given the complex issues associated with transition away from statutory contributions, the industry believes that the reform process would have been substantially improved, particularly for consumers, had more consultation taken place earlier in the process. In particular, the benefits of stronger consultation and communication would have seen greater certainty in the management of the transition year and the adoption of a more systematic framework, including the establishment of appropriate timetables, guidelines and recovery arrangements.

One of the key concerns was the mismatch in timing between the abolition of the statutory contributions system from 1 July 2013 through the passage of the *Victorian Fire Services Property*

Insurance Council of Australia Limited ABN 50 005 617 318
PO Box R1832 Royal Exchange NSW Australia 1225
t +61 2 9253 5100 f +61 2 9253 5111

www.insurancecouncil.com.au

Levy Act 2012 in early October 2012 and the subsequent introduction of the *Fire Services Levy Monitor Act 2012* in mid November 2012. (The Monitor Act subsequently passed the Victorian Parliament on the 18th December which meant the Office of the Monitor was not effectively established until the second quarter of 2013). These problems in timing were exacerbated by the apparent ad hoc nature of policy making in the lead up to the contributions reform process and by the absence of adequate consultation as to the implications of proposed regulatory settings on industry and market practices. Fundamentally, the absence of meaningful consultation with the industry on the *Fire Services Levy Monitor Act* served as an example of how regulatory settings for such a key reform were inadequately planned and conducted in their early stages of development.

The effect of the lags in timing and the absence of consultation resulted in significant challenges for industry and regulators, in particular those associated with decision making around price paths and premium settings. This is best demonstrated using the example of the guidelines for price exploitation and false and misleading conduct. Utilising the powers available under the Act, in April 2013 the Monitor undertook a community consultative process to establish guidelines on price exploitation and false and misleading behaviour concluding the process with the issuance of final guidelines at end May 2013. Given that the finalisation of these guidelines was near the effective end of the transition year, the late introduction of the guidelines (and their wide ranging nature) *retrospectively* altered the regulatory environment insurance companies understood as appropriate during the 12/13 transition year. This marked change in the regulatory environment resulted in costly and extensive adjustments particularly given insurers established their pricing and premium strategies on the understanding of the regulatory settings appropriate at the time of the start of transition year in July 2012.

Compliance & Consultation with the Monitor

A number of issues emerged as part of the compliance process with the Act and also the manner in which the Monitor sought to exercise his powers under the Act.

At a principles based level, the *Fire Services Levy Monitor Act* provided considerable powers to the Monitor which is more in keeping with a *general* framework of price supervision than a targeted framework associated for a discrete reform (in this case, reform of the statutory contributions system) in which there existed a strong commitment and partnership between industry and government. Moreover, the *Fire Services Levy Monitor Act* altered the understanding of the price supervision framework applicable to the industry from that of compliance *post* abolition to active supervision and price path supervision *during* the course of the transition year and beyond. This marked change in regulatory emphasis and culture resulted in significant additional compliance costs for industry as well as a markedly different manner in which the Monitor exercised his powers under the Act.

For example, industry participants consider that the exercise of Monitor's powers under Section 18, 19 and 30 did not have adequate regard to the best intentions and endeavours of the industry to work collaboratively with the Monitor and in the interests of consumers. These requests for information involved the considerable use of resource internally and in their ad hoc delivery appeared to have little regard for their cumulative impacts on industry or their relative cost/benefit given their multiplicity. Requests for information were also often generated following consumer submissions to the Monitor

however the absence of further information on these submissions added to the challenge in responding to them in a timely and adequate manner.

Further concerns on compliance emerged with the exercise of the Monitor's powers under Section 106 and in particular the efficacy of the public hearing in mid 2013 and the issue of several media pronouncements. It is doubtful whether the public hearing process in mid June 2013 served its intended purpose of better informing consumers and the public of insurer practices. Given the extent of insurer resources applied to the hearings, and the commitment of consumer interest in the hearings themselves, the overall benefit to the regulatory process remains questionable. Further, the public hearings arose at a time when the industry was rigorously attending to compliance with the Act and the public hearing process may have inadvertently served to undermine confidence that the industry was applying itself effectively to such a task.

In addition, the industry contends that, in retrospect, several media pronouncements from the Monitor were ill advised to the extent that they may have inadvertently undermined confidence in the insurance sector to adequately transfer and manage risk in an efficient and equitable manner for the policyholder.

The ICA contends that many of the compliance issues raised above could have been better managed had a consultation process with the industry been developed. As mentioned above, the adopted framework of the Act was more in keeping with a general approach to price supervision and arguably ill suited to one for which a targeted measure was being addressed (in this case statutory contributions reform). In the case of the latter, the insurance industry can point to examples of where industry specific regulation (for example prudential regulation) is supported by ongoing consultative arrangements across industry and regulator. Although the Monitor processes on consultation were in adequate for purpose (such as for example around the guideline making process), many intrinsic issues associated with industry practice could have been better managed through improved consultative arrangements.

Capacity, capability and resourcing issues

A corollary of the matters raised above is the extent that given the short timeframes associated with its start up, whether the Monitor attended adequately to ensuring the agency had appropriate expertise and familiarity with insurance specific issues. Although on a day to day basis, staff in the Monitor's office were professional, skilled and responsive, a number of issues arose from an absence of a *specific* understanding of the wider regulatory and self regulatory arrangements applicable in insurance and how these affected the Monitor's supervision. For example, in responding to consumer complaints, the absence of an integrated solution which embraced the existing dispute framework available through the Financial Ombudsman Service and ASIC resulted in weaknesses in the dispute resolution arrangements undertaken by the Monitor.

Similarly, the objective of guaranteeing compliance through the instrument of Chief Executive Officer sign-off added to cost and a drag to timeliness when alternative arrangements gained from the knowledge of insurer regulatory settings elsewhere would have been adequate and fit for such purpose. As mentioned previously, many of the matters raised are the result of the application of a

general framework of supervision as opposed to a framework for a specific targeted measure. Given this, in the absence of industry specific knowledge an adequate substitute would have been to examine the introduction of enhanced consultative arrangements with the industry in order to improve overall understanding between the Monitor and the industry.

Conclusion

The ICA welcomes the opportunity to submit its views to the Monitor as part of the review process of the Act and its administration. Throughout the monitoring process the industry remained committed to the abolition of statutory contributions and to ensuring that the reform process was managed in a way agreeable to all stakeholders. The industry submits that this partnership approach across the community provided the clear basis under which the reform was successfully implemented in Victoria and a clear acknowledgement of the role of the insurance sector in this process should be made by the Monitor.

If you wish the ICA to elaborate on this submission please feel free to contact Alex Sanchez on (02) 9253 5130.

Yours sincerely



Robert Whelan
Executive Director & CEO

Appendix D: Regulatory intervention supporting funding policy change

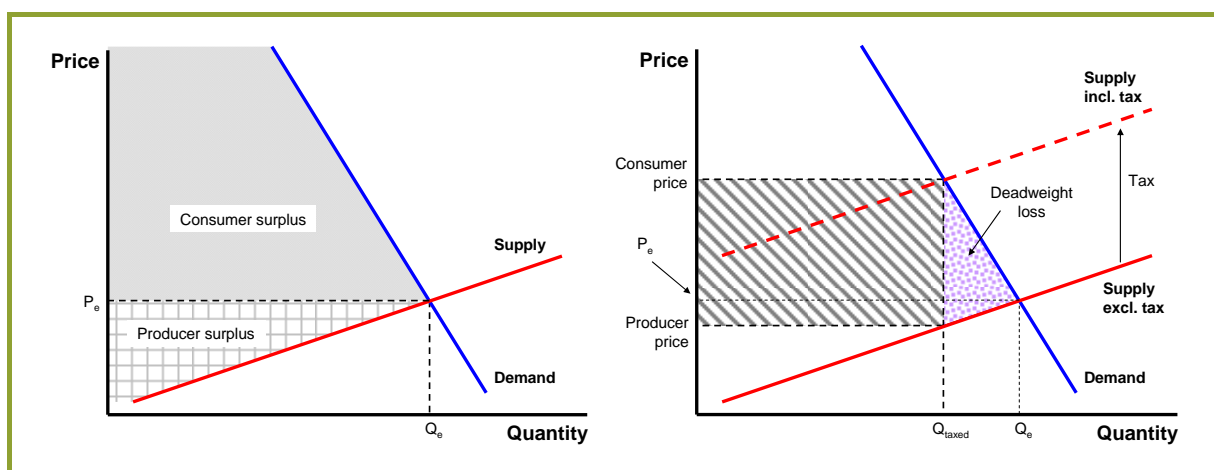
D.1 Prices response to tax change

In order to understand the possible effects that removal of a tax on insurance (such as a 'fire services levy') can have, it is instructive to review some general economic theory on the effects of taxation on the market for goods and services.

Economic theory and the effects of taxation

In a competitive market and in the absence of distortionary taxes, the market clearing price and quantity for a good or service will be established at the intersection of the demand and supply curves – that is, price P_e and quantity Q_e in the left hand panel of Figure 24. Producer surplus³⁵ plus consumer surplus³⁶ is a measure of the economic welfare that accrues as a result of a series of trades in a market.

Figure 24 Effect of imposing a tax on a good or service



The right hand panel of Figure 24 demonstrates the effect of a tax. If a specific tax is imposed on the supply of the good or service, the 'market clearing price and quantity' for that good or service will change by shifting the supply curve upwards and driving a wedge between the price received by the producer (producer price) and the price paid by the consumer (consumer price), with the consequence that a lower volume (Q_{taxed}) of the good or service will be sold / consumed.

³⁵ Producer surplus represents the revenue earned by producers in excess of the cost of supply.

³⁶ Consumer surplus represents the value of goods purchased by consumers in excess of the willingness to pay.

Deadweight loss

Specific taxes on the supply of a good or service impose a 'deadweight loss' on society (the dotted area in the right hand panel of Figure 24) as no party captures a part of the producer surplus or consumer surplus available in a non-taxed environment.³⁷

- Producers capture diminished producer surplus above the supply curve (excl. tax) and below the producer price.
- Consumers capture diminished consumer surplus below the demand curve and above the consumer price.
- Government captures taxation revenue equal to:

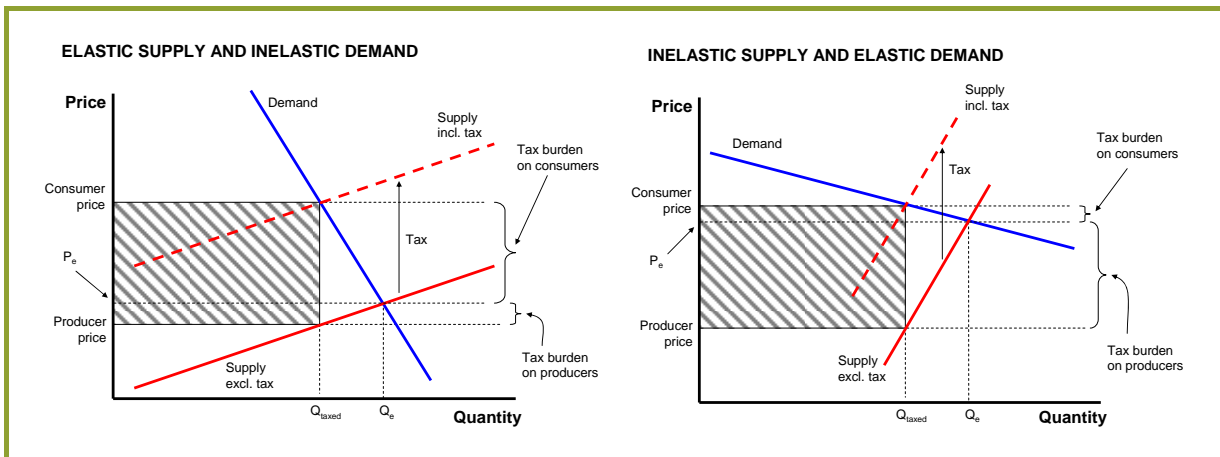
$$(\text{producer price} - \text{consumer price}) \times Q_{\text{taxed}}$$

Burden of a tax

Also relevant to the effect of imposing a tax on a good or service is how the burden of the tax falls on producers and consumers. 'Elasticity' can be used as a measure of how volumes bought and sold will change in response to a change in price – an inelastic response means little change in volume for a relatively large change in price.

When the demand curve is relatively inelastic (consumers tend to *not* respond strongly to a change in price) and the supply curve is relatively elastic, the burden of a tax will fall mostly on consumers – that is, the loss in consumer surplus will be much greater than the loss in producer surplus (see left hand panel of Figure 25).

Figure 25 Relative burden of a tax



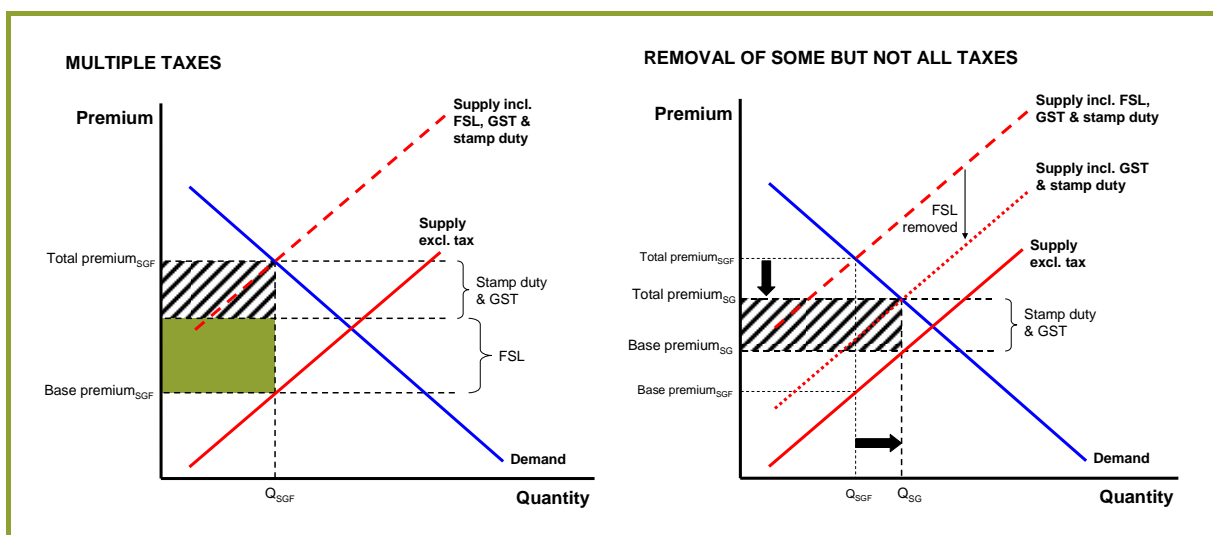
By contrast, when the demand curve is relatively elastic (consumers tend to respond strongly to a change in price) and the supply curve is relatively inelastic, the burden of a tax will fall mostly on producers – that is, the loss in producer surplus will be much greater than the loss in consumer surplus (see right hand panel of Figure 25).

³⁷ Producer surplus *plus* consumer surplus is a measure of the economic welfare that accrues as a result of a series of trades in a market.

Application of taxation theory to the insurance market

The fact that there were multiple taxes (stamp duty, GST and FSL) imposed on property insurance policies in Victoria prior to FSL reform, meant there were multiple levels to the wedge imposed between the price received by the insurer (Base premium_{SGF}) and the price paid by the policyholder (Total premium_{SGF}) as depicted in the left hand panel of Figure 26.

Figure 26 Taxes on insurance



Following FSL reform, GST and stamp duty continued to apply to property insurance policies in Victoria. All other things being equal, economic theory suggests that the removal of FSL results in a smaller wedge imposed between the higher price received by the insurer (Base premium_{SG}) and the price paid by the policyholder (Total premium_{SG}) as depicted in the right hand panel of Figure 26. Given the fall in total premium following abolition of the FSL, the number of policies sold would increase from Q_{SGF} to Q_{SG} .

Robust information regarding the elasticity characteristics of residential property insurance is limited. One study (Barker & Tooth 2008) focused on *demand* elasticities and provided some insights into the potential for changes in premiums to affect levels of non-insurance and under-insurance, observing that:

- demand for residential *building* insurance was *not* responsive to price
- demand for residential *contents* insurance was responsive to price.³⁸

However, given that many residential property insurance policies are for *combined* building and contents cover, conclusions about the responsiveness of consumers to changes in the premiums for these combined cover policies are unable to be drawn.

³⁸ Barker & Tooth 2008, p.6

The role of competition

The impacts of *imposing* a tax on a good/service are described above. Economic theory would suggest that in the long term, provided adequate competitive pressures are exerted, the *removal* of a tax would have the opposite effect – that is, prices experienced by consumers would fall and the quantities of the relevant good/service sold would rise.

However, where competition is less than fully effective and consumers are less than fully-informed, removal of a tax may not be fully passed through to consumers without some form of regulatory intervention. In less than fully competitive markets, where information asymmetry prevails, there may be an opportunity for producers (insurers) to retain additional margin. In some markets, it has been observed that, following regulatory changes, prices tend to be sticky on the down-side in the short term, but not so sticky on the up-side.³⁹

D.2 Interventionist rationale and precedent

Where the removal of a tax applied to a consumer product is not passed on to consumers in the market, consumers should be considered to have experienced a detriment to their financial position. Preventing, or reducing the likelihood of, such a detriment provides a rationale for regulating or intervention by government. Of course, there are efficiency arguments against such intervention relating to the costs that regulation will impose on insurers in complying with the regulatory regime and the costs of the regulator to taxpayers. Will the detriment to consumers avoided by regulation or intervention outweigh the costs to taxpayers and industry's compliance costs?

Another rationale for intervention may be that, regardless of the net outcome of the above considerations, some regulatory oversight of price changes as the tax is removed will increase public confidence in the reasonableness of the change to the funding of fire services. Insurers will be seen to be unable to take advantage of the policy change under the scrutiny of a regulator.

³⁹ For example, banks' changes to mortgage rates in response to RBA changes to cash rates have been found to be slow following reductions in cash rates and relatively fast following increases in cash rates (see Valadkhani and Anwar 2012).

Bibliography / references

2009 Victorian Bushfires Royal Commission (VBRC 2010), *Final Report Summary*, July 2010. Available at:
http://www.royalcommission.vic.gov.au/finaldocuments/summary/PF/VBRC_Summary_PF.pdf

Barker G and Tooth R, Australian National University Centre for Law and Economics (Barker & Tooth 2008), *Insurance Law and Economics: An Analysis of the Demand for House and Contents Insurance in Australia*, Working Paper No. 1, 2008. Available at:
http://150.203.86.5/cle/Papers/Insurance_Demand_Home&Contents_Fina.pdf

Department of Treasury and Finance (DTF 2003 review), *A review of the Victorian fire services funding arrangements*, 2003

_____ (DTF 2011), *Victorian Fire Services Property Levy, Options Paper*, June 2011

Fire Services Levy Monitor (FSLM May 2013 guidelines on price exploitation) *Guidelines on price exploitation in relation to the fire services levy reform*, May 2013

_____ (FSLM May 2013 guidelines on misleading / deceptive conduct) *Guidelines on false representation or misleading or deceptive conduct in relation to the fire services levy reform*, May 2013

_____ (FSLM March 2014 guidelines on resolution of over-collection) *Resolution of insurers' over-collection of fire services levy in 2012–13*, March 2014

_____ (FSLM 2014a), *Report to the Minister for Consumer Affairs, June Quarter 2014*

_____ (FSLM 2014b), *Enhancing the consumer experience of home insurance: Shining a light into the black box*, July 2014. Available at:
<http://www.firelevymonitor.vic.gov.au/home/news+and+information/publications/publication+shining+a+light>

Henry, Ken (Chair) (Henry review 2009), *Australia's Future Tax System, Report to the Treasurer*, Part One Overview, December 2009. Available at:
http://taxreview.treasury.gov.au/content/downloads/final_report_part_1/00_afts_final_report_consolidated.pdf

Parliament of Victoria (CFA Act), *Country Fire Authority Act 1958*

_____ (MFB Act), *Metropolitan Fire Brigades Act 1958*

_____ (FSLM Act), *Fire Services Levy Monitor Act 2012*

_____ (FSLM Bill), *Fire Services Levy Monitor Bill 2012*

_____ (FSPL Act), *Fire Services Property Levy Act 2012*

Reserve Bank of Australia (RBA 2014), *Financial Stability Review*, September 2014

Valadkhani A and Anwar S (Valadkhani and Anwar 2012), University of Wollongong Research Online,
Modelling Australia's Retail Mortgage Rate, 2012. Available at:
<http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1245&context=commwkpapers>