INSURANCE COUNCIL OF AUSTRALIA

SENATE ECONOMICS REFERENCES COMMITTEE

INQUIRY INTO AUSTRALIA'S GENERAL INSURANCE INDUSTRY

Submission from the
Insurance Council of Australia

17 February 2017

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INSURANCE COUNCIL OF AUSTRALIA

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1. Executive Summary

A strong, stable and innovative general insurance industry is an essential component of a modern Australian economy. The industry employs approximately 60,000 people and on average pays out about $125 million in claims each working day[1]. General insurance encourages people and businesses to make productive investments that support and drive economic activity and contributes greatly to recovery after natural catastrophe.

Between 2001 and 2016, home[2] and strata insurance premiums in Australia have increased at higher rates relative to wage growth. However, a range of factors need to be considered when making such a comparison. Matters such as an increase in the number of natural disasters, higher claim volumes and amounts and costs associated with meeting those claims, higher asset values and sum insured amounts, higher rebuilding costs, changes to regulatory[3] requirements and higher global reinsurance costs. In contrast, responding to a different set of circumstances, car[4] insurance premiums have grown at a markedly slower rate.

Australia's general insurance market is highly competitive. It is important to recognise that pricing is only one aspect of competition; general insurers compete vigorously with diverse product offerings, coverage and claims servicing and performance. Premium trends should also be seen against the financial performance of the general insurance industry, which has experienced volatile returns in the past. Over recent years, the industry has experienced a marked deterioration in financial performance.

Evidence is lacking that price comparison websites (PCWs) reduce the cost of insurance for consumers. However, there is considerable research which shows that PCWs exacerbate the already strong inclination for consumers to focus on price rather than whether the policy actually covers the risks they face. There is also serious concern that PCWs lead to policy features being stripped out in order to enhance the policy's price attractiveness.

Such shortcomings result from the nature of general insurance when intermeshed with PCW methodology and are not remedied by the establishment of an "independent" comparison service. The rare examples of independent services such as Norway's Finansportalen and the Australian Securities and Investments Commission (ASIC) run PCW for home and contents insurance in North Queensland have failed to spark consumer interest and use.

The Insurance Council is committed to achieving better, more satisfactory outcomes for consumers buying general insurance and to this end has undertaken large scale consumer research as the basis of a major project on product disclosure. How to facilitate greater comparability between policies will be a key element of this work.

[1] Based on data from the Australian Bureau of Statistics (ABS) and Australian Prudential Regulation Authority (APRA).
[2] In this submission, home insurance refers to home building insurance.
[3] Such as the final implementation of APRA's *Life and General Insurance Capital Standards* (LAGIC) in January 2014.
[4] In this submission, car insurance refers to comprehensive car insurance.

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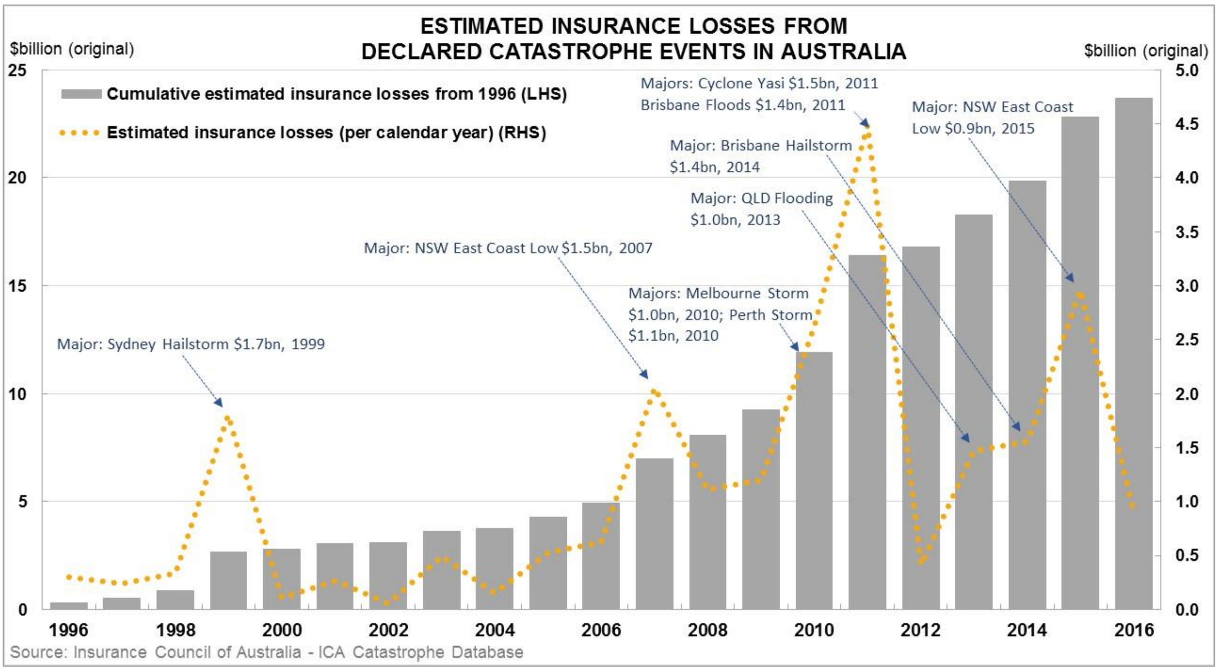
2. Introduction

Through the efficient management of risk, the general insurance industry plays an essential role in supporting the everyday activities of individual Australians, communities and the broader operation of the Australian economy. In particular, the industry plays a critical role in protecting the financial well-being of individuals, households and communities by restoring their standard of living and helping communities recover following natural catastrophes.

The contributions of the general insurance industry to the recovery of communities from natural catastrophes over recent years are significant not only in terms of the billions of dollars of claims paid, but also because of the evolving risk mitigation and emergency management initiatives that make for more resilient Australian communities. The Insurance Council's estimates show that insurance losses from declared catastrophe events in Australia over the past 2 decades total around $24 billion[5] (Chart 1 refers).

Chart 1



The Insurance Council's submission focuses on the following areas:

- The role and value of general insurance and the need for premium pricing to be risk-based.
- Trends in insurance premiums for home, car and strata, relative to wages.
- The level of competition in the general insurance industry.
- The Insurance Council's work to supplement the existing mandated disclosure regime with initiatives to enhance transparency in the industry.
- The Insurance Council's position on the role of comparison services in the general insurance industry.

[5] Insurance Council of Australia *Catastrophe Database*. Estimated loss value from 1996 to 2016 (in original dollars).

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3. The role and value of general insurance

The key role of insurance in an economy is the mitigation of insurable risk. Through the acceptance and pooling[6] of such risks, general insurance improves economic welfare in Australia by reducing the cost of self-insurance and freeing resources for more productive uses. Insurance helps ensure that risks are more efficiently allocated and, at a practical level, that individuals and businesses in Australia can pursue economic activities secure in the knowledge that risk has been transferred to their insurer.

Indeed, insurance is not the only mechanism for managing risk – for example, risk can be mitigated by preventive action or simply borne by individuals or businesses. However, risks are efficiently allocated when those best placed to bear the risks actually do so. In other words, when the parties to whom risks are allocated bear and manage those risks at the lowest possible social cost, the allocation of risk-bearing is said to be efficient. Therefore, distortions to the efficient pattern of risk-bearing would impose unnecessary social costs, and hence reduce economic welfare and living standards.

Although some risks may be more efficiently borne through other mechanisms (for example being managed by governments through the tax and transfer system), general insurers are well placed to provide insurance tailored to specific circumstances and to encourage appropriate management of the risks by individuals and businesses.

If individuals or businesses are forced to bear too much risk, they modify their expenditure and investment plans. Having access to insurance enables individuals and businesses to engage in activities that otherwise would be too fraught with risk, enabling many expansionary initiatives to occur that would otherwise be set aside or curtailed.

For example, if individuals are left bearing too much risk because suitable insurance products are not available, they may choose not to build or renovate a home or relocate to take up a new job opportunity in another town or city. Businesses may not invest in plant and equipment or hire more staff if insurance was not available to cover the risk of fire or theft.

[6] Insurable risk is mitigated through pooling, which aggregates and shares individual risks among a group of similarly exposed individuals and companies. Importantly, where individual risks obey the 'law of large numbers', pooling has the advantage of making more certain at the aggregate level what is uncertain at the level of the individual.

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4. Premium pricing needs to be risk-based

If insurance is to be economically efficient and commercially viable, rigorous risk assessment should determine the underwriting criteria and pricing. This is the basic principle that underpins the sustainable operation of insurance models. This allows insurers to offer insurance at a price appropriate to insureds and enables insurers to put aside reserve funding for future liabilities. Importantly, this also enables insurers to target important risks and provide a diverse range of insurance products for Australian communities.

In pricing risks, insurance companies give a signal to the market as to how they see that risk. In a competitive market such as Australia, risks with a greater severity and/or frequency are priced higher than risks with less of each. If a pricing signal is lost or distorted in any way, for example by way of government intervention, market information may be lost.

The premiums paid by insureds need to be sufficient to cover costs of claims, taxes, levies and stamp duty, reinsurance, internal expenses and margins. On top of this, insurers must meet strict regulatory requirements and set aside enough regulatory capital to meet the prudential capital requirements set by the Australian Prudential Regulation Authority (APRA), so that there are sufficient funds to potentially pay many claims at once, such as to respond to a natural catastrophe. The costs incurred by insurers can also be partly offset by investment income that may be made on insurance and capital reserves.

Claims costs are estimated by insurers based on a combination of historic claims statistics, actuarial models and forecasts. This involves analysing past exposure and claims information to derive assumptions that are expected to represent future trends. Unlike other industries, a large portion of claims costs are uncertain for insurers, and the cost of managing this uncertainty is a key factor that influences premiums. If there is a lack of relevant data or imperfect knowledge, this impacts the assessment of claims costs and the ability to calculate, with precision, a premium for a specific risk. `

The higher the uncertainty, generally the higher the premium will be set to hedge against this uncertainty. Similarly, where there is asymmetric information between insurers and insureds, insurers need to protect against adverse selection that can lead to a higher weighting of ‘bad’ risks compared with ‘good’ risks that can affect the risk pool.

The aim is to minimise the amount of cross-subsidisation between risk pools so that individual policy holders pay an appropriate premium commensurate with the risk exposure. As the quality of insurers’ statistics has improved over time and the availability of external data and models has increased, pricing models have evolved to become more refined.

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5. Home, car and strata insurance premiums and wages[7]

The Committee has been asked to inquire into the cost of home, strata and car insurance cover over the past decade in comparison to wage growth over the same period. We have provided the Committee data spanning over 15 years to help facilitate a longer term view of premium trends in these markets. In looking at the trends in home and strata insurance premiums, it is important to understand the key drivers impacting insurance premiums.

The increases that can be seen in home and strata premiums were driven by a multitude of factors, such as the number of natural disasters, higher claim volumes and amounts and costs associated with meeting those claims, higher asset values and sum insured amounts, higher rebuilding costs, changes to regulatory[8] requirements and higher global reinsurance costs. Anecdotal evidence from members available to the Insurance Council indicates however, that over the past 2 years home and strata premiums have remained broadly unchanged.

Car insurance premiums have risen at a slower rate relative to wages and have remained largely unchanged over the past 4 years. One reason for this trend in car insurance premiums is that the average claim size for car insurance has increased at a similar rate to premium growth.

Observed trends in general insurance premiums must be considered against the financial performance of the industry. Data from the Australian Prudential Regulation Authority (APRA) shows that the financial returns of the general insurance industry can be volatile from year to year. More recently, the general insurance industry has experienced a marked deterioration in financial performance relative to long term averages.

It is critical that the general insurance sector remains financially strong and stable, so that it can continue to meet its claims liabilities. Indeed, the collapse of the HIH Insurance Group in 2001 continues to serve as a reminder of the importance of maintaining system stability. As pointed out by the Australian Treasury, the HIH collapse had far-reaching consequences for Australian communities and a negative impact on consumer confidence[9].

Furthermore, it is also important to recognise that changes in insurance premiums and wages are driven by different factors. As recently explained by the Reserve Bank of Australia[10], recent trends in wages growth in Australia reflect several factors including increased spare capacity in the labour market, a decline in expectations of future consumer price inflation and a lower terms of trade and consequential fall in mining investment.

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[7] This section provides analysis on trends in home and car insurance premiums relative to trends in Australia's national wage price index (WPI). The data for home and car insurance premiums is from Insurance Statistics Australia, while the information on strata insurance premiums is from the Australian Government Actuary. Data for the WPI is from the Australian Bureau of Statistics' (ABS) September 2016 *Wage Price Index, Australia*. The ABS' trend series has been indexed to facilitate comparison with the insurance premium indices used in this submission.

[8] Such as, the full implementation of APRA's *Life and General Insurance Capital Standards* (LAGIC) in January 2014.

[9] Australian Treasury, *Economic Roundup* issue 1 2015, Article 3: '*The HIH Claims Support Scheme*'.

[10] Reserve Bank of Australia, June Quarter 2015 *Bulletin*, '*Why is Wage Growth So Low?*'. Pages 9 and 10.

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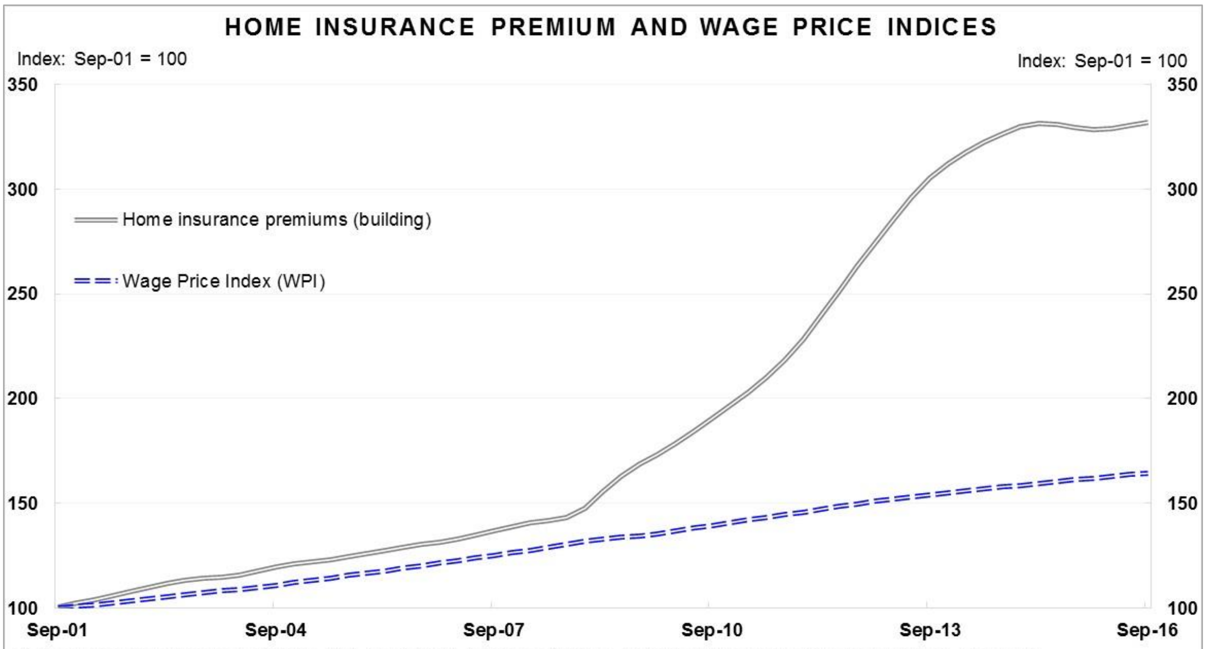
5.1 Home insurance premium trends

Over the past 15 years to September 2016, average home insurance premiums in Australia increased at an average annual rate[11] of around 8.3 per cent. Australia's Wage Price Index (WPI) increased at an average annual rate of around 3.4 per cent over the same period (Chart 2[12] refers). More recently though, Chart 2 also shows that home insurance premiums have experienced subdued growth. Since the beginning of 2014, home insurance premiums have grown at an average annual rate of around 1.7 per cent. In contrast, the WPI has grown at an average annual rate of around 2.1 per cent over the same period.

Chart 2



Sources: Australian Bureau of Statistics (Cat. No. 6345.0), Insurance Statistics Australia and Insurance Council of Australia. Trend data.

Rising premiums for home insurance have been driven by sharp increases in claims volumes, higher claim amounts, and substantial increases in the costs associated with meeting those claims, for example the cost of rebuilding. Over recent years, weather-related and other natural catastrophes in Australia and in other regions around the world have had huge flow-on consequences for the insurance sector globally such as significantly increased reinsurance costs. In 2011 for example, cyclones, severe storms, floods and bushfires ravaged many parts of Australia, which led to record claims levels. The estimated insurance losses from declared catastrophe events in Australia that year was $4.5 billion[13].

Other relevant factors are the rapid expansion in the availability of flood cover in Australia. In 2008, flood cover was only available for only 3 per cent of relevant policies. This had grown by 2015 to 96 per cent of policies. Furthermore, as a result of the implementation by 1 January 2014 of the outcomes of APRA's Life and General Insurance Capital (LAGIC) review, it has been estimated that the regulatory capital requirements of the general

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[11] Compound annual growth rate (CAGR), generally expressed as *CAGR = (end value/beginning value)$^{(1/\#years)}$ – 1*.

[12] The insurance premium data in Chart 2 do not represent dollar values. They are indices that are derived by indexing the original data, provided by Insurance Statistics Australia, to the September quarter 2001. The indices have then been smoothed by applying a moving average technique, making it easier to identify the underlying trends.

[13] Insurance Council of Australia *Catastrophe Database*. Estimated loss value for 2011 (original dollars).

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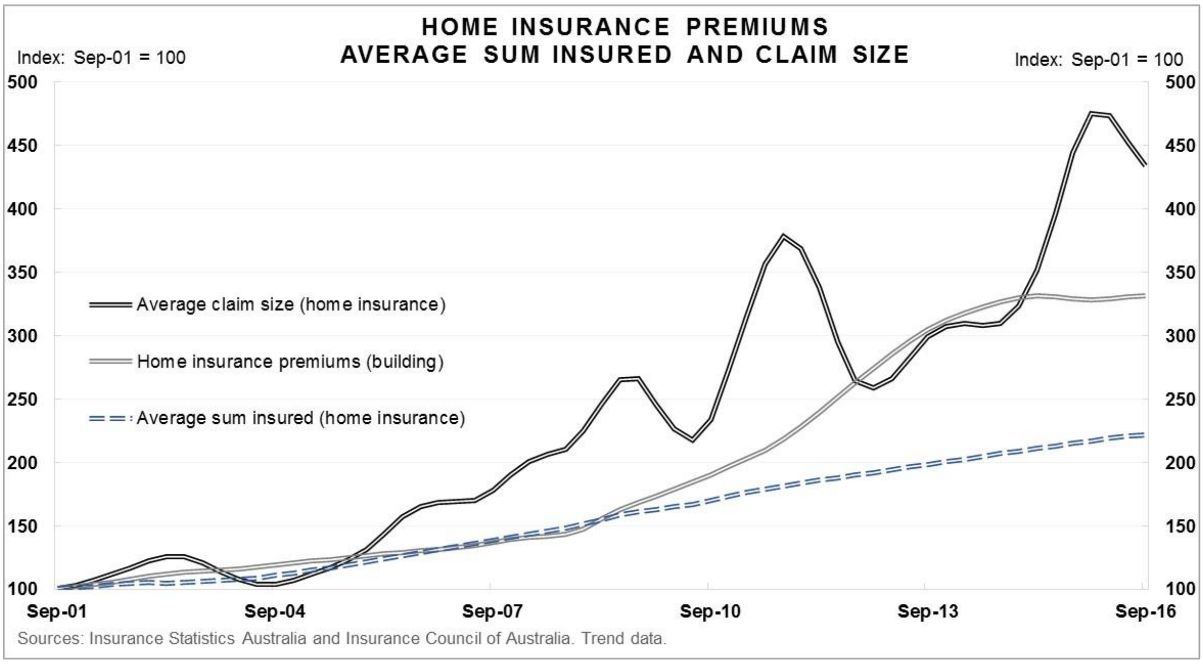
insurance industry increased by 2 per cent.[14] Such an increase in capital could only be achieved through an increase in business costs.

Government taxation also plays a role, with insurance policies subject to varying levels of stamp duty in all Australian jurisdictions apart from the ACT. It is notable that the affordability of insurance in Queensland was not helped by the increase from August 2013 in stamp duty on retail insurance in that State to 9 per cent from 5 per cent.

It should also be noted that the low investment returns which have characterised global markets in recent years have placed increased pressure on insurance underwriting and hence premium levels to reflect closely the cost of the risks being managed.

Chart 3, provided below, shows how increases in the average sum insured and average claim sizes for home insurance have affected average home insurance premiums in Australia. Over the past 15 years to September 2016, the average sum insured for home insurance increased at an average annual rate of around 5.4 per cent, while the average claim size increased at an average annual rate of around 10.2 per cent over the same period. While growth in average home insurance premiums have moderated since 2014 (average annual growth of around 1.7 per cent), the average sum insured and average claim size for home insurance have increased at markedly higher average annual growth rates of around 3.7 per cent and 14.5 per cent, respectively, over the same period (Chart 3 refers).

Chart 3



[14] Finity Consulting, '*d'finitive APRA GI Statistics*'. Published August 2014. Page 1.

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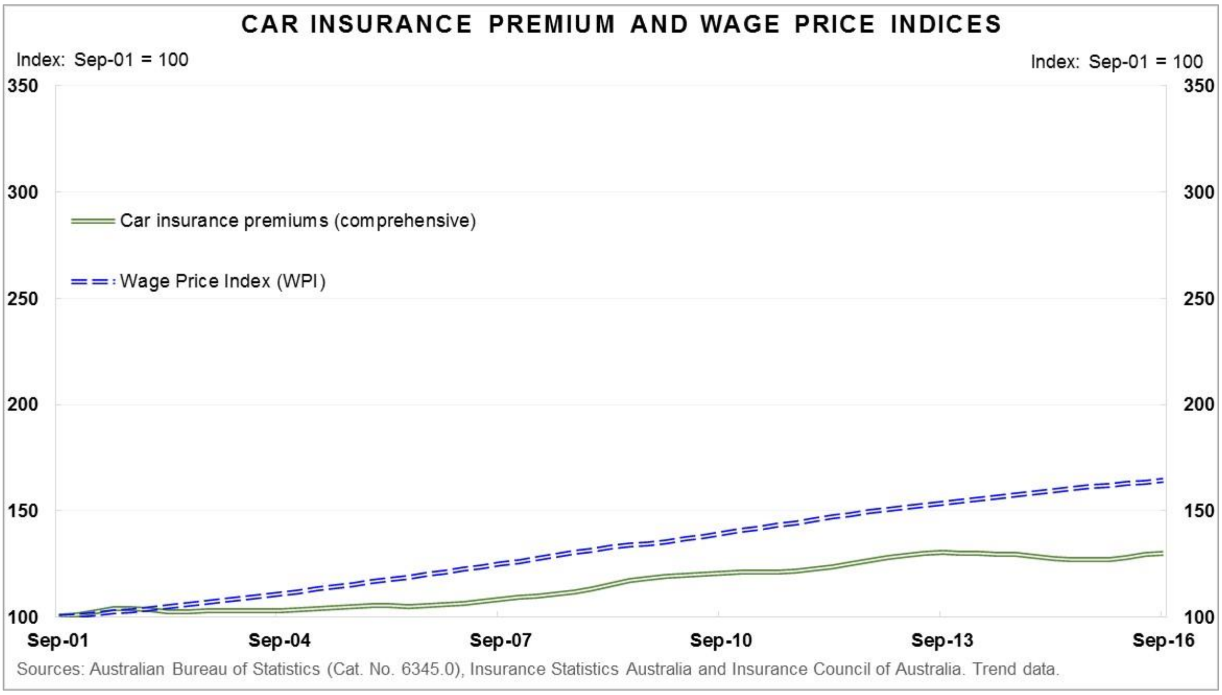
5.2 Car insurance premium trends

Over the past 15 years to September 2016, average car insurance premiums in Australia increased at an average annual rate[15] of around 1.7 per cent (Chart 4[16] below refers). This is lower than the growth in Australia's WPI over the same period (recording an average annual rate of around 3.4 per cent).

Since the beginning of 2014 however, car insurance premiums experienced no growth. In contrast, Australia's WPI increased an average annual rate of around 2.1 per cent over the same period (Chart 4 refers).

Chart 4



Similar to the situation for home insurance premiums, changes in average claim sizes also affect car insurance premiums[17]. However, unlike home insurance premiums, the growth in the average claim size for car insurance has moved along a similar trajectory to car insurance premiums.

As shown in Chart 5 below, over the past 15 years to September 2016, the average claim size for car insurance increased at an average annual rate of around 1.5 per cent, which is broadly in line with the growth in car insurance premiums over the same period (average annual growth rate of 1.7 per cent). This is a key factor underpinning the observed trend in average car insurance premiums.

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15 Compound annual growth rate (CAGR), generally expressed as $CAGR = (\text{end value}/\text{beginning value})^{(1/\#years)} - 1$.

16 The insurance premium data in Chart 4 do not represent dollar values. They are indices that are derived by indexing the original data, provided by [Insurance Statistics Australia](), to the September quarter 2001. The indices have then been smoothed by applying a moving average technique, making it easier to identify the underlying trends.

17 Data for average sum insured amounts for car insurance is not available.

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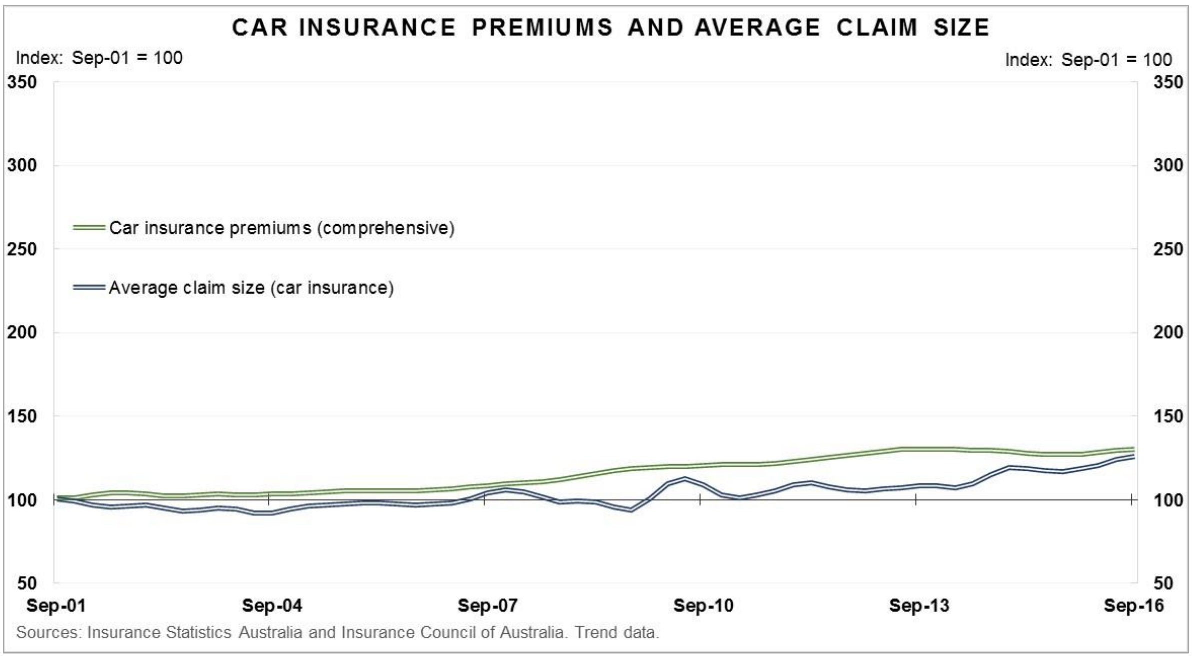
Chart 5



5.3 Strata insurance premium trends

Strata insurance premiums, like other insurance premiums, are risk based. However, we consider that it is important to clearly distinguish strata insurance from home and car insurance. Strata insurance (also known as body corporate cover in some states) is chiefly a specialist commercial insurance product that covers common property under the management of a strata title or body corporate entity. Each strata insurer develops and offers a unique commercial product in accordance with its underwriting appetite.

Strata managers or body corporates purchasing strata insurance generally use a broker or specialist underwriting agency to act on their behalf to negotiate cover. We note that the broker's client would not generally interact with the insurer during contract negotiations. Consequently, we would caution against making generalised comments about strata insurance together with retail general insurance products, such as home or car insurance.

As there is no regular collection of data on strata insurance premiums, the Insurance Council has used for this submission the analysis in the Australian Government Actuary's (Government Actuary) second report[18] on its independent review of strata insurance price rises in North Queensland, which was released on 6 June 2014. The Government Actuary's report is the most authoritative and up-to-date source of information on average strata premiums in Australia.

The Government Actuary report explored strata premium trends across a number of geographic areas in Australia, including Adelaide, Brisbane, Gold Coast, Melbourne, North Queensland and Sydney. It also considered the reasonableness of any variation in premium pricing across those geographic areas.

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[18] Australian Government Actuary, '*Second Report on Strata Title Insurance Price Rises in North Queensland*', 6 June 2014.

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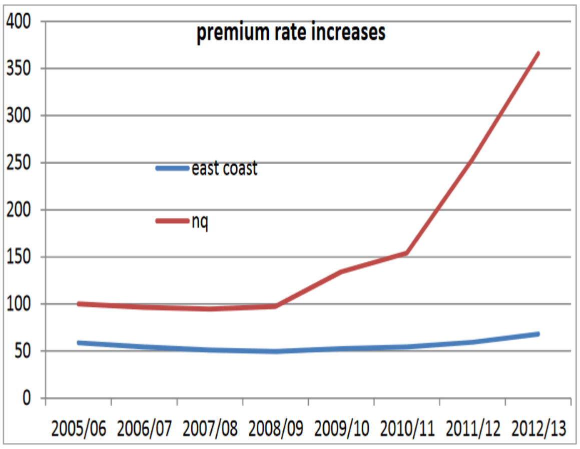
The Insurance Council has used the information in the Government Actuary Report, which covers the period from 2005-06 to 2012-13, to compare changes in strata insurance premiums to wage price growth.

Between June 2006 and June 2013, Australia's WPI increased by around 28 per cent (Chart 6 refers). The Government Actuary report shows that strata premiums for the Australian east coast centres[19] increased at a similar rate relative to Australia's WPI over the same period (Chart 7 refers)[20].

Chart 6

Chart 7



Sources for Charts 6 and 7: Australian Bureau of Statistics (Cat No. 6345.0), trend data; and the Australian Government Actuary, 'Second Report on Strata Title Insurance Price Rises in North Queensland', released 6 June 2014. Page 19.

The Government Actuary report found that the premium increases experienced in North Queensland, particularly over the few years leading up to 2011-12, were a result of numerous factors, such as historical under-pricing, increases in the cost of reinsurance and losses caused by a number of natural disasters[21].

It concluded that the rate of the increase in strata premiums in North Queensland was related to how strata insurers in high-risk areas were experiencing high losses compared with the premiums being collected. The Government Actuary report found, for example, that claims costs in that region were both higher and more volatile than those in the east coast centres during the 8 year period of its investigation[22] (Charts 8 and 9 below refer).

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[19] In the Australian Government Actuary report, 'east coast centres' refers to Adelaide, Brisbane, Gold Coast, Melbourne and Sydney.

[20] Australian Government Actuary, '*Second Report on Strata Title Insurance Price Rises in North Queensland*', released 6 June 2014. Page 19.

[21] Australian Government Actuary, '*Second Report on Strata Title Insurance Price Rises in North Queensland*', released 6 June 2014. Pages 3 and 4.

[22] Australian Government Actuary, '*Second Report on Strata Title Insurance Price Rises in North Queensland*', released 6 June 2014. Pages 10, 11 and 24.

Chart 8

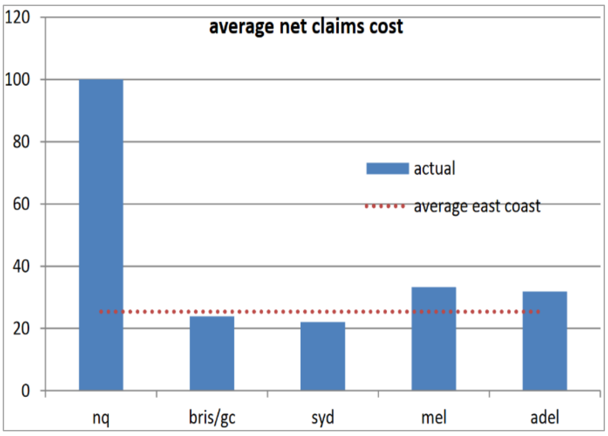
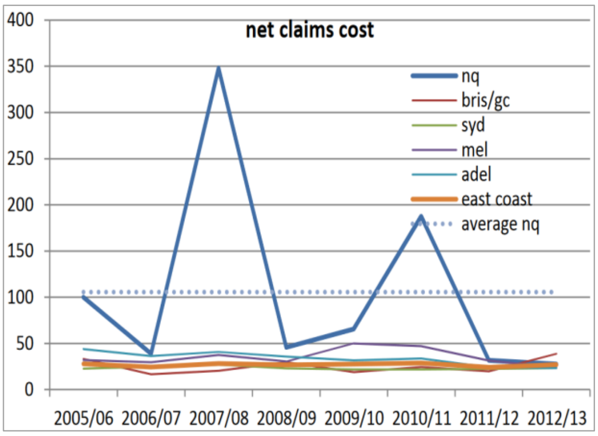


Chart 9



Sources for Charts 8 and 9: Australian Government Actuary, 'Second Report on Strata Title Insurance Price Rises in North Queensland', released 6 June 2014. Pages 10 and 11.

In this regard, it is crucial to understand why in some parts of Australia the risks to property are more significant than elsewhere. Cyclone-prone areas are exposed to greater risks and as a consequence are more expensive to insure than less-hazardous regions. Insurers are required to operate in a financially prudent manner under Australian law and must take into account the geographical risks.

This is strongly illustrated by work done for the Insurance Council's submission[23] to the Northern Australian Insurance Premiums Taskforce. Analysis of Policy in Force data showed that premiums were higher, on a like for like basis for some north Queensland buildings. These were predominantly located near the coast and, based on year of construction data, were not compliant with the cyclone wind code.

Notwithstanding this however, it is also important to note that many strata unit holders now pay, on average, premiums on parity with those paid by the average household in the same location. Strata insurance is available in all markets at a price that is consistent with the risks and with the cost of insurance for stand-alone households.

5.4 General insurance industry financial performance

It is important to balance any views on changes in general insurance premium levels against the broader financial performance of the industry. Our analysis, using data released by APRA[24], indicates that there has been a deterioration in the financial performance of the general insurance industry over recent years, relative to historic long term[25] performance.

Chart 10 below shows that total net profit after tax in the year ending 30 September 2016 for the Australian general insurance industry was $3.1 billion. While this was up from $2.4 billion in the previous year, it is down around 25 per cent from the longer term 13 year average[26] of $4.1 billion.

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[23] Insurance Council of Australia's submission of 18 September 2015, refers.
[24] APRA September 2016 *Quarterly General Insurance Performance Statistics*.
[25] Captures APRA data 4 quarters ending Sep-03 through to 4 quarters ending Sep-16.
[26] Captures APRA data 4 quarters ending Sep-03 through to 4 quarters ending Sep-16.

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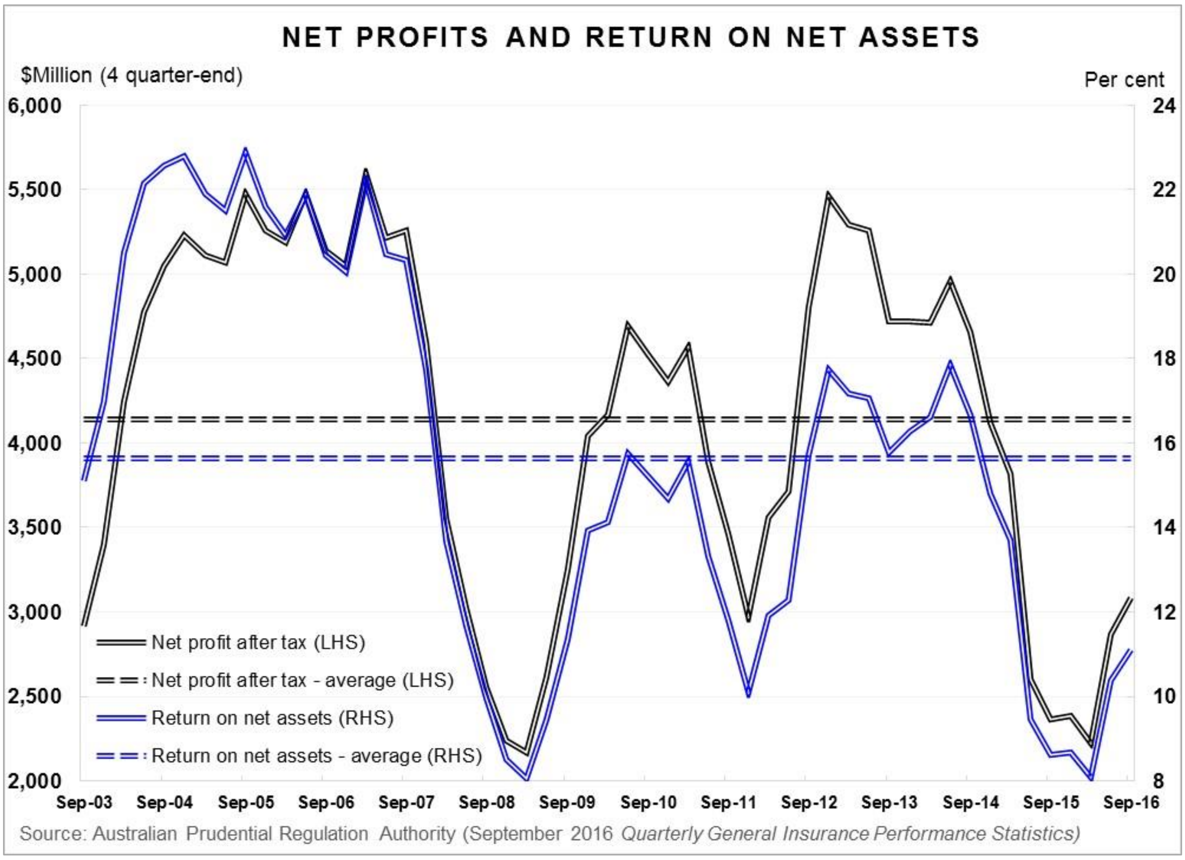
The lower level of industry net profit has had a noticeable impact on industry return on net assets, which measures how effectively and efficiently the industry has been able to use its assets to generate earnings. Chart 10 shows that the total general insurance industry's return on net assets in the year ended 30 September 2016 was around 11 per cent. While this was up from around 9 per cent in the previous year, it is much lower than the longer term 13 year average of around 16 per cent.

Chart 10



In relation to the general industry's investment performance, our analysis shows that returns have been markedly lower over recent periods relative to historic long term performance.

The general insurance industry's return on investment in the year ended 30 September 2016 was around 4 per cent (Chart 11 below refers). This is down from around 5 per cent in the previous year and 3 percentage points lower than the longer term 13 year average[27] of around 7 per cent. Return on investment is a widely used financial performance measure for evaluating the efficiency of investments.

[27] Captures published APRA data 4 quarters ending Sep-03 through to 4 quarters ending Sep-16.

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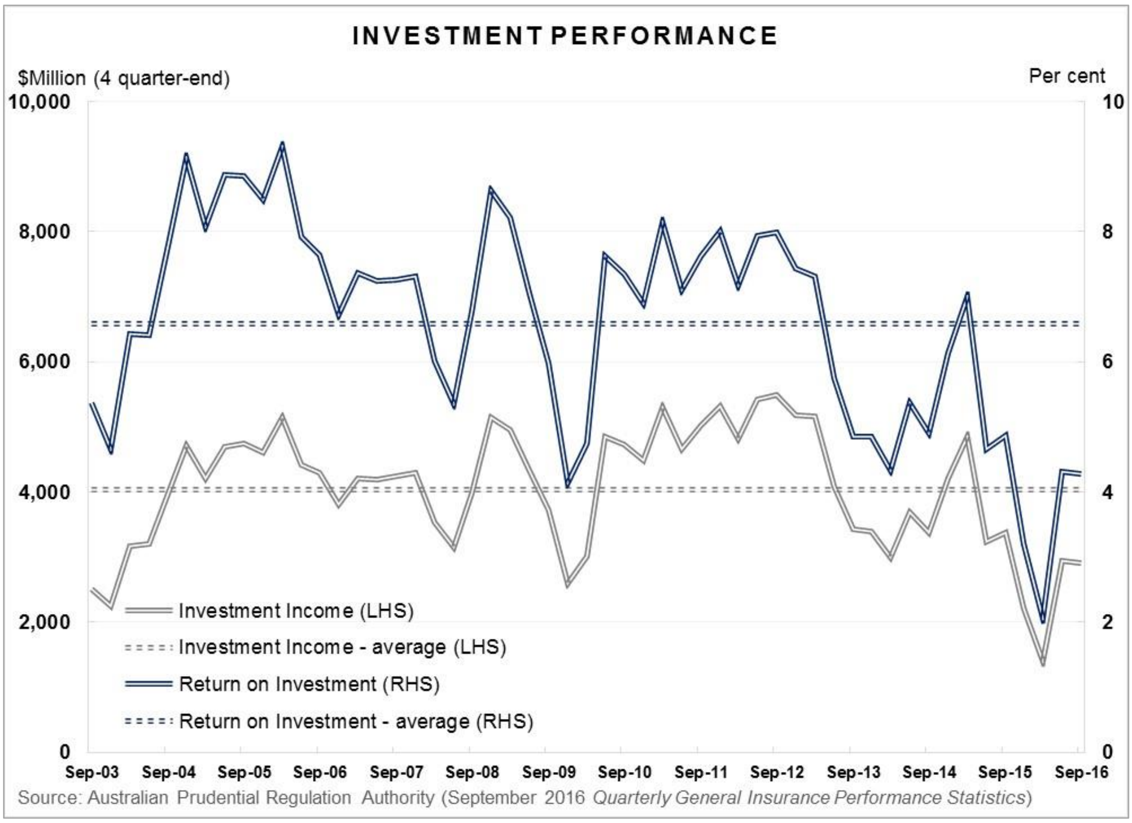
Chart 11



The Insurance Council's analysis is consistent with recent analysis by Finity Consulting (and Deutsche Bank), which found that lower investment returns accompanied by continuing low premium growth, mean the financial outlook for the general insurance industry will be satisfactory but not strong. Finity Consulting's view is that "*investment returns are at record lows, which means profitability from underwriting operations is more important than ever – yet it is getting harder to achieve*"[28].

Additionally, Finity Consulting found that low investment returns on shareholders' funds are also impacting the return on equity (ROE). As a result, it estimated that the ROEs for 2015-16 to be in the 9-10 per cent range, the first time in a few years that ROEs have been in single digits.

[28] 2016 Pendulum report, co-authored by Finity Consulting and Deutsche Bank. Released 27 July 2016.

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6. Competition in Australia's home, strata and car insurance industries

The Australian general insurance industry is highly competitive and is characterised by relatively low barriers to entry, particularly in the retail short-tail classes of insurance such as home and motor vehicle insurance.

Over recent years, these insurance classes have been subject to additional competition from APRA-authorised foreign insurers entering[29] the Australian market. New competitors are also emerging from other industry sectors (notably banks, large retail groups and motor vehicle retailers) that have engaged in aggressive advertising as well as offering lower premiums and alternative product features. The level of competition has also been enhanced through technology – particularly the internet and other digital technology – and has provided an efficient and cost-effective way for new participants to compete.

6.1 Participants in the general insurance industry

Australia's general insurance industry is comprised of a large number of insurers providing a diverse range of insurance products for consumers. As at 30 September 2016, there were 109 APRA-authorised general insurance businesses operating in Australia, largely unchanged over the past year but representing a net decline of 24 insurers over the past decade.

As recently pointed out by APRA[30], the decline largely reflects a number of mergers and acquisitions, and rationalisation within some insurance groups that held multiple licences arising from past acquisitions. APRA added that the rationalisation included the privatisation of state government insurers and demutualisation of mutually owned insurers and, in a number of such cases, their subsequent takeover.

Notwithstanding the net decline, APRA explained in its 2015 Annual Report[31] that a number of new entrants, particularly APRA-authorised subsidiaries and branches of foreign insurers, have entered the personal and commercial lines markets over the past decade, offsetting the general trend towards consolidation and adding to the level of competition present.

APRA has also observed[32] that strong levels of competition are evident in most classes of general insurance. In the personal lines market, the presence of various foreign insurers as well as large retail groups is having an impact as they seek to build market share, particularly in the domestic motor class of business.

The Insurance Council notes that the Financial System Inquiry (FSI) Interim Report[33] made a similar assessment on the level of competition in the general insurance industry, observing that although the insurance sector has generally become more concentrated, some trends are moving in the opposite direction. The FSI Interim Report remarked that a number of new insurers have entered the market, including 'Youi', 'Hollard' and 'Progressive', adding that

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[29] APRA, Submission to the Financial System Inquiry, 31 March 2014. Page 99.
[30] APRA, Submission to the Financial System Inquiry, 31 March 2014. Page 9.
[31] APRA 2015 Annual Report, released 7 October 2015. Page 20.
[32] APRA *Insight*, Issue 3 2013. Page 8.
[33] The Financial System Inquiry *Interim Report*, released 15 July 2014. Page 2-39.

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banks and retailers have also entered the insurance market, usually by white labelling products provided by the main insurers, but with some underwriting themselves.

Recent analysis by the Australian Treasury[34] indicates that there has been an intensification of competition and contestability broadly across the general insurance sector in recent years. The Australian Treasury explained that there have been new entrants offering a range of general insurance products and capturing market share by advertising aggressively and offering cheaper premiums and/or enhanced product features. It added that a number of new entrants are offering online services only, and that incumbents are responding by establishing low-cost competitors that operate online.

6.2 Concentration in the general insurance industry

The Insurance Council has conducted a general assessment of the level of concentration in the general insurance market using the Herfindahl-Hirschman index (HHI). Our assessment is based on a HHI constructed using publicly-available APRA data[35] on gross written premium as a broad measure of a general insurer's market power.

As the Committee may be aware, the HHI is widely used by regulators internationally as an initial indicator of market competitiveness. The measure is also regularly used by the Australian Competition and Consumer Commission (ACCC) both for assessing the competitive impact of proposed horizontal mergers and also more generally in assessing the level of competitiveness of particular industries.

The HHI is calculated by squaring the market share of each firm competing in a market, and then summing the resulting squared-market shares[36]. The HHI can range from close to zero to 10,000; the higher the figure, the more concentrated the market. For example, the closer a market is to representing a monopoly, the higher the concentration. If there was only one firm in a market, it would have a 100 per cent market share, and the HHI would equal 10,000, indicating a monopoly. In contrast, if there were thousands of firms with similar market shares, each would have close to 0 per cent market share, and the HHI would be close to zero, indicating nearly perfect competition.

Despite its widespread use, the HHI has a number of limitations[37]. Firstly, there are several variables unaccounted for by the HHI which can influence competitiveness. The HHI alone cannot be used to ascertain either the level of market power in an industry or the risk of collusive behaviour between firms.

Changing market conditions may also mean that estimated market shares, which form the basis for HHI calculations, are quickly invalidated. Furthermore, even when the HHI can be associated with a decrease in competition, the costs of this decrease may be offset by benefits to consumers in terms of reduced prices resulting from economies of scale due to market consolidation.

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[34] The Australian Treasury's submission to the Financial System Inquiry, released 3 April 2014. Page 64.

[35] APRA June 2016 *General Insurance Institution-level Statistics*, database, company-level, gross written premium. The Insurance Council's HHI calculations exclude 'captive' and 'run-off' general insurance companies.

[36] The HHI is expressed mathematically as $HHI = S_1^2 + S_2^2 + S_3^2 + \dots + S_N^2$ (where S represents the market share of each firm expressed as a whole number (not a decimal) and $_N$ represents the number of firms in the industry).

[37] Roberts, T 2014, '*When Bigger Is Better: A Critique of the Herfindahl-Hirschman Index's Use to Evaluate Mergers in Network Industries*': Pace Law Review, vol. 34, issue. 2.

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Under the ACCC's 2008 *Merger guidelines*[38], the ACCC will generally be less likely to identify horizontal competition concerns when the post-merger HHI is less than 2,000, or greater than 2,000 with a 'delta' (i.e. the change in market concentration as a result of the merger) of less than 100.

Assessing the impact of horizontal mergers is not the only use of the HHI by the ACCC. For example, the ACCC applied the HHI to the grocery sector as part of its 2008 Grocery Inquiry[39]. In that Inquiry, the ACCC estimated the HHI for packaged groceries in Australia to be between 2,750 and 3,000[40]. While the ACCC took this figure to indicate a high level of concentration, it considered that other factors such as barriers to entry and expansions also needed to be considered before a judgement on market competitiveness and the need for intervention could be made.

Additionally, we note that the FSI Interim Report[41] found Australia's banking sector to be relatively concentrated by international standards, noting that concentration had increased since the global financial crisis. However, the Interim Report considered that it would not be unusual for concentration to increase following a financial crisis or economic downturn. On balance, it assessed the banking sector as being in a competitive state – this reflected a number of key indicators; one of these being a deterioration in one of the banking sector's key profitability measures:

> "*Net interest margins of the major banks are around historic lows and mid-range by world standards. In the lead-up to the GFC (2004–08), the average return on equity of the major banks was around 16 per cent, and has since averaged about 14 per cent*". [42]

Based on the latest general insurance institution-level APRA data as at June 2016, the Insurance Council has estimated that the HHI for the general insurance industry is around 740 (Chart 12 refers). This is broadly unchanged from one year ago, but is about 200 points higher over the decade. The increase in the HHI over recent years appears consistent with recent assessments published by APRA and in the Financial System Inquiry Interim Report (as outlined above). The Australian Treasury also recently explained that:

> "*The level of concentration does not in itself indicate that competition in these sub-markets is uncontested. On the contrary, reports suggest that insurers in these markets are competing vigorously for business, evidenced by the plethora of advertisements by insurance providers during prime time media slots*" [43].

[38] Australian Competition and Consumer Commission (ACCC) *Merger Guidelines*. Published 21 November 2008. Pages 37-38.
[39] ACCC price inquiry into the price of groceries ('Grocery Inquiry') 2008.
[40] ACCC, '*Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*'. July 2008. Page 51.
[41] The Financial System Inquiry *Interim Report*, released 15 July 2014. Page 2-6
[42] The Financial System Inquiry *Interim Report*, released 15 July 2014. Page 2-7
[43] The Australian Treasury's submission to the Financial System Inquiry, dated 3 April 2014. Page 65.

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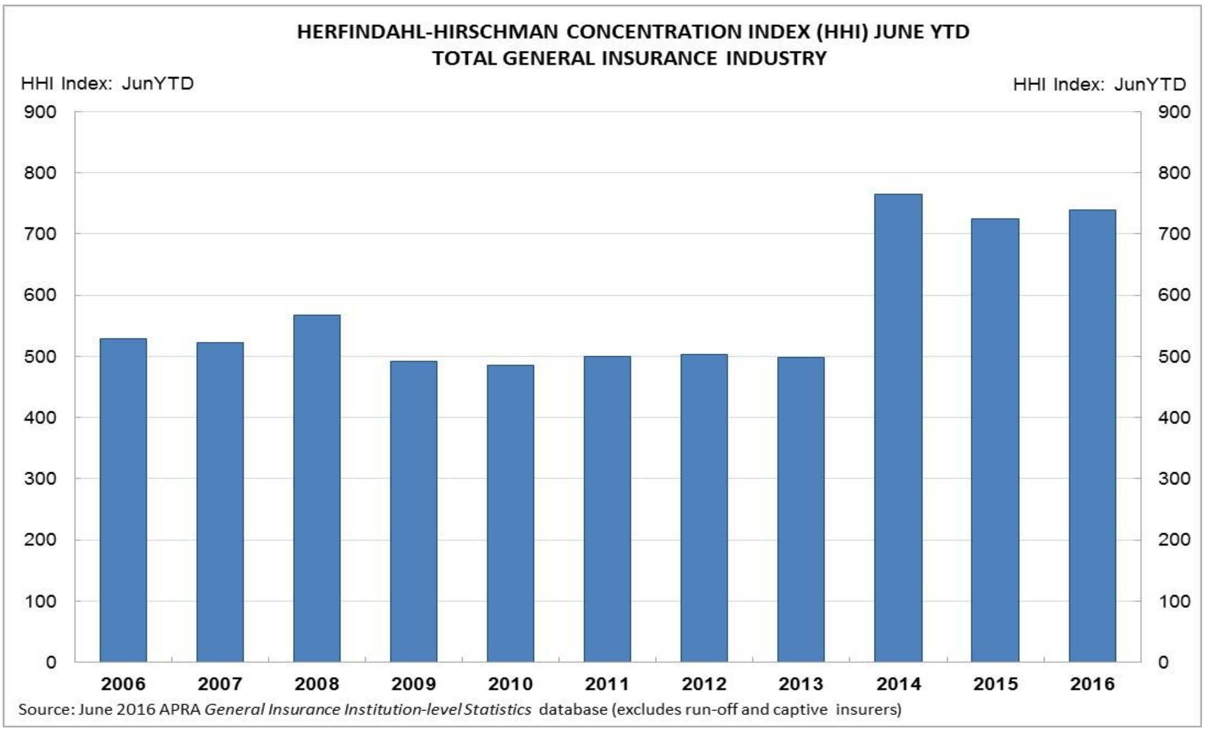
Chart 12



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7. Transparency in Australia's home, strata and car insurance industries

Transparency underpins consumer trust and is an essential component of any well-functioning market. It is necessary across the sales process; with post sales transparency, particularly during the claims process, also being important. However, given the Inquiry deals with consumer issues at the point of sale, our submission will focus on transparency in terms of what is needed for informed consumer choice and decision-making.

There are two key aspects of transparency at the point of sale necessary to facilitate informed consumer decision-making when purchasing a general insurance product:

- the price should be prominent and simple to compare with that of other products; and
- the product features and attributes, including product exclusions, should be clearly disclosed to consumers.

7.1 Transparent pricing

It is important at the point of sale that consumers can obtain the policy premium, with ease. Most insurers provide consumers with access to simple and quick internet or telephone quotes. Obtaining a quote for car and home insurance typically takes a matter of minutes. Consumers are often given the option of an annual premium or the price of multi instalment payments.

Once the consumer receives the initial quote, they also typically have access to a number of means to alter the price (for example, by reducing or increasing the excess) and determine the price of optional extra cover. This ease of obtaining a quote enables consumers to compare a number of policies within a small amount of time.

Research[44] into consumer pre-purchase behaviour recently commissioned by the Insurance Council suggests that a range of information is sought by consumers to obtain pricing information. Price is the most common stated reason by consumers for using the renewal letter, insurer website and insurance provider call centre; more than 80 per cent of consumers who used these as their main source of information indicated that they were seeking pricing information.

The Insurance Council, as part of its effective disclosure work program (described in more detail at section 7.3), is also facilitating the trialling of disclosing the previous years' premium at renewal. The objective of this disclosure is to enhance transparency around any premium changes for renewing consumers. Two insurers have committed to trialling this disclosure, and the Insurance Council is facilitating information sharing across the industry around the impact of such disclosure on consumer behaviour. If the trials result in positive consumer outcomes, wider implementation of this disclosure can be encouraged.

[44] Research involved a nationally representative survey of 2,430 consumers who had, in the last three months, taken out a motor, home building, home contents or travel insurance policy. Field research was conducted in December 2016.

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7.2 Product transparency

The transparency of product features is underpinned by the comprehensive disclosure regime applying to general insurance products contained in Chapter 7 of the *Corporations Act 2001* (the Corporations Act). The objective of disclosure, as stated in section 2013D, is to provide information that:

> "… *a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product*".

For general insurance, the key document for consumers is the Product Disclosure Statement (PDS)[45], and the legislation requires, amongst other information, the following content to be included for general insurance products:

- any significant benefits to which a holder of the product may become entitled, the circumstances in which and times at which those benefits may be provided and the way in which they may be provided;
- any significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product;
- the dispute resolution system that covers complaints by holders of the product and about how that system may be accessed; and
- the consumer's cooling off rights.

The *Insurance Contracts Act 1984* (the IC Act) imposes a number of additional disclosure obligations for general insurance policies. These disclosures relate to any non-standard term as well as any unusual term in policies, and are generally included in the PDS.

For home building and home contents insurance products, insurers are also required to provide a Key Facts Sheet (KFS) providing a summary of a policy's coverage in respect of key prescribed events (such as flood, storm, actions of the sea, etc.).

We note that the mandated disclosure regime would not generally apply to the sale of commercial products, including strata policies. In the commercial market, insurance brokers often play a key role in assisting insureds to select an appropriate product and negotiate the price and terms of cover with insurers.

Complementing the mandated disclosure documents, a range of information is also provided by insurers to aid consumer decision-making, including:

- point of sale printed and online information;
- information provided through the application process (online and phone);
- call centre facilities;
- renewal notices; and
- advertising.

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[45] A Financial Services Guide (FSG) disclosing information including about the financial services offered, remuneration received by the adviser and the conflict management process is required where financial services are provided to retail clients. The FSG is combined with the PDS for general insurance policies.

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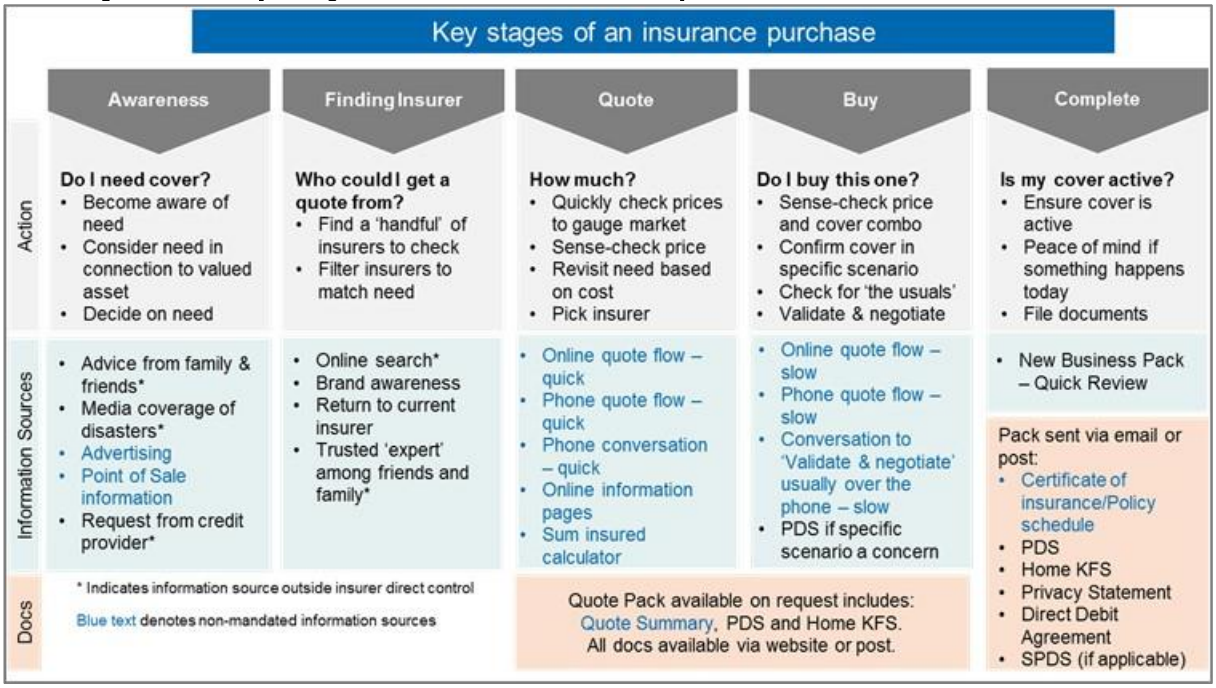
Diagram 1 below illustrates the range of information available to consumers at key stages of the purchase process.

Diagram 1: Key stages of a direct insurance purchase and information sources



7.3 The Insurance Council's Effective Disclosure Taskforce

Concerned that the existing product disclosure regime wasn't optimising consumer outcomes, the Insurance Council established an Effective Disclosure Taskforce (the Taskforce) in 2015 to develop initiatives for improvement. The Taskforce found that a major shortcoming in the disclosure regime to date has been its sole focus on information provision without the necessary regard for the consumer's ability to make use of that information.

The challenge to ensure that information is delivered at the right time, and in the right way, to improve consumer decision-making is complex. The Taskforce therefore recommended a new approach to consumer engagement with product information, and a shift from observing the mandated disclosure requirements to an approach underpinned by best practice transparency. Best practice transparency, as defined by the Taskforce, is the provision of information that encourages effective decision-making and comprises:

- **Information that is clear in purpose** – The design of the disclosure is mindful of the customer life-cycle.
- **Information that promotes consumer engagement** – Consumers want to use the disclosed information because it will make a difference to them. The disclosure is 'action' oriented.
- **Information that encourages informed decision-making** – Information which helps consumers assess the risks they want covered and the level of the cover they want.
- **Information that is targeted and timely** – Information that is immediate to the decision-making needs of the individual consumer at a particular point in time.

- **Information that is contextual** – Any disclosure of risks to consumers needs to be salient; they need to be specific and relevant to the consumer. Examples need to be concrete. Consumers are unlikely to engage with generic risk information in a useful way.
- **Information that is accessible** – Information that consumers can easily locate and prompts that reduce the friction costs of accessing the information. Information that is understood intuitively and is easily transferrable/sharable.
- **Information that is balanced** – Disclosure should be balanced in presenting the benefits and risks of the product.

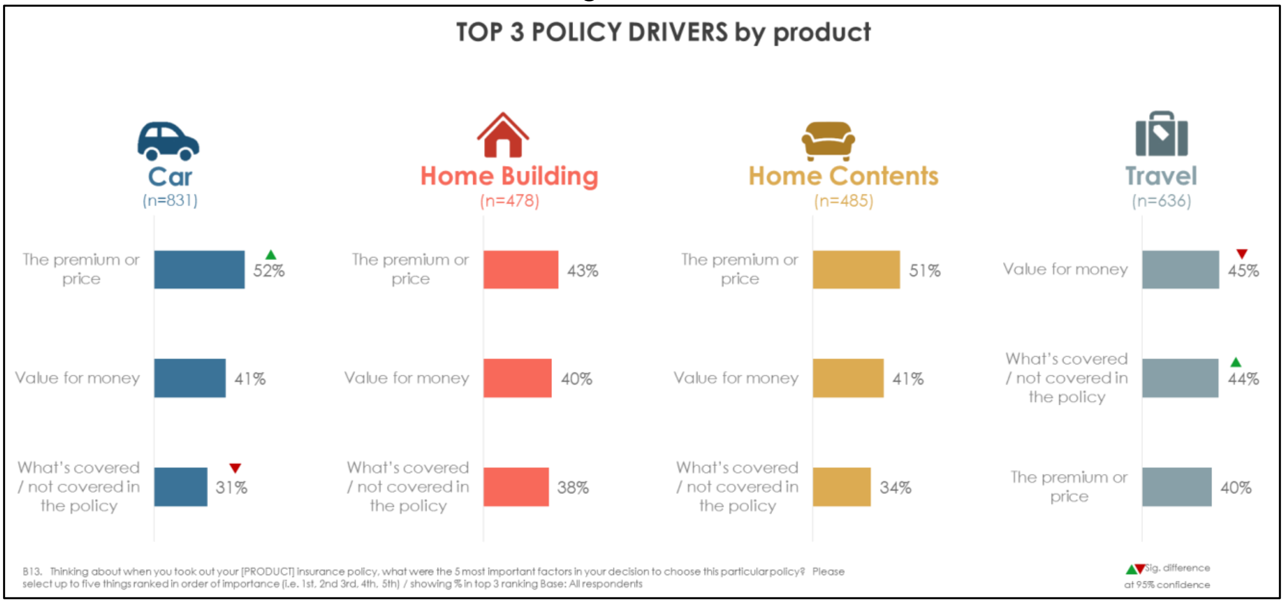
The Insurance Council's Board has endorsed all 16 recommendations of the Taskforce, reflecting a significant commitment by the industry to better facilitate consumer decision-making. The Insurance Council is currently implementing the recommendations through a two year work program, which is scheduled for completion by end-2017.

The key initiative undertaken to date has been a comprehensive research work program to better understand how consumers actually purchase general insurance products (including motor and home policies), and how information is currently used as an input to decision-making. The research has employed an ethnographic approach to observe actual consumer pre-purchase behaviours.

Findings from the research indicate that there is no single pathway to purchase; consumers approach the purchasing process and use information in widely varying ways. This suggests that any change to how consumers are engaged at the point of sale will need to be nuanced and a mandated regulatory solution is unlikely to be effective.

The research confirmed that consumers are price sensitive, and price is the key driver of policy selection for most products (Diagram 2 refers).

Diagram 2



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Of concern, the research indicated that many consumers believed they had made an informed choice on the basis that they have considered the price. However, a singular focus on price without due consideration for policy coverage (such as inclusions, level of cover, key exclusions and limits) puts consumers at risk of unintended underinsurance and an expectations gap come claim time. Given the lack of focus given to non-price related features of products, consumers generally displayed poor comprehension of common policy exclusions.

The research has provided insights into how consumers currently approach decision-making and provides the industry with a common resource to inform experimental trialling of innovative disclosure by insurers. Importantly, the research confirms the vast potential of information sources, other than the PDS, that are currently influential in aiding decision-making; including the renewal letter, online quotation platforms, insurer websites and insurer call centres.

The Taskforce also recognised the opportunity provided by digital innovation to more efficiently, and in more user-friendly formats, present information to consumers. Electronic forms of disclosure have the potential to enable insurers to better target information that is relevant to a consumer. Since 2010, there has been a number of changes to the disclosure regime to facilitate the provision of documents electronically.

However, the need for insurers to obtain explicit client consent[46] to provide disclosures electronically, is a significant barrier to more widespread use of electronic disclosure. The Insurance Council has made a submission to Commonwealth Treasury seeking law reform to facilitate electronic disclosure.

As part of the effective disclosure work program for 2017, the Insurance Council will conduct an industry review of product comparability options to identify methods of improving consumer understanding of coverage differences between products.

The current Productivity Commission inquiry into data availability and use has illustrated the potential uses across the economy of consumer data to facilitate consumer choice. As part of the Insurance Council's product comparison review, the industry will consider innovative ways consumer data can be shared and used to inform consumer choice.

[46] Approval cannot for example be implied from provision of an email address.

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8. The effect in other jurisdictions of independent home, strata and car insurance comparison services on insurance cover costs

The most common comparison service used for insurance in Australia and other developed economies is the online aggregator or price comparison website (referred to generically in this submission as PCW).

These services act as an intermediary between insurers and consumers searching for a range of insurance products, especially home, car or travel insurance products. After consumers provide their details in a quotation process online, they are presented with information on a number of insurance products to compare on a single platform.

From the information available to the Insurance Council, PCWs are typically not independent, with coverage of the entire market. They are usually owned and operated privately and funded by commission from sales of insurance. Despite undertaking research through its counterpart associations overseas, the Insurance Council is unaware of any independent service comparing all the home, strata and car insurance available in a jurisdiction.

However, we have found that there are two independent internet-based price comparison services in operation, both very different. The first is a consumer advocate run service in Norway, Finansportalen, which compares car and home insurance, financial services and banking[47]. The other is a more simplistic government-run car and home insurance comparison service operated by the Californian Department of Insurance. It is based on estimates and refers consumers to the insurer for accurate quotation and pricing.

8.1 Norway

Proposed by Norwegian stakeholders such as the Consumer Council, the Consumer Ombudsman, the Financial Supervisory Authority, and the Ministry of Children, Equality and Inclusion, Finansportalen received Government funding and went live in 2008. It has been administered by the Consumer Council since 2012[48].

By collating information, Finansportalen's purpose is to make consumers aware of the different financial services products available and make it easier to compare and switch between providers[49, 50]. Finansportalen provides consumers with an accurate price from the insurer that the consumer is able to purchase via the online platform.

A survey on the use of Finansportalen found that of those interviewed, 34 per cent have knowledge of the portal; 40 per cent have changed their banking and/or insurance arrangements within the same or to another company during the last year. Only 5 per cent that had changed their insurance did so via the Finansportalen; with most contacting the insurer themselves. Of those surveyed, 11 per cent had been looking for information on Finansportalen before they contacted the insurer. These figures do not demonstrate a great take-up of an independent comparison service.

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[47] See the Finansportalen website.
[48] See the Finansportalen website (About Finansportalen).
[49] See the Finansportalen website (About Finansportalen).
[50] The Consumer Council of Norway, Forbrukerrådet and the Consumer Ombudsman of Norway (Forbrukerombudet).

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The Insurance Council is seeking data to gauge Finansportalen's effect on general insurance premium levels in Norway. We will be pleased to provide the Committee with any relevant information we find.

8.2 California

The home and car insurance comparison service in California is significantly less sophisticated than the Norwegian Finansportalen. The Californian service prompts the consumer to select from predefined form options (4 for home and 7 options for car insurance) that which closest resemble the consumer's own scenario and the service provides premium estimates from multiple insurers[51]. The consumer is unable to purchase a policy via the website. The service provides the telephone number of the insurer so they are able to follow through an accurate quotation process and receive an accurate price.

According to a study commissioned by Insure.com[52], California had the seventh highest average car insurance premium in 2016 (out of 51 states), at a total of USD1,752. This was 32.2 per cent higher than the national average of USD1,325. In the US, car insurance prices have been steadily rising and experienced significant spikes in 2016. In California alone, rates increased by 7 per cent compared to the year before[53]. It seems clear that the Californian model offers no proven benefits in terms of improved consumer outcomes.

8.3 United Kingdom

Although not providing any examples of independent comparison services, when considering the impact of PCWs on general insurance premiums, it is useful to look at recent research and work undertaken in the UK where PCWs have played a major part in insurance distribution for over 15 years.

A purported benefit of introducing a PCW is an increase in price competition, effectively lowering the premiums for consumers. As can be seen at Chart 13 below, this has not been the case in the UK. During the period that PCWs were introduced (from 2000 to 2006), car insurance premiums remained relatively flat (according to the longest running UK motor premium index[54]).

Premiums in the Australian car insurance market over the past three to four years have remained relatively constant without the significant penetration of aggregators[55]. Following this period, car insurance premiums almost doubled in the UK from 2007 to 2011[56]. Premiums then fell in 2012 but they were still significantly above 2006 levels[57].

In 2013, the Competition and Markets Authority published a report[59] with provisional findings on its investigation into the private insurance markets, to see if there are any features of these markets which have an adverse effect on competition. The Report noted:

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[51] California Department of Insurance, Compare Insurance Premiums.
[52] Insure.com study, '*Car insurance rates by state, 2016 edition*'. Released 2 March 2016.
[53] CNBC '*Auto insurance rates rising at fastest rate in almost 13 years*'. Released 27 May 2016.
[54] The Automobile Association, AA *British Insurance Premium Index*. United Kingdom.
[55] Chart 4, section 5.2, refers.
[56] The increase in car insurance premiums in the UK chiefly reflects a sharp escalation in accident injury claims.
[57] Suncorp Group Limited, submission to the Financial System Inquiry Interim Report. Dated 26 August 2014. Page 8.

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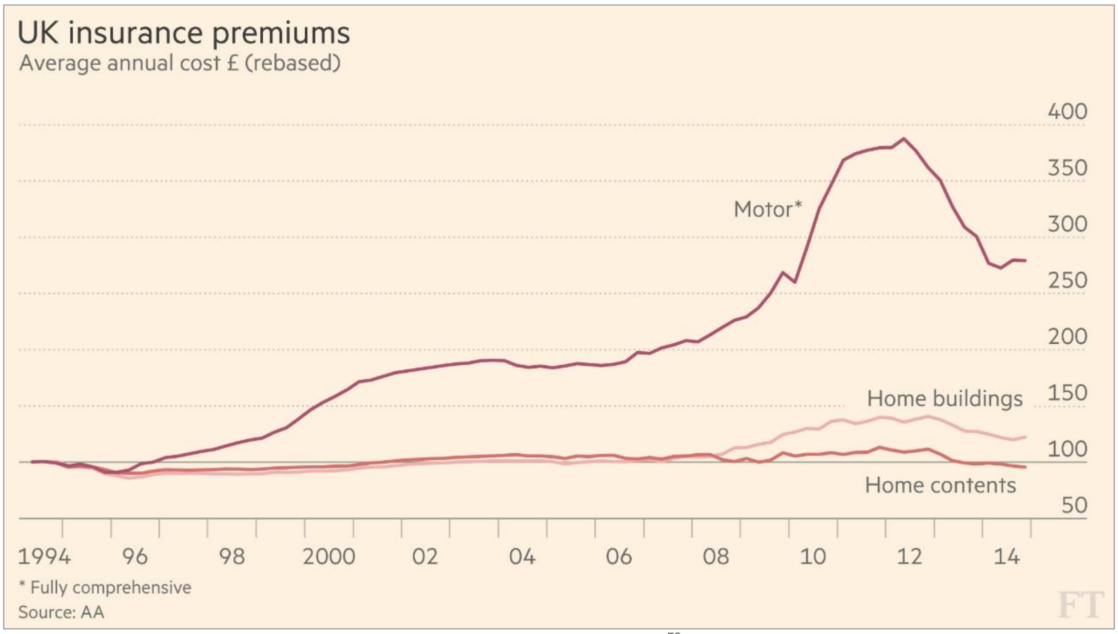
"*In the PCW market, we found that some of the contracts between insurers and PCWs contained conditions that limited price competition, reduced innovation and restricted entry. We also identified that PCWs have a degree of market power by virtue of the number of single homing consumers (that is, consumers who do not shop around between PCWs). These wide 'most-favoured nation' (MFN) clauses, and practices having an equivalent effect where a PCW takes advantage of single homing, are a feature of the PCW market. The result is that consumers pay higher motor insurance premiums*."[58]

Chart 13



Source: Financial Times[59]

Commoditisation of insurance products in the UK

Following the introduction of PCWs in the UK car and home insurance markets, insurance product offerings have become more and more commoditised, focusing on price over policy features. This is particularly the case in the UK car insurance market. The introduction of PCWs significantly changed the distribution of car insurance, contributing to what is now a low value commodity market, with insurers responding to consumer demand through PCWs to compete mainly on price.

The outcome has seen insurers reduce or remove policy features and inclusions to a basic product, so that pricing remains competitive with products ranked highly on comparison sites and visible to consumers. The risk is that a minimalistic product may not suit a consumer's particular requirements and leave them underinsured (as is discussed in more depth in section 9 of this submission)[60].

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[58] United Kingdom Competition and Markets Authority '*Private Motor Insurance Market Investigation*' Provisional Findings Report. Notified 17 December 2013. Page 2.

[59] Financial Times, '*Chart that tells a story – insurance premiums*'. Published 21 February 2015.

[60] QBE, submission to the Financial System Inquiry *Interim Report*. Dated August 2014. Page 13.

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It has been recognised that issues of the PCW distribution model may be exacerbated in the case of complex insurance products[61]. Insurance products have different attributes, features, and inclusions reflecting the individual and should not be commoditised. This is particularly the case for products where more information is required than usually can be obtained by a short set of questions and where customer engagement on the specific insurance requirements is important, such as home and contents insurance[63].

8.4 Insurance penetration rates

Table 1

Rank	Country	Insurance penetration	Rank	Country	Insurance penetration
1	Netherlands	9.5	20	Poland	1.9
2	New Zealand	5.2	23	Chile	1.8
3	South Korea	4.6	23	Malaysia	1.8
4	United States	4.1	25	Norway	1.7
5	Canada	4.0	25	Thailand	1.7
6	Germany	3.6	27	Colombia	1.6
7	Austria	3.2	28	United Arab Emirates	1.5
8	Taiwan	3.1	28	Singapore	1.5
8	United Kingdom	3.1	28	Brazil	1.5
10	Australia	3.0	31	Hong Kong	1.4
11	Denmark	2.9	32	China	1.2
12	Spain	2.7	33	Turkey	1.1
12	South Africa	2.7	33	Mexico	1.1
14	Israel	2.4	35	Saudi Arabia	1.0
15	Italy	2.3	36	Vietnam	0.9
15	Russia	2.3	37	India	0.7
15	Argentina	2.3	38	Indonesia	0.6
18	Ireland	2.2	39	Nigeria	0.5
18	Japan	2.2	40	Philippines	0.4
20	France	1.9	40	Egypt	0.4
20	Sweden	1.9	42	Bangladesh	0.2

Source: Lloyd's[62]

The insurance penetration rate indicates the general level of take-up of insurance in a country. It is measured as the ratio of premium underwritten in a particular year to the GDP. With reference to the rates of general insurance penetration in other jurisdictions (Table 1 above refers), there is no discernible connection between the existence of PCWs and rates of insurance cover in the population.

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[61] European Insurance and Occupational Pensions Authority (EIOPA), '*Report on Good Practices on Comparison Websites*'. Released 30 January 2014. Page 7.

[62] Lloyd's, '*Lloyd's Global Underinsurance Report*'. Published October 2012. Page 5.

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Jurisdictions without a significant influence of PCWs have populations covered by insurance in the same manner as those who do. The insurance markets of Australia, Canada and New Zealand do not have a significant PCW presence but these countries all have a substantially higher rate of insurance penetration than Norway, a jurisdiction with an established independent insurance PCW.

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9. The costs and benefits associated with the establishment of an independent home, strata and car insurance comparison service in Australia

The Insurance Council appreciates the argument that appropriately designed comparison services may provide benefits such as enhanced competition and lower search costs for consumers. However, the international experience gives no great confidence that PCWs lead to better overall consumer outcomes.

Poor Consumer Outcomes

The evidence presented in section 8.3 of this submission indicates that PCWs have not had a determining impact on insurance premiums in the UK car insurance market. Despite the strong presence of PCWs in the UK market, it appears that car insurance premiums in Australia and the UK have followed a similar trajectory.

The design and natural price focus of PCWs, regardless of whether they are commercially run or independently operated can create an environment which leads a consumer to purchase an insurance product that is not right for their needs. A “one stop shop” PCW may cause consumers not to detect differences between policies and choose a policy based on price or convenience. This creates a risk of under insurance or at least less than ideal coverage. The impact of PCWs may in fact run counter to the industry’s current initiatives to enhance transparency in the general insurance industry.

The Insurance Council’s recent research into effective disclosure supports the conclusion that Australian consumers are price-driven and susceptible to overlooking policy detail. The research found a significant disparity between consumer perception and behaviour. Whilst most consumers (75 per cent) indicated that they looked at all or most of the detail of their policy prior to purchase, very few consumers used the PDS (19 per cent for car and 22 per cent each for home building and contents) to inform pre-purchase decision-making.

This suggests that many consumers consider there are very few important “details” requiring consideration. Similar to overseas, the Insurance Council research found that price is the key driver of policy selection. This proven propensity should be considered carefully before taking action on PCWs which may exacerbate this short sighted focus. As noted in the discussion of the UK experience, another consequence of price driven comparisons is the stripping down of policy features to a minimum which risks encouraging under insurance.

Information provision

General insurance policies can differ greatly. While on first glance features and exclusions may appear the same, the difference often lies in the detail such as exclusions and limits. It is not practical to summarise all the matters which may be relevant for a particular consumer on one page for side-by-side comparison, and to assume that the consumer can interpret the information appropriately.

For example, using the information displayed by a PCW, a consumer may assume that two car insurance policies provide the same coverage for towing following an accident. However, each policy may have different features, for example in the number of kilometres offered or the circumstances in which the service is provided. The result is that the consumer assumes

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the two products to be the same, and perhaps selects a product that will not provide the most appropriate cover, presenting a risk of non-cover or underinsurance.

The United Kingdom's Financial Conduct Authority's (FCA) concluded in its thematic review on PCWs in the UK [63] that they did not provide clear and consistent information on the level of cover, features, exclusions and limitations. This prevented consumers from being able to compare the policies effectively in order to make informed decisions. The findings were based on the way information was presented in PCWs and the limitations of policy summaries, often directing the consumer to find the information externally. Consumers mistakenly believed that the extent and quality of cover for the policy were largely the same regardless of price.

Ranking and consumer's price focus

The PCW is a ranking system, providing results in a top to bottom order similar to a search engine. This ranking arranges the order of the policies by, for example, policy premium price, alphabetically by brand or filtered by specific product features. Recent studies in behavioural science indicate that people make purchasing decisions based on price, individual biases and short cuts[64]. The consumer is most likely to choose the policy with the cheapest price or ranked within the first few entries. PCWs exacerbate a consumer's natural tendency not to consider all policy features when purchasing a home, car or travel insurance policy.

The FCA's consumer research indicated consumers focused on price when using PCWs, and this was validated by data from the PCWs themselves[65]. The FCA found that PCWs design placed the price of the product more prominently than other policy details. These findings were consistent with a study on comparison tools by the European Commission[66].

Likewise, a report by Accenture[67] on the evolution of aggregators in the UK notes that price is the single most important factor for the majority of UK consumers when choosing an insurance provider and price sensitivity of aggregator business is between two and three times higher than comparable direct online books. EIOPA[68] notes in its report on comparison websites that consumers using a PCW, tend to over-rely on the price of products neglecting the underlying terms and conditions. A focus on price, combined with the difficulty of absorbing product information, can lead to a large number of consumers buying the cheapest product that may not be their ideal option.

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[63] See: United Kingdom Financial Conduct Authority, '*Price comparison websites in the general insurance sector*', released July, 2014; and Atticus Market Research Consultancy '*Price Comparison website: Consumer market research*' (prepared for the Financial Conduct Authority), released June 2014.

[64] United Kingdom Financial Conduct Authority, '*Applying Behavioural Economics at the Financial Conduct Authority*', Occasional Paper No. 1. Released April 2013.

[65] United Kingdom Financial Conduct Authority, '*High-Cost Short-Term Credit Price Comparison Websites – A* behavioural study for the Financial Conduct Authority'. Released October 2015.

[66] European Commission, '*Comparison Tools and Third-Party Verification Schemes*'. Accessed February 2017.

[67] Accenture, '*The Evolution of Aggregators: Impacts and Future Challenges for Insurers*'. Published 2010. Page 4.

[68] European Insurance and Occupational Pensions Authority (EIOPA), '*Report on Good Practices on Comparison Websites*'. Released 30 January 2014. Page 7.

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Market coverage

PCWs do not always provide clarity in their coverage of the market and the nature of the services they offer[69]. To meet the consumers' needs of transparency and accuracy, the independent comparison service must ensure that all[70]:

- relevant insurers and products are listed;
- product information is up-to-date and disclosure documents provided; and
- policies are updated to reflect any changes by the insurer.

This requires significant engagement with insurers, regular site maintenance and investment in technology. This is often not the case, with the ACCC concerned that comparison websites can mislead consumers in significant ways[71]. Similarly, ASIC and APRA both expressed concerns about the failure of comparator websites to disclose which insurers are being compared and how rankings are compiled[72, 73].

Cost

The cost of establishing and operating an independent PCW must also be considered. The cost to the Federal Budget in 2015-16 of the PCW for home building and contents insurance in North Queensland which ASIC inaugurated in March 2015 was over $3 million. After a lot of careful development work between ASIC and general insurers, the North Queensland website is a perhaps unique example of a website designed to avoid a focus on price. However, anecdotal evidence from discussions with ASIC indicate that the site receives only a low number of consumer visits.

The Norwegian example, as outlined above, similarly demonstrates a high cost to implement an independent comparison service. According to a report[74] by the World Bank, it cost approximately AUD2.25 million to establish Finansportalen and AUD2 million annually to maintain and operate the PCW. Considering that Finansportalen was designed for a population almost one-fifth of Australia and a smaller number of insurers and insurance products available in Norway, the cost of establishing and maintaining a similar service in Australia would be substantially higher.

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[69] United Kingdom Regulators Network (UKRN), '*Price Comparison Websites Final Report*', Released 27 September 2016.

[70] European Insurance and Occupational Pensions Authority (EIOPA), '*Report on Good Practices on Comparison Websites*'. Released 30 January 2014. Page 13.

[71] Australian Competition and Consumer Commission (ACCC), '*Empowering Consumers in the Digital Age*'. ACCC Chairman address to National Consumer Congress in Sydney, 13 March 2014.

[72] Australian Securities and Investments Commission (ASIC) Media Release '*12-304MR ASIC Warns Comparison Websites*'. Released 5 December 2012.

[73] See: Australian Prudential Regulation Authority (APRA), '*General Insurance Industry Overview*', APRA *Insight* Issue 3, 2013; and Australian Securities and Investments Commission (ASIC) Media Release '*12-304MR ASIC Warns Comparison Websites*'. Released 5 December 2012.

[74] See: The World Bank, '*Public Sector–Operated Price Comparison Websites: Case Studies and Good Practices*'. June 2013. Page 28.

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