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By email: edic@parliament.vic.gov.au

The Executive Officer
Economic Development and Infrastructure Committee
Parliament House
Spring Street
EAST MELBOURNE VIC 3002

Dear Sir/Madam

Submission to Inquiry into State Government Taxation and Debt

We welcome the opportunity to make a submission to the Economic Development and Infrastructure Committee's (**Committee**) Inquiry into State Government Taxation and Debt (**Inquiry**).

The Inquiry terms of reference require the Committee to consider and report on the impact and effectiveness of increased State Government taxation (including land tax, payroll tax, stamp duties, State Government taxes and charges and development levies) and increased State Government debt on Victorian development, competitiveness, sustainability, employment, job creation and small businesses.

In this submission we concentrate on one particular type of taxation, being the state taxes and charges levied on home building and content insurance policies. While we do not necessarily support the high level of taxes and charges now imposed on these insurance policies – there is some merit in the arguments both that they have grown too large and that they are levied on too narrow a base – we strongly disagree with claims that the impact and effect of these taxes and charges is a high rate of under-insurance or non-insurance of Victorian property.

Such claims are assumptions that “sound like they would be right” but are, in fact, questionable on the evidence. By contrast, there is evidence that other, more significant factors are contributing to rates of under- and non-insurance in the community, which have been ignored or understated by the insurance industry.

We submit that any recommendation regarding insurance taxation should be made by the Committee only after considering all the available research and information on this issue,

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including research which indicates that insurance taxes and levies may not contribute to rates of under- or non-insurance in the community to a significant degree and that other factors may be much more significant contributors to levels of under- or non-insurance.

Our comments are detailed more fully below.

Insurance taxes and affordable insurance

It is often claimed that the fire services levy and stamp duty (and subsequent GST) on home building and contents insurance may encourage people either to under-insure or not insure at all by increasing the cost of insurance. Such claims also argue that this places a greater financial burden on governments if they must then provide financial help to uninsured persons after a natural disaster strikes.

For example, in submissions to this Inquiry the National Insurance Brokers Association states that the level of insurance taxation in Victoria:

by any measure has a significant effect on the take up of insurance in Victoria. A low level of insurance protection is evident in both Victorian businesses and households. Affordability is a major reason why Victorians choose not to insure or to only partly insure their property¹

and the IAG states that:

the current regimes for taxation of insurance in Victoria...contribute to under-insurance and non-insurance, with consequential negative fiscal impacts when the public purse is inevitably called upon in times of climate related disasters.²

Several submissions also refer to the current Commonwealth Government *Review of Australia's Future Tax System*. The Commonwealth Treasury's tax review consultation paper of December 2008 briefly discussed the issue of state insurance taxes. It noted that submissions to the review argued that 'stamp duty on insurance may encourage people to either under insure or to not insure at all by increasing the cost of insurance products relative to other goods. While this in itself is inefficient, it may also lead to an increase in government expenditure if assistance is provided to the uninsured in the event of a disaster'.³

The leading submission in this regard was from the Insurance Council of Australia (ICA), which argued that 'reform of general insurance taxes should be a priority for the Review'.⁴ The reform sought is the removal or reduction of insurance taxes and the fire services levy in a number of states. The ICA advanced two arguments in favour of these reforms, also argued in submissions to the current Inquiry about Victorian insurance taxation specifically:

1. The need to relieve insurance policy holders from the burden of insurance taxation as an unfair impost on consumers of insurance,⁵ and

¹ National Insurance Brokers Association, *Inquiry into State Government Taxation and Debt*, Submission 8, 1 October 2009, p2.

² Insurance Australia Group, Submission 5, 25 September 2009, p4.

³ Commonwealth Government, *Australia's future tax system: Consultation paper*, December 2008, p191.

⁴ Insurance Council of Australia, *Submission to the Review of Australia's Future Tax System*, October 2008, p2.

⁵ See also comments by Karl Sullivan, General Manager Policy - Risk and Disaster Directorate, quoted in insuranceneews.com.au, *NSW regulator wants fire services levy scrapped, stamp duty cut*, 20 October 2008.

2. These state taxes have impacted on the take-up of insurance and contributed to the level of non-insurance and under-insurance in Australia.⁶

We agree that the imposition of taxes and levies does make insurance products more expensive. It is a matter of government policy as to whether such taxes and levies fall fairly or unfairly on those consumers.

However, we also believe that the argument that state taxes have impacted on the take-up of insurance by consumers has been overstated and that other, more significant factors have been ignored or understated by the ICA, insurers and insurance brokers.

The following research findings were published in the ICA's own report into the causes of non-insurance:⁷

- Home type and tenure prove to be very significant factors affecting the take-up of contents insurance (p13);
- Non-insurance for contents cover is much greater for renters and those not living in detached houses (p13);
- A household's financial position including their savings, outstanding debts and income are closely related to rates of non-insurance (p17);
- Affordability appears to be a key driver of non-insurance (p17); and
- The results are consistent with people weighing up the costs and benefits of insuring and insuring primarily when they have significant assets to insure and sufficient funds to do so (p26).

These findings are reinforced by Table 2 of the ICA's report, drawn from the Australian Bureau of Statistics *Household Expenditure Survey 2003/2004*, which sets out the levels of contents insurance by tenure of housing:⁸

**Table 2: No contents insurance by tenure
(000s of households)**

	Dwellings	No Contents Insurance	% without insurance
Own / paying off	5,417	625	12%
Rent / other	2,319	1,545	67%
Total	7,736	2,170	28%

The findings appear to suggest that home contents insurance is a comfort product purchased by middle class home owners with assets to protect and sufficient disposable income to afford the purchase.

A closer examination of the report suggests that the reduction in premiums that would follow the reduction or removal of taxes, charges and levies would assist no more than one or two percent of consumers currently without contents insurance.

⁶ See also Insurance Council of Australia, *The Non-Insured: Who, Why and Trends*, Prepared by Dr Richard Tooth and Dr George Barker, Centre of Law and Economics, May 2007.

⁷ As above.

⁸ As above at p12.

For example, the report considers the effect of the removal of the fire services levy in Western Australia (**WA**), an event that has been cited by submissions noted above as providing evidence that removing the fire services levy leads to increased insurance cover by consumers. Figure 18 in the ICA's report indicates that the removal of the fire services levy in WA led to an increase of about one per cent in the number of consumers taking out contents insurance.⁹ The Sigma Plus Consulting report on the phase-out of the fire services levy in WA, also referred to in some of the submissions noted above, confirmed that insurance premiums dropped but contained no data or information as to whether more consumers had taken out insurance cover as a result.¹⁰

We do not dispute that a decrease in taxes would have a marginal impact on a small number of middle class consumers taking out insurance, but there are other reforms that would have a far greater impact on the problem of non-insurance in the community.

We believe that the insurance industry has failed to acknowledge that it has contributed to the problem of non-insurance by failing to provide products and payment methods suitable to the needs of low- and lower middle-income consumers. The ICA's own report identified tenants and asset rich, income poor retirees as demographic groups with low levels of contents insurance. Research by community sector groups has explored the reasons for non-insurance among both groups.

A 2006 Brotherhood of St Laurence Report investigated the reasons why many low-income people were uninsured.¹¹ Through group interviews with low-income consumers in Victoria and New South Wales, they identified specific barriers to taking out or maintaining insurance cover – not just simple cost, but also perceived limitations of insurance products or insurers, problems with payment options and attitudes to assets. The report findings included the following:

- The primary reason for not obtaining insurance was perceived affordability of premiums. A typical comment by a focus group participant was: "Insurance is a luxury when your income is that way. The numbers don't add up".¹²
- Many people on low incomes manage their finances fortnightly, and so consider whether something is affordable in the context of their fortnightly budget. Both payment frequency and the total annual cost of the premium are key aspects of affordability, as noted by one participant: "A lot of people can't afford to pay yearly, then you have the options of, say, quarterly and half-yearly. About a hundred dollars quarterly is still a lot of money".¹³
- A feeling of distrust and dissatisfaction of insurers was significant. One woman said: "[Insurers] don't care about the little people"; and another added, "They look down on you".¹⁴

The main recommendation of the report was that the insurance industry should address issues of affordability by creating and marketing 'no frills' insurance products which might:

⁹ As above at p13.

¹⁰ Sigma Plus Consulting, *Emergency Services Levy Insurance Compliance Review: Final Report*, April 2004.

¹¹ Brotherhood of St Laurence, *Risk and reality: Access to general insurance for people on low incomes*, Genevieve Sheehan and Gordon Renouf, June 2006.

¹² As above at piii, p7.

¹³ As above at piii, p20.

¹⁴ As above at piii, p9.

- allow fortnightly payments;
- provide payment options which are convenient for low-income people, such as Centrepay;
- provide an appropriate level of cover for people with limited household assets;
- provide more options on the payment of an excess;
- be structured as ‘disaster cover’—that is, claims are only payable in the event of substantial loss above a certain value.¹⁵

The insurance industry does provide for pay by the month insurance but the premiums are often significantly more expensive than annual premiums. We acknowledge that paying an annual premium via monthly instalments means that the insurer does not gain the benefit of the use of the total annual premium funds upfront from which to generate investment income, however, for consumers looking for a way to budget for insurance, the impact is that this option is more expensive. Further, pay by the month insurance is subject to savage and unforgiving provisions in the *Insurance Contracts Act 1984* that provide little or no relief for late payment due to financial hardship.

It is noteworthy that long after the publication of the ICA and Brotherhood of St Laurence reports on non-insurance, not one mainstream insurer has allowed the option of fortnightly instalment payments through Centrepay for Centrelink recipients, even for asset rich, income poor pensioners, one of the specific non-insured groups identified in the ICA research. Note that the option of direct debit payments, especially for Centrelink recipients, is a different proposition to Centrepay.¹⁶ Direct debits are risky for low-income consumers as any timing errors in the payment of benefits or the debiting of their account may lead to the imposition of bank penalty fees for a dishonoured direct debit transaction or an overdrawn account and/or the charging of late payment penalties by the service provider. Further, as noted above, direct debits are generally offered only on a monthly basis (even though income tends to be credited on a fortnightly basis and thus this is the cycle used by lower-income people for budgeting). In addition, direct debits are generally withdrawn on the monthly date corresponding to the policy commencement date, not on a date corresponding to when the policy holder receives their income.

We believe that the failure of the insurance industry to provide appropriate instalment payment options for low- and lower middle-income consumers has a more significant impact on levels of non-insurance than the impact of taxes and charges on the lump sum annual premium to be paid by those consumers.

Recent research appears to confirm the Brotherhood of St Laurence findings that current insurance products often fail to meet the needs of low- and lower middle-income consumers. A recent examination of home contents insurance policies for the Tenants’ Union of Victoria has suggested that most contents policies are home owners’ policies and of limited value to tenants,

¹⁵ As above at p27.

¹⁶ Centrepay is a free, direct and voluntary bill paying service offered by Centrelink to persons receiving Centrelink payments. It allows regular amounts to be debited from a person’s Centrelink payments, before they are paid to that person, and instead paid directly to businesses that are registered with Centrepay to pay bills such as rent, utilities such as electricity, gas, water and telecommunications, education fees, court fines and childcare.

another of the specific non-insured groups identified by the ICA research.¹⁷ Even the two renter's policies available for the research had a range of serious limitations, with one being merely a home owners' contents policy with minor variations.

For example, the research revealed that most home contents policies are priced according to the dollar amount of contents covered by the policy. Many policies provide cover for a minimum of \$40-50,000 worth of contents but most tenants do not need and cannot afford these more expensive traditional contents policies (by contrast the AAMI renter's policy provided cover for a maximum of \$25,000). As another example, most contents policies are sold on the assumption that the purchaser also has building insurance. Unfortunately for tenants, who do not have building insurance, this creates a policy gap that leaves them struggling to meet the costs of emergency accommodation in the event of a natural disaster. Building insurance provides cover for temporary accommodation costs, so home owners are covered. However, this sort of cover is not available under the home contents policies available to tenants.¹⁸

It is interesting to note that similar problems exist with car insurance products. Low- and lower-income consumers have tended to purchase third party property insurance if they purchase any insurance, as it is the cheapest form of car insurance. However, it does not cover any damage to the consumer's own car, thus is of limited attractiveness to consumers. A decade ago insurers added a benefit called "uninsured motorist's extension" to these policies, which ostensibly covers the consumer for damage to their own car if caused by an uninsured driver, however, neither consumers nor their advisors are widely aware of this benefit and, further, the requirements involved before a claim will be paid under this extension make it difficult to claim on.¹⁹ However, it seems possible that cheaper third party policies could be extended to provide more effective cover for a modest increase in premium.²⁰

We believe that a greater number of low- and lower middle-income consumers would purchase insurance if the insurance industry provided a reasonable range of products that actually met the needs of such consumers at a price they could afford. At present, most insurance products – with or without taxes and levies – represent poor value for money for these consumers.

As a final matter, we note that the February 2009 Victorian bushfires tragedy led to renewed public comments from the insurance industry about under-insurance and non-insurance in the Victorian community. However, many of these claims have been misleading, for example, the ICA conflated its own data about home building and home contents insurance to overstate rates of non-insurance and, again, ignored the fact that most of those without home contents insurance are low-income earners and tenants, and that there is substantial evidence indicating that removal of the fire services levy would provide only marginal assistance in addressing under-insurance and little if any assistance to these low-income earners and tenants (see the attached document). We consider that additional unsubstantiated claims such as that there was a greater likelihood that the uninsured perished in the fires because they were more likely than

¹⁷ Tenants Union of Victoria, *The Insurance Industry and the Needs of the Tenancy Market*, Denis Nelthorpe, 2008 (forthcoming, copy on file).

¹⁸ See also Lesley Parker, 'Keep your head above water', *Sydney Morning Herald*, 30 July 2008, available at www.smh.com.au/news/planning/keep-your-head-above-water/2008/07/28/1217097144036.html.

¹⁹ See also Michelle Innis, 'Disasters and other excuses', *Sydney Morning Herald*, 27 September 2005, available at www.smh.com.au/news/money/disasters-and-other-excuses/2005/09/26/1127586791041.html.

²⁰ For example, some insurers have begun offering third party fire and theft policies that cover damage to the consumer's car in more circumstances and involve only a small increase in the annual premium.

the fully insured to have remained at their property and attempted to fight the fire, are inappropriate and offensive.

In summary, it is correct that the Victorian fire services levy and stamp duty (and GST) on home building and contents insurance products make them more expensive, but it is not correct to assume that this is contributing in any significant way to under-insurance or non-insurance (or, therefore, to an increase in government expenditure to assist the under-insured in the event of a disaster).

While it is clearly important for the Committee to consider the desirability and effect of state taxes and levies on insurance take-up as part of its Inquiry, we strongly recommend that the Committee scrutinise the claims made on this issue carefully, including reviewing any primary materials cited in support of such claims to consider whether it thinks these materials do, in fact, provide such support. We submit that the Committee should make any recommendations on Victorian insurance taxes and levies based on all of the available research and information in this area, including research that indicates there are other, more significant factors that could be addressed to improve rates of under-insurance and non-insurance in the Victorian community.

About Brotherhood of St Laurence

The Brotherhood of St Laurence is an independent non-government organisation with strong community links that has been working to reduce poverty in Australia since the 1930s. Based in Melbourne, but with a national profile, the Brotherhood continues to fight for an Australia free of poverty, guided by principles of advocacy, innovation and sustainability. Our work includes direct service provision to people in need, the development of social enterprises to address inequality, research to better understand the causes and effects of poverty in Australia, and the development of policy solutions at both national and local levels.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

About Footscray Community Legal Centre

Footscray Community Legal Centre is a non-profit, community-managed association providing legal and financial counselling services to the community. In recent years our service has targeted the needs of refugee communities from Horn of Africa and Burma.

About West Heidelberg Community Legal Service

The WHCLS commenced operation in 1975 with the volunteer legal services of John Cain, the former Premier of Victoria. Informed of the high levels of legal need in the area he offered his services to the newly established West Heidelberg Health Service on a Monday night. The legal service is based within the Olympic village of 1956, the facilities of which were handed over for public housing. Today, due to tightly targeted, segmented waiting lists, many but not all, of the

clients of the service come from significantly disadvantaged social backgrounds including families fleeing domestic violence, newly arrived and older migrant communities with a large proportion of people from the Horn of Africa, people with some form of disability or mental health issues, people with poor income support or on social security benefits. The legal service has been fortunate for thirty years to partner with a Clinical Legal Education Program of La Trobe University and is co-located with Banyule Community Health. The health service provides health, allied health and social welfare services and enables the legal service to reach out to more people in need through these partnerships.

Please contact Nicole Rich at Consumer Action on 03 9670 5088 or at nicole@consumeraction.org.au in the first instance if you have any questions about this submission.

Yours sincerely



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