

Pre Budget Submissions
Budget Policy Division
Department of Treasury
Langton Crescent
PARKES ACT 2600

16 January 2009

Dear Treasury

Insurance Council Submission to the 2009/10 Commonwealth Budget

The Insurance Council of Australia¹ welcomes the opportunity of providing the following submission to the 2009 Commonwealth Budget.

The Insurance Council's 2009 submission builds on previous representations and submissions made to the Commonwealth Treasury including submissions to the 2007 and 2008 Commonwealth Budget and more recently to the Review of Australia's Future Tax System (AFTS)

The Insurance Council welcomes the Federal Government's commitment to tax reform through the AFTS Process. Accordingly, the Insurance Council made a detailed submission to the initial AFTS consultation seeking reform of general insurance tax taxes.² The Insurance Council submission details the net cost of general insurance tax reform at \$1.7 billion (after taking into account second round effects).

The Insurance Council recognises that to meet the goal of insurance tax reform (and transaction tax reform more widely) this reform task must be set within a broader framework of COAG and in particular, Commonwealth State Financial Relations. Insurance Council submissions emphasise the primacy of the 2000 Intergovernmental Agreement (IGA) as the key instrument under which hitherto inefficient State taxes have

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2008 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of \$31.2 billion per annum and has assets of \$91.0 billion. The industry employs approx 60,000 people and on average pays out about \$87 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

² See Insurance Council of Australia (2008) "*Submission to the Review of Australia's Future Tax System*" available at <http://www.insurancecouncil.com.au/Portals/24/Submissions/Submission%20-%20Review%20Australia%20Future%20Tax%20System.pdf> and the Finance Industry Council of Australia at www.fica.com.au

been reformed. The Insurance Council contends that the absence of insurance tax reform in the original 2000 IGA remains a significant policy anomaly. Further, the Insurance Council believes that the absence of general insurance tax reform in the 2000 IGA does not preclude the adoption of an IGA like process to facilitate general insurance tax reform today.

Nevertheless, the Insurance Council contends that in recent times a number of new measures undertaken by some State governments have placed additional impediments and so retarded the goal of achieving general insurance tax reform. These are:

- The new measure introduced in 2008 by the NSW Government to fund the NSW State Emergency Service through the existing statutory contributions arrangements applied to the fire services in NSW.
- Deferral in 2008 of the abolition of specific transaction taxes by both NSW, Queensland and SA, which were previously scheduled for abolition under the 2000 IGA between the Commonwealth and the States.

An outline of these measures, together with their implication for insurance tax reform, are set out further below.

NSW Emergency Service Funding

As part of its 2008/09 Mini Budget, the NSW government announced that from 2009/10 onwards, the NSW State Emergency Services will be funded under the statutory contributions arrangements currently used to fund the Fire Services in NSW. The measure is expected to raise some \$39 million.³

Although the Insurance Council concurs with the importance of the States retaining a well equipped and resourced emergency service capability (particularly given severe and erratic weather events and the challenges identified under various climate change scenarios) the NSW Mini Budget measure represents a significant departure from the reform pathway recommended by the NSW Government's own Independent Pricing & Regulatory Tribunal (IPART).

In October 2008, the NSW IPART recommended that in the short term, the statutory contributions by insurance companies to fund fire services should be replaced by an equivalent, transparent, property-based levy collected by local councils.⁴ The NSW IPART found that:

"The Fire Services Contribution by insurers is effectively a levy on insurance and creates disincentives for taking out appropriate insurance. On this basis, its removal should be a priority".⁵

The recommendation of the NSW IPART would have seen emergency services funding in NSW mirror the funding approaches of the other States, apart from Victoria.

Significantly, the announced NSW government Mini Budget measure to fund the SES using the statutory contributions arrangements is directly at odds with the NSW IPART recommendation. Moreover, the Insurance Council contends that with the weather challenges identified under various climate change scenarios (including the predictions

³ See NSW Government 2008/09 Mini Budget at http://www.treasury.nsw.gov.au/_data/assets/pdf_file/0016/12706/08-09_Mini-Budget.pdf

⁴ See NSW Independent Pricing & Regulatory Tribunal (2008) "Review of State Taxation: Final Report to the Treasurer" page 9

⁵ See NSW IPART (2008) "op cit" page 68

of far more extreme and erratic weather events⁶), the task of finding a long term and sustainable method of funding State emergency service capability is all the more pressing and urgent.

Arrangements, such as those in NSW and Victoria, that fund emergency services through levies on general insurance, exacerbate the extent of non insurance in communities, thereby placing such communities at further risk of recovery from extreme weather events. The potential impact of non insurance on government outlays is succinctly stated in the Consultation Paper of Australia's Future Tax System:

"Submissions note that stamp duty on insurance may encourage people to either under insure or to not insure at all by increasing the cost of insurance products relative to other goods. While this in itself is inefficient, it may also lead to an increase in government expenditure if assistance is provided to the uninsured in the event of a disaster. Further, the fire services levy – which is levied on insurance companies to partly fund fire brigades – can exacerbate the effects of the stamp duty on insurance".⁷

The Insurance Council contends that the Federal government has a key role in ensuring that the States have long term and sustainable approaches to funding their emergency services capabilities. The role of the Commonwealth in supporting disaster recovery and in funding emergency disaster assistance to the States could potentially be used to leverage change in State emergency service funding arrangements and to have these arrangements placed on more sustainable footings. The Insurance Council submits that the Commonwealth Government has the critical ability to drive essential change in State emergency services funding through its support arrangements with the States on emergency funding.

Deferral of IGA taxes

As part of their respective budget statements, the NSW, Queensland and South Australian governments have announced their intention to defer the abolition of transaction taxes previously slated for removal under the 2000 Intergovernmental Agreement between the Commonwealth and the States. In the case of NSW, the government has deferred the abolition of mortgage duty on business loans, transfer duty on non-land business assets and duty on unquoted marketable securities until 1 July 2012. The Queensland government has announced deferring the abolition of duty on the transfer of core business assets until 1 July 2012. South Australia has reset the abolition date for stamp duty on non quoted marketable securities and non real property transfers until 1 July 2012.

While the States continued commitment to ultimately abolish these transaction based taxes is to be welcomed, the Insurance Council contends that the ability of the States to defer State taxation abolition timetables poses an issue for any future Commonwealth State agreement involving State transaction tax reform. For example, in past submissions to the Commonwealth, the Insurance Council has submitted that reform of general insurance taxes (and transaction taxes more broadly) should be a priority for future Commonwealth State Financial Relations.⁸ Based on modelling from Access Economics, the Insurance Council submission to the Review of Australia's Future Tax System argued that reform of general insurance taxes would cost a net \$1.7 billion (after

⁶ See Australian Greenhouse Office (2006) *Climate Change Impacts & Risk Management* page 14.

⁷ See Australia's future tax system (December 2008) " *Consultation Paper*" page 191

⁸ See Insurance Council (2008) " *Submission to the Review of Australia's Future Tax System*" and Insurance Council (2008) " *2008 Federal Budget Submission*" both available at www.insurancecouncil.com.au

taking into account second round effects) and yield gains to household consumption of around 0.48% or a little under \$2.6 billion.

However, in recognition of the magnitude and scale of the reform task, the Insurance Council has submitted that reform of general insurance stamp duties requires new undertakings in Commonwealth State Financial Relations and desirably, a new Intergovernmental Agreement with timetables for the removal of State based general insurance stamp duties.⁹ However, the recent budgetary measures in the NSW, Queensland and SA suggest that undertakings given to remove State transaction taxes are potentially fragile and subject to ad hoc revision by the States. This gives rise to potential “moral hazard” problems to the extent that States may be reluctant to remove or abolish transaction taxes given their immediate revenue loss and the potential for other States to defer undertakings later on.

Notwithstanding the above issue, the Insurance Council contends that a revamped IGA between the Commonwealth and the States remains the only realistic and feasible pathway to reform of general insurance taxation. The Insurance Council submits that the absence of general insurance tax reform from the original 2000 IGA represented a major anomaly and policy oversight and that the goal of tax reform should be to remove those taxes that are the most inefficient and carry large deadweight costs. In this way, overall economic efficiency can be improved.

A Productivity Commission Review into Natural Disaster Relief Arrangements

In its 2008 Federal Budget submission, the Insurance Council raised the suggestion of reviewing the current arrangements applicable to natural disaster relief. In particular, the Insurance Council submitted that in an era of the challenges identified under various climate change scenarios (including the likelihood of more extreme weather events), a key task for government was defining the appropriate roles for government in natural disaster relief - including the “moral hazard” effects of how government support and relief may affect incentives and capacity building amongst individuals, households and communities. The Insurance Council concluded that while it is clearly unfeasible and inappropriate to remove natural disaster relief altogether, the government would be well placed to consider a review of existing arrangements including the option of introducing mutual obligation style frameworks to disaster payments.

Since the Insurance Council submission, the Commonwealth Government announced a Productivity Commission Inquiry into Government Drought Support with the Commission releasing a Draft Report in October 2008.¹⁰

The Insurance Council contends that aspects of the findings of the Productivity Commission in its review into drought relief have policy parallels for natural disaster relief funding. The Productivity Commission’s draft recommendations on facilitating adaptation and adjustment to climate change risks (including supporting greater self reliance) are equally applicable to government assistance provided under natural disaster relief arrangements. For example, the Insurance Council’s policy statement on *Building Community Resilience to Extreme Weather Events* highlights the significance of

⁹ The Insurance Council notes that at the 24th meeting of the Council of Australian Governments (COAG) on the 29th November, 2008 an agreement was reached on a new phase in the IGA to include rationalisation of Special Purpose Payments.

¹⁰ Productivity Commission (2008) “*Inquiry into Government Drought Support: Draft Report*”

supporting adaptive behaviours amongst individuals and within communities to protect against loss due to extreme weather events.¹¹

In the light of the current policy pathways to encourage greater self reliance amongst households and communities (as evidenced by the Productivity Commission review into drought support) the Insurance Council submits that the Commonwealth would be equally well served by referencing the Productivity Commission with a review of natural disaster relief arrangements. The terms of such an inquiry would be similar to that of the drought support review including examining the appropriateness, effectiveness and efficiency of natural disaster relief arrangements and to identify the impediments to improving self reliance and mutual obligation amongst individuals, households and businesses.

Funding for the National Disaster Mitigation Program (NDMP)

In its 2008 Federal Budget submission, the Insurance Council highlighted the need to review and upgrade the capability of the National Disaster Mitigation Plan. The NDMP provides an application and funding mechanism for mitigation projects aimed at reducing community exposure to natural hazards.

For approved mitigation projects, the program provides for equal funding from the Commonwealth, State and affected local government. (ie 1/3rd Commonwealth, 1/3rd State and 1/3rd Local Government). Projects are prioritised by the relevant State planning bodies with assistance from applicant Local Governments. Projects are not prioritised nationally.

Mitigation projects approved under the NDMP have included:

- Natural disaster risk management studies;
- Disaster mitigation strategies;
- Investment in disaster resilient public infrastructure;
- Structural works to protect against damage (eg. disaster proofing of existing buildings at risk; levees, retarding basins and channel improvements, permanent fire breaks, other engineered works that offer protection from natural disasters);
- Disaster warning systems;
- Community awareness and readiness measures;
- Audits of levees and warning systems;
- Disaster and mitigation related research of public benefits;
- Development of nationally consistent data collection and analysis;
- Development of nationally consistent post-disaster evaluations;
- Geographic Information Systems (GIS) based hazard and flood data for disaster mitigation purposes; and
- Land and building purchase schemes in high-risk areas.

The Insurance Council submits that the broad objectives of the mitigation program remain appropriate, however the scale and importance placed on the program will increase as a result of the changed hazards predicted as a result of climate change. In this regard, the Insurance Council submits that the NDMP program objectives would be properly improved with an expansion to include stormwater mitigation and drainage works.

¹¹ See Insurance Council (2008) "Improving Community Resilience to Extreme Weather Events" available at <http://www.insurancecouncil.com.au/Portals/24/Issues/Community%20Resilience%20Policy%20150408.pdf>

The general insurance industry strongly urges government to expand the program to include projects that aimed at replacing or upgrading critical stormwater mitigation works in communities. Bureau of Transport & Economics data shows that 55% of property damage in Australia arising from weather events comes from flooding and severe storms¹². Insurance Council analysis of insurance claims for these events, failures and inadequacies in existing public stormwater mitigation measures, typically account for an average of one third of water damage experienced by private property owners during large rainfall events, manifested as flash flooding.¹³ The extent of this issue is to be examined further by the National Adaptation Research Network as part of the National Adaptation Research Plan for Climate Change. While this review will result in a national consensus regarding broad scale upgrades to stormwater management standards, there are currently critical works required in at risk communities that lack a funding mechanism.

Accordingly, the Insurance Council submits that a review of the funding adequacy of the NDMP program be undertaken. Federal funding for the NDMP is estimated to be around \$35 million in 2008/09, as compared to some \$90 million set aside for natural disaster relief recovery.

Under each of the various predicted climate change scenarios it is increasingly clear that there will be greater funding calls upon each available component of the mitigation program, in particular for the more costly works such as public infrastructure and structural mitigation works. Further, it is conceivable that individual projects designed to combat climate change induced hazards will increase in complexity and expense in proportion to growth in demand for hazard controls and the nature of the hazards. The Insurance Council contends that funding the NDMP will become a growing challenge exacerbated by a constrained ability of some partners to the program to effectively contribute.

The Insurance Council submits that an urgent funding review of the NDMP is required in light of predicted climate change scenarios and that such a review should be carried out in conjunction with national stakeholders through the National Adaptation Research Facility. Until completion of this review and adoption of any relevant recommendations, funding of the NDMP should be continued at present levels.

General Insurance and consumer confidence in the sector.

The recent global financial crisis has placed considerable focus on the overall financial services sector including exposure of some practices and behaviours by segments of the financial system around the globe. However, in Australia, where the overall regulatory and prudential regime for financial services remains strong, the general insurance industry remains in a solid financial position and is able to meet its obligations to policyholders.

The Insurance Council supports the overall regulatory/prudential regime applicable to the general insurance sector. However, the Insurance Council contends that the Federal Government and the relevant regulators should continue to publicly assure the Australian community of the integrity of the regulatory framework in Australia and the solid position of the general insurance industry in this country. This contention is supported by research undertaken by the Insurance Council which, at the height of the global crisis, demonstrates that consumer confidence in the Australian insurance sector was diminished.

¹² Bureau of Transport Economics (2001) *Natural Disasters Report*, Table 3.1

¹³ Source: Insurance Council; *Analysis of Catastrophe Data Base*

For example, in late 2008, consumer research commissioned by the Insurance Council from UMR Research found that:

“The financial crisis does pose a problem – with nearly half of the people surveyed believe an insurer may become insolvent as a result of the current financial crisis.”

The Insurance Council submits that the interests of the Federal Government/regulators and the general insurance industry to provide continued assurance of the strength of the Australian general insurance sector and its strong prudential settings. In that regard, as part of its consideration around the 2009/10 Federal Budget, the Insurance Council submits that the Government give consideration to re-assuring Australians of the strong regulatory system that operates to protect Australian consumers in the overall financial services sector, including the general insurance sector.

Product Disclosure Statements

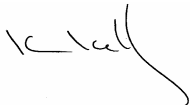
The Insurance Council recognises the significant work that the Commonwealth Government has undertaken in the area of strengthening consumer knowledge and understanding of financial service products, including seeking to simplify Product Disclosure Statements. The introduction of a simplified and short Product Disclosure Statement for the First Home Saver's Account is an example in this regard..

The general insurance industry is cognisant of the need to ensure that consumers are well informed about general insurance products they intend to purchase, including the respective obligations of both the insured and the insurer. Nevertheless, the Insurance Council contends that it is important for decision makers to distinguish between the various types of financial service products and their disclosure arrangements. In particular, the Insurance Council contends that products sold in the banking and funds management sector have marked differences from products sold in the general insurance sector and accordingly, policy settings need to be applied to take account of these differences. The general insurance industry is keen to work with the Federal Government on identifying those aspects of Product Disclosure Statements in General Insurance that can be improved to assist consumers to be better informed.

Conclusion & further information

The Insurance Council welcomes the opportunity provided in lodging this submission to the 2009/10 Commonwealth Budget. For further elaboration on the matters raised in this submission please contact Mr Alex Sanchez, General Manager, Economics & Taxation on (02) 9253 5130 or email asanchez@insurancecouncil.com.au

Yours sincerely



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