Submission by the
Financial Rights Legal Centre

Emergency Services Levy Insurance Monitor

Price Differences: New vs Existing customer, Discussion paper, November 2018

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About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took close to 25,000 calls for advice or assistance during the 2017/2018 financial year.

Financial Rights also conducts research and collects data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how CLCs utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether.

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Introduction

Thank you for the opportunity to comment on the NSW Emergency Services Levy Monitor's Discussion Paper regarding Pricing Differences: New vs Existing customers. The Financial Rights Legal Centre is not in a position to be able to answer many of the questions posed in the discussion paper since many can only, and should only be answered by the insurance sector.

However Financial Rights does seek to provide comment on a number of issues raise by the paper, namely

- differential pricing ;
- year on year disclosure;
- sum insured calculators; and
- base price increase.

Financial Rights also wishes to express our strong support for the work of the NSW Emergency Services Levy Monitor and the development of this discussion paper. The ability for the Monitor to collect and analyse pricing data is vital work to ensure that there is no serious consumer harm arising out of pricing practices and potential exploitation. If anything, it is disappointing that such critical regulatory examination takes place only within the context of the removal (and subsequent reinstatement of) the Emergency Services levy.

This paper has raised legitimate questions that insurers should answer. The findings that in the NSW general insurance market there *may* be:

- significant price discrimination leading to an identifiable "loyalty tax";
- over-insurance borne of possible inappropriate increases to the sum-insured; and
- potentially opportunistic increases in prices of base premiums coinciding with the reduction in the ESL rates

should be of serious concern for NSW consumers. We expect insurers to take these findings seriously and provide the information required of them to get to the bottom of the observations made. Financial Rights is keen to understand the industry's perspective. We believe the ESLIM's work and the Industry's positive engagement can only serve to improve transparency, increase financial literacy and potentially improve consumer outcomes.

Financial Rights believes that given the issues already identified by the Monitor, that there are strong grounds for the Monitor's remit to be extended beyond the monitoring of the ultimate removal of the levy. Ideally the monitor's functions should be a permanent fixture of the NSW regulatory landscape, be it in as an ongoing stand alone insurance pricing monitor or a clearly identified role within the Department of Fair Trading. Alternatively, ongoing examination of insurance pricing practices should be taken up at a national level by the ACCC, ASIC or APRA.

Insurers should welcome greater scrutiny with respect to pricing practices. Such scrutiny will lead to improvements in competition, transparency and reputation to an industry whose current image has been severely tarnished by poor behavior and ongoing scandals, as recently highlighted by the Royal Commission.

Differential Pricing

General insurers are broadly speaking able to freely choose the factors that they will use to set their price and do so either at a grouped level (where they set the price for like members of a group such as people in a flood zone) or at an individual level (where individual property factors come into play). This is opposed to those forms of insurance that are based on community pooling for the greater good e.g. health insurance or where restrictions are placed to ensure affordability as a social good (e.g. CTP).

General Insurers are therefore largely able to charge different prices based on say building materials, or age of driver (if there is a proven statistical basis and where anti-discrimination law allows).

There are also a number of other elements that will impact upon an insurance contract's price. These can include:

- administrative and overhead expenses
- profit margins
- net reinsurance costs
- expected claims costs
- cost of capital
- customer discounts
- price moderation
- business pricing
- government taxes, levies and duties

Overlaying this is the practice of differential pricing or price discrimination. As identified in the ESLIM Discussion paper, differential pricing focuses on customer specific factors that are unrelated to cost such as a customer's willingness to pay, the quantity of product purchased or qualities of a product and their personal attributes that act to discriminate against people where there may or may not necessarily be a strong statistical basis to support that discrimination.

As a general principal, Financial Rights supports consumers being empowered to purchase insurance products on the basis of a genuine risk mitigation partnership with insurers.

This involves to some extent price and/or risk signalling, particularly with respect to controllable risks as opposed to uncontrollable risks. In other words, risks that are within the individual's control to mitigate and will benefit society are risks that ought to be transparently priced. For example, rewarding better driving or rewarding those who undertake flood or fire mitigation work on their home. Risks that are not able to be controlled by an individual, such as their genetic make-up or those people who find themselves living in an area subject to a natural hazard arising out of climate change, lend themselves better to pooled pricing from a public policy perspective.

While it could be argued that people who move to an obvious flood plain, for example, do have some control over that decision, it should be recognised that housing affordability, developer greed and a lack of clear access to risk data all contribute to such decisions. Further, people in lower socio-economic demographics are less likely to be able to exercise genuine choice.

Financial Rights has long argued for the need to provide consumers with the full components of an insurance product's price. Component pricing would provide a healthy 'signal to consumers of the risk factors taken into account when premiums are set.' This 'risk signal' would be particularly helpful in parts of Australia that face severe weather risks. Knowing that a huge portion of your insurance's base premium is made up of fire, flood or storm risk, is incredibly valuable information to a homeowner and can lead to positive consumer and societal outcomes through say risk mitigation.

This leads to a key question raised by the Discussion Paper: Is price discrimination on the basis of the length of time owning an insurance product unfair?[1]

Price discrimination between new business and long standing customers is not always seen as a straightforward matter of unfairness. The argument most commonly raised is that it rewards engaged and motivated consumers who shop around for a good deal.

Another argument put forward is that many consumers have developed an expectation that there will be cheaper prices if they shop around, leading to increased competition for this business and the subsequent offering of prices so low that insurers are making a loss on at least the first year.[2]

However, Financial Rights believes that this form of price discrimination is solely based on the insurer's ability to earn the maximum amount of money from each individual consumer based upon factors that are not necessarily in their conscious control. Insurers should treat all their customers fairly rather than gouge their loyal customers to cross subsidise ability to attract new business.

It could be argued that this practice incentivises increased engagement among consumers with their insurance however this assumes that the ideal rational actor – one that engages with the market with full and complete knowledge - is an ideal that can be achieved. In the real world it cannot. Only a small number of disproportionately motivated people will do so, and there is no guarantee that this minority's research and decision-making will lead to optimal outcomes.

Price discrimination based on the length of time owning an insurance product naturally penalises people who are less able to engage with their insurance. This can be most of us in an

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[1] Implied in Discussion Paper Question 5: What are the pros and cons of differential pricing from the perspective of insurance companies and from the perspective of insurance consumers.

[2] https://www.abi.org.uk/news/news-articles/2018/05/insurance-industry-takes-action-on-excessive-differences-between-new-customer-premiums-and-renewals/

increasingly time poor society. But it is heightened for those who experiencing some form of vulnerability such as a low level of financial literacy, lower financial means, or an inability to engage or shop around to the extent required such as older Australians, or non-English speaking consumers.

It takes advantage of the natural tendency in most people to avoid engaging with the highly complex nature of insurance products and their pricing structures (a complexity encouraged and exacerbated by insurers themselves). Indeed the notion of a "loyalty tax" or "lazy tax" may be better described as a "confusion tax" or an "avoidance tax" since rather than being loyal – most people are so overwhelmed by the complexity of insurance and the difficulties in shopping around – complexities and difficulties encouraged by insurers – that they simply avoid doing the necessary work to swap products or shop around.

It also takes advantage of the well understood grudge nature of insurance. A loyalty, lazy, confusion or avoidance tax will therefore naturally harm the grand majority of people and particularly discriminate against those in lower socioeconomic strata or experiencing some form of vulnerability.

We also believe that consumers are being misled up front by cheaper discounted loss leader premiums. They are not receiving the full information about the likely cost of an insurance product if kept for number of years, as they tend to expect.

We therefore believe that price discrimination based on the length of time with an insurer is fundamentally unfair.

British general insurers have also recognised and acknowledged that this practice is a problem. The ABI (Association of British Insurers) and BIBA (British Insurance Brokers' Association) in May 2018 stated that:

> *Premium variation is a natural consequence of a competitive market. However, there are occasions where the differentials become marked. This is often linked to inertia and can result in poor customer outcomes.*

To address the issue the ABI and BIBA have established a set of Guiding Principles and Action Points for General Insurance Pricing. The principles are as follows:

> *1) ABI and BIBA members do not support excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.*
>
> *2) ABI and BIBA members commit to working towards better outcomes for long-standing customers. For a stable and consistent outcome, all market participants outside of the ABI and BIBA need to make similar commitments.*
>
> *3) We support the FCA's requirements on disclosure of last year's price at renewal. It is essential that all market participants meet these requirements in full.*
>
> *4) ABI and BIBA members will take action so that customers' tendency to shop around at renewal is not used to lead to excessive pricing differences that unfairly penalise long-standing customers.*

5) The ethos and approach to better outcomes for long-standing customers will be given Board or senior management level priority and formally incorporated into firms' procedures for determining the premium at renewal.

The ABI and BIBA have also committed to the following actions:

1) ABI and BIBA members should make clear in written, online or verbal customer communications that the new customer premium only applies for that year and subsequent renewal premiums may be higher.

2) ABI and BIBA members who impact the final premium paid by customers should review their pricing approach for customers who have been with them longer than five years and assess whether this approach delivers a fair outcome.

3) ABI members will actively review their customers' tendency to shop around in line with the existing ABI and BIBA Code for potentially vulnerable customers at renewal, to ensure outcomes for these customers are carefully considered against the Guiding Principles.

4) The ABI and BIBA will publish a report in no more than two years' time that demonstrates how ABI and BIBA members have sought to tackle excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.

5) The ABI and BIBA will not seek to defend cases where there are excessive differences between new customer premiums and subsequent renewal premiums that unfairly penalise long-standing customers.

We believe that the general insurance industry in Australia should commit to similar actions.

Furthermore, the UK's Competition & Markets Authority (**CMA**) (the equivalent of the ACCC) have just responded to a super-complaint from the UK Citizens Advice Bureau highlighting concerns regarding the loyalty tax and its impacts in 5 markets – one of which is home insurance.[3]

The CMA found that:

"the loyalty penalty is significant and impacts many people, including those who can least afford it. Customers rightly feel ripped off, let down and frustrated. They should not have to be constantly 'on guard' or spend hours negotiating to get a good deal. This erodes people's trust in markets and the system as a whole."[4]

They identified that the loyalty penalty

"affects many consumers across different markets and at different points in time. The exploitative practices used by some suppliers can cause serious problems for all consumers,

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[3] CMA, Tackling the loyalty penalty Response to a super-complaint made by Citizens Advice on 28 September 2018, Published 19 December 2018https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766795/Loyalty_Penalty.pdf

[4] Page 1. CMA, Tackling the loyalty penalty response

> *who do not have the time or are not able to take the steps necessary to avoid paying a penalty."*

More significantly though they found that the hardest hit were the most vulnerable in society such as the elderly, those on low incomes, or with physical disabilities or poor mental health. In other words"

> *"people who struggle to use online services, or people with poor mental health who may avoid or fear change. This means they may be more at risk of paying the loyalty penalty and may be least able to afford it."*

The CMA also identified some additional actions businesses take that exacerbate the problem including:

- *making it more difficult to leave a contract than it is to sign up;*
- *rolling over customers onto new contracts without sufficient warning;*
- *imposing 'stealth' increases in price on renewal year after year, which can lead to very significant price increases without customers being aware of it; and*
- *requiring customers to auto-renew or get rolled over when they take up a service or buy a product; in most markets there should be a choice*

We would argue that most of these apply to the Australian home insurance market.

Auto-renewal has been a regular source of complaint for insurance consumers. The law does not current prevent insurers from automatically renewing insurance policies and in some cases consumers do seek this feature out. However by structuring the sales and disclosure practice in a way that does not fully inform consumers of this renewal practice unreasonably advantages the insurer and promotes the loyalty penalty."

Financial Rights believes that a prohibition on the practice of automatic renewal in insurance should be considered. By doing so it may have the collateral benefit of engaging a consumer on an annual basis to review their insurance, review price information, cover and risk rather then "setting and forgetting". At the very least automatic renewal should be prevented from being set as a standard term of a policy. Instead automatic renewals should be a specific feature consented to at the point of purchase.

The CMA proposes a series of reforms including addressing the problem of auto-renewal. In addition to using their existing powers in a bolder fashion to "tackle harmful business practices" they recommend a series of reforms. Among them that apply to the home insurance market are:

> *Recommendation 2*

- *auto-renewal should generally be on an 'opt in' basis upfront, and include a clear and prominent option without auto-renewal in most markets;*
- *auto-renewal onto a fresh fixed term should not generally be used;*
- *customers must be sufficiently informed about the renewal and any price changes (through sufficient notifications) in good time;*

- *Publish the size of the loyalty penalty in key markets and for each supplier, through for example an annual joint loyalty penalty report.*

Recommendation 4

- *Empower intermediaries to support switching*

Recommendation 6

- *Capture and share best practice on 'nudge' remedies that have been tested and shown to work or not. Some remedies (such as requiring suppliers to give last year's price on renewal) could be rolled out across markets and potentially strengthened*

Recommendation 7

- *Consider targeted pricing regulations such as limiting price differentials or price caps, alongside other measures where there is clear harm, particularly to protect vulnerable consumers*

Specific Insurance Recommendations

- *Investigate insurance pricing practices and consider pricing interventions that limit price walking,*
- *Explore how intermediaries can continue to benefit the home insurance market*

We think consideration needs to be given to all of these approaches in Australia.

Finally we reiterate our call for the need for component pricing to be introduced. Insurers should be required to provide information as to the components in their premium pricing. Knowing what makes up the price of a premium will better inform consumers about risk and what effect mitigation strategies may have on reducing insurance premiums or what behaviours or conditions might increase premiums.

Component pricing information should apply uniformly across all insurers but will be particularly helpful in addressing a lot of the issues faced by those in parts of NSW that face severe weather risks. It would provide an easy to read, easy to understand signal to consumers of the risk factors taken into account when premiums are set

Component pricing would provide a 'signal to consumers' of the risk factors taken into account when premiums are set.

Year on Year Disclosure

In addition to the above actions, price discrimination based upon length of time of ownership can also be better identified by consumers if insurers were to expand upon the year on year disclosure idea.

The Emergency Services Levy Insurance Monitor has published an order under section 30 of the Act relating to year on year price comparisons for the issue of regulated contracts of insurance. The price comparison order requires all insurers to provide the information in the price comparison order, in premium renewal notices sent to policyholders identifying the price payable for their insurance.

Financial Rights strongly supports this order and have been arguing for its broad application to all forms of general and life insurance for some time. We understand it will be considered by Treasury in a review into disclosure and standard cover.

We however believe that the observations made in this current discussion paper on price differences raise the need to expand upon year on year disclosure to a series of years. That is providing multiple year comparisons upwards of five or ten years.

We note that multi-period price/usage notices are used elsewhere – most notably in electricity. An example AGL bill featured on its website features 14 periods on the front page of their bill.[5]

Providing multiple annual prices will present a clearer picture for people to see how, over time, their insurance prices have risen, or decreased as the rare case may be. The presence of a "loyalty" tax may present itself more clearly with this information being presented.

Such a visual/graphical description of this information would need its specification mandated to avoid presenting such information in a distorted manner.

We also continue to maintain that the year on year comparison should clearly display any difference between the new price and the previous year's price; the reasons for the change; and any substantial change to coverage (up or down).

Sum insured

Financial Rights notes the Monitor's observation that sum-insured valuations increase every year reflecting increasing building and other costs. This is, as the Discussion Paper indicates, important to ensure consumers are not caught out at the time of a claim. However we would also be concerned if these sum insured figures are increasing at a rate higher than what would appropriately be required, leading to over-insurance.

Financial Rights points to the recent findings by the ACCC and ASIC that sum insured calculator results vary wildly.

> *Despite near universal reliance from insurers in Australia on the Cordell calculator for building sum-insured, the results can vary considerably—our own research confirmed this. ASIC even found that some home insurance brands within the same insurer group even differed in their estimates. (ASIC report 415, Review of the sale of home insurance, October 2014, p. 58)*[6] *The ICA has suggested variations can also occur because:*
>
> - *the frequency of updates to data varies (quarterly/annually)*

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[5] https://www.agl.com.au/help/payments-billing/your-energy-bill-explained

[6] Page 159, ACCC, Northern Australia Insurance Inquiry, December 2018 https://www.accc.gov.au/system/files/Northern%20Australia%20Insurance%20Inquiry%20-%20First%20interim%20report%202018.PDF

- *the cost of rebuild differs from insurer to insurer based on individual arrangements with suppliers*
- *insurers' have their own intelligence about the cost of rebuild derived from previous claims costs in the area. (ICA Report Too Long; Didn't Read: Enhancing General Insurance Disclosure, October 2015, p. 36)*

There was also a high amount of distrust in sum calculators:

> *When a calculator suggested a sum insured higher than a consumer expected or variations occurred, ASIC reported that consumers had a tendency to assume the higher estimate was a deliberate sales tactic of the insurer to push up the premium, rather than an accurate reflection of current re-building costs. (ASIC report 416, Insuring your home: consumers' experiences buying home insurance, October 2014, pp. 14–15) The Effective Disclosure Taskforce made a similar finding, as did a subsequent ICA research report, which reported only 63 per cent of respondents find the home building/contents calculator trustworthy, although many consumers appear to be using them. 7 ICA Report Consumer Research on General Insurance Product Disclosures, February 2017, p. 32*
>
> *During our consultation, consumers in northern Australia also shared their scepticism of calculators and similarly suggested that automatic indexing upwards of sum insured were both just tactics to raise premiums. Insurers seem well aware of such perceptions, and yet say indexing (for example with reference to CPI or an index of construction costs) occurs as a measure to account for inflation and new purchases. (See for example, ASIC report 89, Making home insurance better, January 2007.)*[7]

Ultimately the calculation of a sum-insured is a fairly opaque process and one based on algorithms that are far from transparent.

The ACCC has recommended that:

> *Draft recommendation 1: Insurers should estimate a sum insured for customers*
>
> *The Insurance Contracts Regulations should be amended to require insurers to estimate an updated sum insured for their home insurance customers and advise them of this estimate on their renewal notice.*
>
> *This estimate should note when the information used by the insurer to form the estimate was last updated by the consumer, and direct the consumer to contact the insurer if renovations/alterations to their home had occurred since then. Where the sum insured estimate is materially higher than provided for under the policy, the renewal notice should also include a warning to the customer about the dangers of their property being underinsured.*

The ACCC states in support of this that:

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[7] Page 159, ACCC, Northern Australia Insurance Inquiry, December 2018 https://www.accc.gov.au/system/files/Northern%20Australia%20Insurance%20Inquiry%20-%20First%20interim%20report%202018.PDF

We consider that estimating the sum insured is one area where insurers could, and should, provide better guidance to consumers to lessen the risk of underinsurance. Insurers are likely to already have access to the information necessary to estimate a sum insured in relation to their customers' insured buildings. As such, they should be in a position to understand if there are material differences between the sum insured a customer has selected and the amount suggested by their own sum insured calculators.

The ACCC also recommends the following:

Recommendation 9: Disclose costs that count towards 'sum insured'

The Insurance Contracts Regulations should be amended to require that insurers clearly disclose the types of costs that will count towards the sum insured amount for buildings (such as the costs of demolition, debris removal or for professional fees) where these are not provided for through a separate allowance under the policy. This information should be provided on any sum insured calculators used by the insurer and alongside the sum insured figure.

This will help consumers understand why and how calculator estimations can differ and empower them to make more informed decisions about their nominated sum insured. It should be provided alongside the sum insured amount for a property, including in quotes for new policies, renewals and on certificates of insurance.

We support both these recommendations.

The observations by the ESLIM with respect to the sum insured reflect some of the issues raised by the ACCC and sum insured variability described above. It also goes directly to a real need to build greater trust in the use of sum insured calculators and the need for accuracy in these calculators. Financial Rights has argued in other fora, including the recent review of the General Insurance Code of Practice, that insurers should commit to regular reviews and independent auditing of the sum insured calculators. Where an error is identified with a calculator, insurers should commit to correcting the calculator and any affected consumers.

Another significant issue that is a headache for consumers (and regulators) in the use of sum insured calculators is the fact that the calculators do not provide an audit trail. Consumers regularly report that they cannot recall if they put in the incorrect information into the calculator (generating the wrong figure) or if a calculator provided them with an incorrect figure on correct information. To our knowledge calculators on insurers' websites or third party websites, generally do not currently allow for any recording of the information submitted or resulting, due to the perceived risk of the liability.

If an insurer has a calculator to be used by a consumer to determine their sum insured it should be entrenched into the sales process and the insurer should take some responsibility for any errors if an error is identified in the calculator (for example, outdated building estimates). If a sum calculator is used in the sales process, this information should be recorded and kept on a policyholder's file.

Given the central role of sum insured in the price of an insurance product, we believe there is a role for the Monitor to investigate the accuracy of sum insured calculators.

Ultimately we believe that insurers should make an enforceable commitment under the General Insurance Code to:

- provide access to an accurate and informative sum insured calculator as part of the home building insurance application process;
- engage independent experts to undertake regularly reviews and audits of the sum insured calculators and where an error is identified with a calculator that the insurer commits to correcting the calculator and informing any affected consumers;
- record all information used in a sum calculator during the sales process and keep this information on a policyholder’s file;
- standardise how extras such as removal of debris relate to the sum insured for greater ease of price comparison.

If insurers are unwilling to take this important steps towards greater accuracy and transparency, we believe regulatory intervention will be required to ensure that this takes place and confidence in the calculators be restored.

Base price increase

Financial Rights wishes to express serious concern over the observation by the Monitor that the price of new insurance product purchases increased during a period that coincided with the time that the emergency services levy rates were being phased down ahead of the originally planned removal of the emergency services levy.

We support the need for further analysis at an individual insurer level and expect insurers to work with the Monitor to establish what has occurred during this period and explain why an increase was made at this time.

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact Financial Rights on (02) 9212 4216.

Kind Regards,

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