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Disclosure in General Insurance: Improving Consumer Understanding – Discussion Paper January 2019

SUBMISSION – Strata Community Insurance Agencies Pty Ltd, 28 February 2019

About Strata Community Insurance

Strata Community Insurance is an independently owned strata and community title insurance specialist, underwriting on behalf of the Allianz Group, one of the world's largest property and casualty insurers. It is a business founded, owned and staffed by a group of Australia's most experienced strata insurance professionals, and designs and builds specialist insurance products and services for the strata and community title sector Australia-wide. Its directors have strata and community title insurance experience spanning four decades across six countries, including some of the world's most challenging markets such as the United States of America, the United Kingdom and the Middle East, and are well positioned to offer credible input into this process.

Strata Community Insurance welcomes the opportunity to make a submission to the Australian Government in response to Treasury's January 2019 Discussion Paper *Disclosure in General Insurance: Improving Consumer Understanding* (the **Discussion Paper**).

Approach to this submission

This submission addresses only selected 'Issues for discussion' and 'Consultation questions' in the Discussion Paper. Specific reference to relevant issues and questions is made where applicable. Commentary provided is from the perspective of our experience in the strata insurance market, and should be construed and considered in this context only.

Further information

To discuss any aspects of this submission or if any further information is required, please feel free to contact:

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‘Component pricing’, and the disclosure of commissions and fees

The following commentary is of relevance to Recommendations 4 and 12 arising from the Senate Economics References Committee Report – *Australia’s general insurance industry: sapping customers of the will to compare* (**Senate Report**), which provided:

Recommendation 4

3.77 The committee recommends that the government initiate a review of component pricing to establish a framework for amending the Corporations Act 2001 to provide component pricing of premiums to policyholders upon them taking out or renewing an insurance policy, as well as an assessment of the benefits and risks to making such a change.

Recommendation 12

5.34 The committee recommends that the government strongly consider introducing legislation to require all insurance intermediaries disclose component pricing, including commissions payable to strata managers, on strata insurance quotations.

As such, it is of relevance to ‘Consultation questions’ 1-3, and 5-7.

We acknowledge that Recommendation 12 outlined above is not mentioned in the Discussion Paper, and consider this to be a missed opportunity. To clarify:

- The Senate Report included two separate Recommendations referring to the term ‘component pricing’ – Recommendations 4 and 12, reproduced above.
- In respect of Recommendation 4, the term ‘component pricing’ was used in the sense of which ‘components’, or factors, contribute to establishing the *insurance premium* – such as: cost of claims; internal expenses; reinsurance costs; and profit margins; as well as the impact of loadings such as for cyclone and flood components (refer, e.g., Senate Report at 1.23 and 3.37).
- In respect of Recommendation 12, on the other hand, the term ‘component pricing’ was used (albeit in the context of strata insurance) in the sense of displaying each ‘component’ of the total price payable by the insured as a separate line item on any insurance quotations presented to the insured (at or before the time the decision is made by the consumer to select a particular insurer) – including amounts attributable to: base premium; taxes, duties and levies; commissions payable to insurance intermediaries including strata managers and/or insurance brokers; and fees charged by insurance brokers (refer to Senate Report discussion at 5.15 - 5.33, and especially at 5.31).
- In the Australian Government’s response to the Senate Report, dated December 2017:
 - o In respect of Recommendation 4, the Government agreed there was merit in further reviewing the recommendation, and tasked Treasury with assessing the relevant proposal; and



- In respect of Recommendation 12, the Government noted the recommendation and undertook to '*bring the recommendation to the attention of state and territory governments who are best placed to consider the merits of this proposal given their overall responsibility for legislation regulating strata managers*'.
- It is apparent that the Government inappropriately narrowly construed Recommendation 12 of the Senate Report. Specifically:
 - Recommendation 12 *broadly* referred to the importance of '*all insurance intermediaries*' disclosing 'component pricing' – in the sense of displaying each 'component' of the total price payable by the insured as a separate line item on insurance quotations (including base premium, taxes, duties and levies, commissions and/or fees payable to strata managers, insurance brokers and other intermediaries).
 - The Government's response, however – which was to 'bring the recommendation to the attention of state and territory governments' on the basis that they have overall responsibility for legislation regulating *strata managers*. This was a misinterpretation and mischaracterisation of the Recommendation. The Recommendation envisaged introducing legislation requiring *insurance intermediaries* to disclose component pricing, including commissions payable to strata managers. That is, it foresaw enactment of legislation affecting *all insurance intermediaries*, not just strata managers.
- As the changes envisioned by the Recommendation relate to *all insurance intermediaries*, legislative amendments necessary to implement the changes would be required at a *federal* level – specifically, amendments to Chapter 7 of the *Corporations Act 2001* (Cth) (the **Act**). Compelling all insurance intermediaries to present particular categories of information on insurance quotation documentation is not a matter within the purview or authority of state and territory governments.

We note again that the Discussion Paper refers only to Recommendation 4 of the Senate Report. However, consistent with the above, it is our position that it would be prudent and proper for Treasury to consider 'component pricing' in the context that it was used in Recommendation 12 of the Senate Report.

Why the need to breakdown the total cost of insurance?

Part of the stated objective for consulting on changes relating to disclosure of 'component pricing', as well as on changes to disclosure associated with insurance renewals, is to 'enhance the comparability of products' (Discussion Paper, p.9).

The Discussion Paper also notes (Introduction, p.2):

'The critical importance of effective disclosure is an area on which consumer advocates and industry all agree. And it is not merely that information is disclosed to consumers, but that information is presented in a way that improves the consumer's capacity to make informed and appropriate decisions about the insurance coverage they purchase. The risks of ineffective disclosure include inadvertent underinsurance,



lack of understanding of the insurance product purchased and purchase of an insurance cover which does not serve its purpose.’

Another consideration in terms of the risk of ineffective disclosure, is that it can lead to consumers obtaining goods or services that do not reflect relative *value for money*.

As noted by the Australian Competition & Consumer Commission (**ACCC**), in its November 2018 First Interim Report in respect of the Northern Australia Insurance Inquiry (**ACCC Report**) (at pp. 181, 183 – our emphasis):

‘A consumer may arrange their insurance:

- directly with the insurer
- through an intermediary acting on behalf of an insurer
- through an insurance broker (an intermediary acting on behalf of a consumer).

In addition, a number of other third parties can also play a role in connecting a consumer with an insurer:

- a referral network of affiliated businesses (such as bank branches, credit unions or motoring clubs)
- comparison websites, or
- a strata manager (also referred to as a body corporate manager).

Our analysis of industry data shows that *the way in which an insurance product is purchased can have a significant impact on the final premium paid by a consumer, with commission payments and other incentives in some cases exceeding half the total cost of the insurance policy...*

Insurance brokers are usually contracted with multiple insurance companies in order to effectively obtain quotations and place coverage for their clients. This contract will set out the broker’s remuneration arrangements... As well as remuneration from an insurer, a broker fee may also be paid directly from the client (the consumer).’

Firstly, it is worth commenting on the italicised section of the ACCC Report extract above. The ACCC has essentially stated that ‘commission payments and other incentives’ can significantly impact the ‘final premium paid’ by consumers. We consider that the ACCC were actually referring to the *final total price payable* by consumers for insurance products, and it must be noted that the *premium* charged by insurers is only part of that final total price payable. Remuneration arrangements including commissions and insurance intermediary fees apply over the top of the base premium, as do various taxes, levies and duties. We consider that this problematic phraseology is symptomatic of the very confusion and misunderstanding that the ACCC refers to in the context of consumers, arising from issues of insufficiently transparent disclosure (we go on to discuss the issue of consumer misunderstanding later in this submission).

While ‘component pricing’ factors such as cost of claims, reinsurance costs, and loadings for factors such as cyclone and flood components are intrinsically linked to the cost of the *base premium* associated with an insurance policy, other ‘component pricing’ factors such as taxes (GST), stamp duties and levies (such as emergency services levies), as well as the differential commissions and/or insurance intermediary fees that may apply also significantly impact the *total price payable* by a consumer for any particular insurance policy.



To illustrate the above points made by the ACCC by way of example: in the case of strata insurance particularly it is standard industry practice for intermediaries to present multiple quotations to consumers – from three or more different insurance companies – and in each case the contractual arrangements the intermediary has in place with the insurance company will potentially stipulate a different commission rate payable on placement of coverage. Additionally, in the case of insurance brokers, a ‘broker fee’ may also be applied which, similarly to the case with commissions, may be different for each individual quotation presented by the broker to the consumer.

All insurance intermediaries have a valuable role to play in providing advocacy and guidance to consumers of strata insurance products. The income these intermediaries receive and/or cost they choose to charge for these services (whether by way of commission, fees, or a combination of both), needs to be made transparent before the insurance purchasing decision is made. While it is true that, for strata managers, income disclosure and transparency may be regulated at a state and territory level – for other insurance intermediaries such as insurance brokers subject to the financial services regime enshrined in the Act, regulation can only be effected at a federal level.

Further to this, it is also important to note that any changes to laws and regulation applying only to insurers relating to disclosure of ‘component pricing’ factors (in the sense of breaking down costs by base premium, emergency services levies, GST, stamp duties, commissions and/or fees payable to all parties, etc.) risks not securing the level of transparent disclosure desired unless the same obligations to provide granular information are not mirrored for, and applied to, insurance intermediaries.

Part of the reason issues around insufficiently transparent disclosure practices have been allowed to arise is, essentially, that technical legal compliance with existing laws and regulation around disclosure of remuneration arrangements does not equate with, or meet, current community expectations around transparency. To illustrate:

- When insurance is sold through an intermediary, such as an insurance broker, the intermediary must provide the consumer with a Financial Services Guide (FSG). An FSG must disclose information about the financial services offered, remuneration arrangements, and any potential conflicts of interest (Senate Report, at 3.10). Disclosure of remuneration arrangements extends to commissions and/or fees, and other benefits that may be received, in respect of or attributable to their services, by themselves, associated bodies corporate, directors and employees and any associates of these parties.
- An FSG must be provided to the consumer at or before the time a financial service is first provided to them (subject to limited exceptions), and the level of information required is such as a person would reasonably require for the purpose of making a decision on whether to acquire financial services from the providing entity as a retail client.
- While the Act stipulates that remuneration must be disclosed, as noted in the ACCC Report (at p. 193):

‘...current disclosure requirements only offer a limited degree of transparency regarding the actual remuneration paid. For instance, a common disclosure



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clause within an FSG may state that an intermediary, upon placing the insurance, will receive a commission that varies between 0 and 25 or 30 per cent of the base premium paid. Information obtained in this inquiry indicates that the majority of base commission payments are made at the higher end of the possible range indicated. When all other remuneration payments are considered actual commission rates may exceed 30 per cent of the final cost of the product.'

The limited degree of transparency required by the Act has in practice resulted, in many instances, in 'disclosure' of remuneration arrangements in FSGs being convoluted and opaque, and in a lack of transparency on insurance quotation documentation relating to commissions payable to insurance intermediaries as well as broker fees.

The extent to which existing practices have led to consumer confusion and misunderstanding is apparent. As articulated in the ACCC Report (e.g., at pp. 181, 189, 193):

'The different types of remuneration arrangements between intermediaries and insurers... are not well understood by many consumers...

It is apparent from information obtained by the ACCC that these complex remuneration arrangements are not well understood or even known to exist by many consumers...

A recurring theme of stakeholder submissions to this inquiry is that there is confusion regarding how intermediaries (including insurance brokers and strata managers) are remunerated by insurers and who ultimately bear the cost of these payments.'

To ensure meaningful 'comparability', transparent disclosure of commissions and fees on insurance quotations is paramount. This information is essential for consumers to make an informed, educated decision in respect to insurance options or recommendations presented to them. If such information is not provided, is provided at an inappropriate time in the insurance transaction process (such as after a decision on placement has already been made) or is otherwise disclosed in a manner that is not transparent – consumers will necessarily be making decisions based on incomplete and imperfect information.

Legislating for such a simple, common-sense and targeted reform initiative would immediately improve consumer outcomes in terms of disclosure and transparency around product pricing and comparability, and any changes should be easy for insurance intermediaries to implement.