Insurance Council of Australia

Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
Parliament House of Australia
CANBERRA ACT 2600

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To whom it may concern

Financial Services Compensation Scheme of Last Resort Levy Bill 2021

The Insurance Council of Australia (Insurance Council) welcomes the opportunity from the Senate Standing Committee on Economics (the Committee) to comment on the *Financial Accountability Regime Bill 2021* and the *Financial Compensation Scheme of Last Resort Levy Bill 2021* (the CSLR Bill). The Insurance Council made earlier submissions during the development of both Bills under consideration.[1] This letter outlines some of the insurance industry's outstanding concerns about unintended consumer impacts in relation to the CSLR Bill.

The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95 percent of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $57.4 billion per annum and on average pays out $164.2 million in claims each working day ($42.7 billion per year).

Compensation Scheme of Last Resort

The Insurance Council's principal concern regarding the CSLR Bill is the moral hazard created by the elements of cross-subsidy in the proposed design. The Insurance Council supports the Government's decision not to extend the scope of the proposed CSLR to insurance product providers. A CSLR is required where a firm subject to an adverse judgment is unable to fulfill its obligations to the consumer. A typical example would be where the Australian Financial Complaints Authority (AFCA) has issued a judgment in favour of a consumer but the financial services provider subsequently becomes bankrupt and is unable to pay. In that case, the consumer could approach the CSLR to receive the compensation award. In effect, the CSLR would operate as a "safety net" to ensure that compensation awards to consumers are honoured.

Importantly, this scenario is not applicable to insurance product providers. Insurance product providers are prudentially regulated firms and there are no circumstances within the general insurance industry that might lead to the collapse of an insurer and result in unpaid compensation. Further, the Financial Claims Scheme already exists in order to provide consumers with compensation in the event that an Australian insurer fails. The key point is that prudentially regulated general insurers have the financial

[1] Insurance Council, *Submission: Financial Accountability Regime – Consequential Amendments and Transitional Provisions* (link); Insurance Council, *Compensation Scheme of Last Resort: Proposal Paper* (link)

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capacity to pay compensation awarded through any external body or tribunal. Therefore, extending the scope of the CSLR to include prudentially regulated insurers would impose additional costs on the insurance industry with no corresponding benefits to consumers.

An additional challenge is that imposing CSLR obligations on general insurers would create a cross-subsidy that, in turn, creates a moral hazard. The Insurance Council's earlier submission outlines the concerns as follows:

- *Cross-subsidisation raises a moral hazard risk as it essentially requires firms which meet expected ethical and prudential standards to underwrite those who do not and cannot afford to pay compensation.*[2]

We note that the CSLR Bill still contains some elements of cross subsidy. In particular, we draw the Committee's attention to the following:

- The **secondary funding mechanism**. This mechanism is designed for instances where primary levies (ie. levies on the relevant sector) are not sufficient to fund outlays in a given year. In these instances, the Minister may choose to levy a broad range of sectors that are not normally within scope and who have not contributed to the shortfall.
- The **upfront levy on large financial firms**. The Bill proposes to introduce a one-off levy to fund unpaid determinations that have accumulated between the commencement of AFCA until the day on which the Bills were introduced into Parliament. The levy would apply to the ten largest financial firms. Again, the Insurance Council notes that general insurers (who would be subject to the levy) have not contributed to these unpaid determinations.

There are several concerns with this design. Requiring insurers to fund unpaid compensation claims from unrelated sectors will inevitably impact insurance affordability as costs are passed onto consumers. Such an outcome would be incongruous with recent policy initiatives of the Australian Government that seek to improve insurance affordability. Further, cross-subsidisation removes the incentives for in-scope sectors to improve professional standards as poorly performing sectors will look to larger, prudentially regulated sectors to make up any shortfall.

Cross-subsidisation therefore enhances the likelihood of poor consumer outcomes – either through placing upward cost pressure on insurance premiums, or by removing incentives to sectors to improve professional standards.

The Insurance Council reiterates our position that general insurers should be removed entirely from scope – including both the secondary funding mechanism and the upfront levy on financial institutions. We note that to ensure that the CSLR truly operates as a scheme of last resort, Treasurer Frydenberg has announced that the Government will consult on proposals to enhance the effectiveness of professional indemnity insurance in responding to compensation claims.[3] The Insurance Council looks forward to working with Treasury on this inquiry.

[2] Insurance Council, *Compensation Scheme of Last Resort: Proposal Paper* (link) 2
[3] Treasury Frydenberg, *Media Release: Government Meets Legislative Commitments in Response to Hayne Royal Commission* (link)

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Next Steps

We trust that our observations are of assistance. If you have any questions or comments in relation to our submission please contact Aparna Reddy, the Insurance Council's General Manager, Policy – Regulatory Affairs, on telephone: [redacted] or email: [redacted].

Yours sincerely

[redacted]

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