Emergency Services Levy Insurance Compliance Review: Final Report

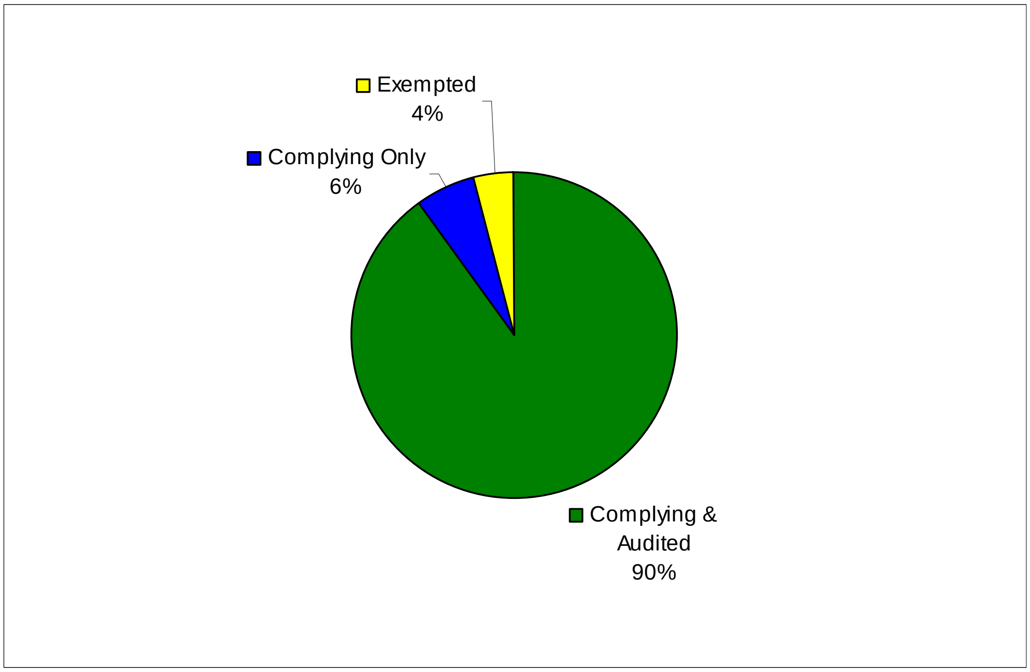
Contents

Executive Summary

Sigma Plus Consulting commenced work on the Emergency Services Levy (ESL) compliance project in October 2003. Our brief is to write a report describing the effect of the phase-out of the Fire Services Levy (FSL) upon property insurance premiums and more specifically to demonstrate whether insurers have passed savings on to consumers.

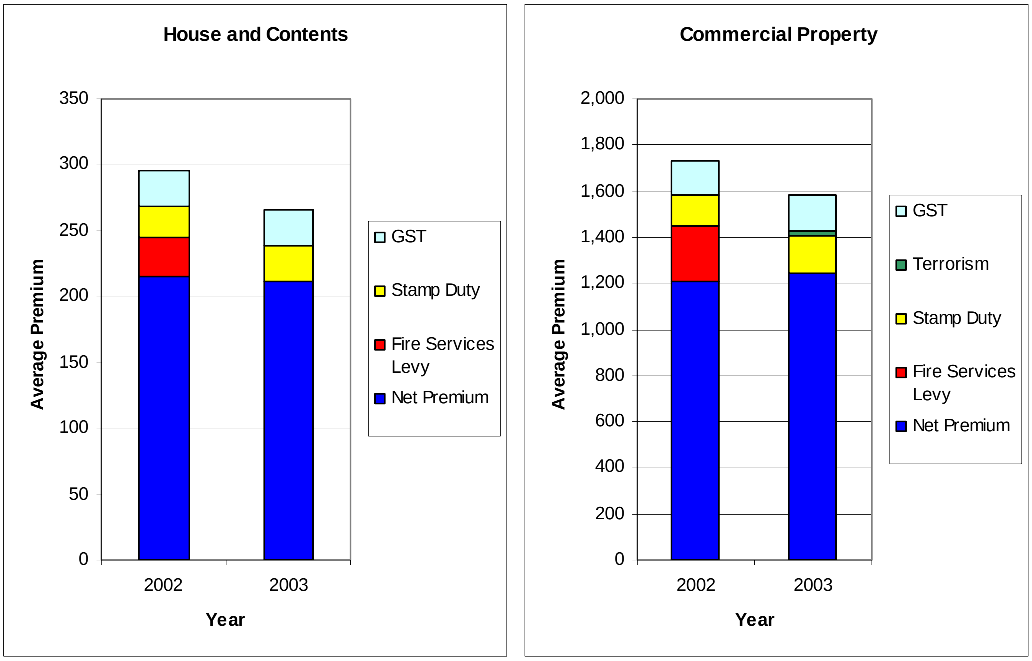
We are pleased to report that insurers have passed on the savings to consumers. The removal of FSL in Western Australia contributed to Western Australia having one of the most price competitive insurance markets in Australia in 2003. On average, buildings and contents insurers actually dropped their premium rates. Consumers have responded to cheaper insurance by increasing their insurance cover to more adequately protect themselves.

Graph 1: Compliance Categories (% Premium Pool)



Based upon data supplied to and analysed by Sigma Plus Consulting as at 27th April 2004, 34 businesses (representing a 90% market share) have now been classified as complying and audited, while a further 29 businesses (representing a 6% market share) that did not carry out audits have also been categorised as complying. These businesses are listed by name in Appendix C.

Graph 2: Savings in Insurance Premiums (constant sum insured)



The evidence shows that the insurance industry has passed on the FSL savings to consumers. Gross premiums have dropped over the year - consumers are paying less for insurance. Net premiums (after removing government charges) have increased by amounts similar to other states. This is despite extra costs to insurers that are specific to WA, such as higher claim costs and the extra cost to insurers of complying with the new FSL regime.

Colin Priest
Director
Sigma Plus Consulting
29th April 2004

Data

Insurer Data

When South Australia phased out FSL, some consumers claimed that insurers were profiteering from its removal by increasing their premiums to offset the reduction in FSL. The South Australian government commissioned an independent report which showed that insurers had indeed passed on the savings. That report collected data from insurers in a form that has been the basis for our data request to FSL paying businesses.

Our data request consists of three sections:

Section A allows categorisation of the FSL paying business. Not all businesses that pay FSL are insurers. Some are underwriting agencies that sell and process insurances in Australia, but which pass the insurance risk to overseas insurers. Other entities operate as captive insurers – risk pooling entities within large corporations, which only insure their parent corporation's properties, and do not insure the general public. Section A gives the opportunity for the business to explain why they should opt out of the data request. Some insurers only write motor insurance, which is not part of our data request. Other insurers no longer write property business in Western Australia, and some have ceased writing any business.

Section B consists of premium statistics, renewal quotes and premium rate quotes. The purpose of this section is to determine how much premiums have moved in total, and to measure some of the possible components of premium changes. There is a particular focus upon government charges (including FSL) because many of these amounts have changed during the course of 2003. We have also measured increases in the sums insured because the property boom has increased the value of insured properties - consumers have purchased greater amounts of insurance to cover their rapidly appreciating assets.

Section C is optional. It covers some possible causes of changes to premium rates. These causes were suggested by insurers during the initial consultation period.

The complete data request is included in Appendix A.

Disclaimer: We have relied upon the accuracy of the data supplied to us by the FSL paying businesses.

Industry Data

In addition to the data provided by individual insurers, Insurance Statistics Australia (ISA) has supplied us with selected industry data. ISA collects premium and claim data from its member companies and collates the data into time series summaries. The latest release of this data does not contain the premium data for commercial property. For commercial property premium data we have used numbers from an industry study published by JP Morgan.

We are using the ISA data to compare changes to premiums in Western Australia against those of South Australia and Queensland, states which have similar profiles to Western Australia. The premium increases in Western Australia can be compared to those in South Australia and Queensland, which have not had any changes to FSL during 2003. If the percentage changes to premiums (net of FSL) are similar between the states, then we can be comfortable that insurers have generally passed on the savings from the changes to FSL.

The claims data within the ISA data is also helpful in determining whether there have been extra claim pressures specific to Western Australia that would in turn place pressure upon premium rates. A number of insurers told us that a long period of storms in Perth had caused claim costs to rapidly rise. The ISA data gives separate statistics for weather related claims that allow us to quantify the cost of the storms.

We are using the JP Morgan data to compare changes to premiums in Western Australia against those of Australia in total. If the percentage changes to premiums in WA (net of FSL) are similar to those of all the states in total, then we can be comfortable that insurers have generally passed on the savings from the changes to FSL. The JP Morgan survey data covers a number of years. This allows us to compare premium rate movements in the latest year to those of previous years. If the premium increases in 2003 are similar to those of previous years (after adjusting for changes in FSL and stamp duty), then we can be comfortable that insurers have generally passed on the savings from the changes to FSL, and that any premium increases are the result of normal business practice.

Compliance Status

ESL compliance consists of two parts:

1. whether the FSL component of insurance is being correctly calculated and quoted during the phase-out period
2. whether reductions in FSL are resulting in savings to consumers

While the quarterly audits that insurers have been carrying out have a focus upon the process of calculating and charging FSL, the independent report looks at the total premiums charged to consumers, with a particular focus upon the way in which the savings from FSL are passed on to customers (i.e. whether base premium rates are increased to balance out the reduction in FSL). Its key objectives are to:

1. identify whether individual insurers are in compliance (have passed on the savings to consumers)

2. assess the effect of FSL changes upon insurance premiums
3. identify and assess any other factors that have affected insurance premiums

We have chosen to focus on FSL as it applies to property. The FSL component of motor insurance is very small (typically less than 1%) and unlike property insurance, motor insurance premiums do not separately identify the FSL component of the premium.

Complying Businesses

A complying business is a FSL paying entity that has:

- charged the correctly calculated FSL amount, *and*
- passed on the FSL savings to the insured

FSL percentages reduce daily from the full FSL percentage for policy anniversaries at the start of 2003 to no FSL payable for policy anniversaries at the end of 2003.

The phase out of FSL reduces the total cost of property insurance. This saving should result in lower insurance costs, all other things being equal. FSL savings can be passed to the insured via a number of mechanisms:

- total premium rates reducing by the amount of the FSL savings (some allowance must be made for "normal" premium increases)
- premium refunds to the insured for the amount of the FSL reduction
- arrangements whereby the insured is also the insurer

Correct calculation of FSL percentages does not ensure that the savings are passed on to the public.

Exemptions from the Independent Report

Some FSL paying entities were exempted from the scope of this report. Reasons for exemptions include when the entity:

- is not writing property insurance (e.g. motor insurers)
- does not set the premium (e.g. coinsurers must accept the price of the lead insurer) and where FSL was not included in the premium set by the lead insurer
- incurred a trivial amount of FSL
- does not charge separate premiums for the West Australian property component of a nation-wide corporate insurance policy

In general, exemptions were granted only on request and only in those cases where the FSL phase out had no significant effect upon the calculation of the premium to be charged.

Exemptions and Variations from the Data Request

Some FSL paying entities did not fill out the standard data request because they:

- wrote non-standard policies
- wrote only a small number of policies
- were a reinsurer who required that the direct insurer paid all of the FSL
- were a captive insurer
- only wrote policies with anniversaries at the start of the year
- only started writing property policies in 2003

Statistical analysis of data from insurers who wrote non-standard policies and insurers who only wrote a small number of policies would not produce reliable results. We asked for more individual data from those insurers. One reinsurer had implemented a program of requiring direct insurers (its customers) to pay all of the FSL for the insurance. Since there was no longer any FSL payable from that reinsurer, we did not require any detailed data. One insurer only wrote insurance policies that covered the insured for a calendar year. In such a situation the FSL phase out did not affect the FSL calculation.

When insurers only started writing business in 2003 there was no historical premium rate to determine whether savings were passed on. However, we did check that the FSL charges were correctly proportioned down throughout the year.

Determining Compliance

Insurers' Letter of Understanding

The legislation, which was replaced with the introduction of ESL, previously established how much insurers should pay to FESA rather than how much FSL insurers should collect. The legislation did not cover how insurers would raise the money required to pay their contribution. Instead it dealt with the contribution required from the insurance industry, and how to allocate that amount between individual insurers. While there are standard industry practices for the manner in which FSL charges were collected against individual policies, some insurers have their own way for charging FSL, and the standard practices are different between different types of business. These differences are not a problem so long as the insurer pays the correct total amount of contribution to FESA.

Since the previous legislation was about how much insurers should pay rather than how much FSL insurers should collect, it was not feasible to establish a statutory obligation upon insurers to comply with the proportional reduction in FSL charged to the public, nor to contribute information that confirms their compliance. Instead, as a result of negotiations between FESA and the insurance industry (represented by the Insurance Council of Australia), a recommended practice was agreed and insurers were asked to sign a letter of understanding in which they agreed to carry out that standard practice. A copy of the standard letter of understanding can be found in Appendix B.

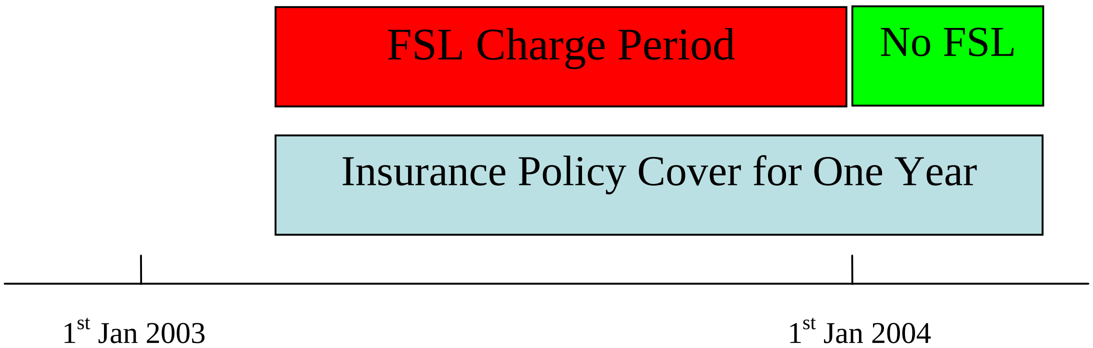
Sections 18 and 19 of the letter of understanding refer to this independent report and require the co-operation of the insurer with the party who is writing the report. Other sections of the letter cover the gradual reduction of FSL amounts during the transition period, refunds of any overcharged FSL amounts, communication with the insured public, and quarterly audits of the FSL charges. The original arrangement for a funding advance, set out in clause 20, for the insurance industry to pay a $15 million advance to FESA on 1st July 2003 was changed. Instead, FESA and the insurance industry (via the Insurance Council of Australia) agreed to a “non repayable transitional payment” of $1.25 million

While not all insurers signed the letter of understanding, insurers representing 88% of market share did sign the letter, while a further 6% agreed to follow the letter of understanding, but did not sign. The Insurance Council of Australia (ICA) is an industry representative, but has no binding powers over its members. While most large insurers are members of the ICA, several smaller insurers are not, and some FSL paying businesses are not insurers, and are therefore not part of the ICA. A list of those insurers who signed the letter of understanding can be found in Appendix C.

Quarterly Audits of FSL Calculation

As part of the letter of understanding, insurers were required to have their FSL charges audited, and the audit results were to be submitted quarterly. The purpose of these audits was to ensure the correct calculation of the proportional reduction of FSL percentages during the transition period.

Figure 1: Proportional FSL Charges



Insurance policies are typically written for one year. FSL is not charged for any policy periods after 2003. So insurance policies written in 2003 will have a proportion that attracts FSL, and a proportion that does not attract FSL charges. An example is shown in the figure above.

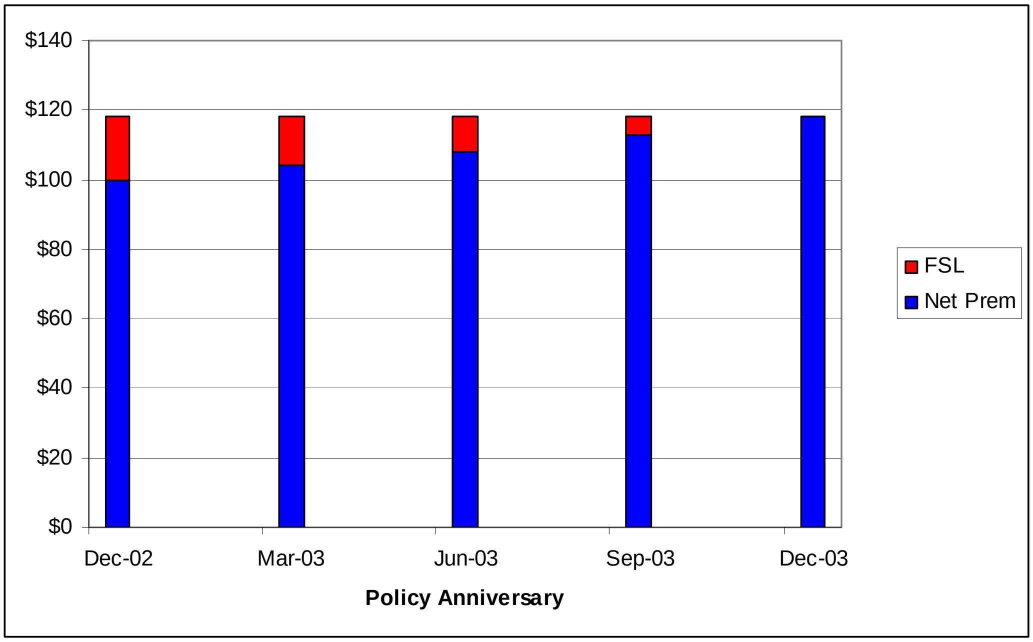
The calculations are a little different for insurance policies that have monthly premium payments, but the principle is exactly the same:

- monthly premiums for periods entirely within 2003 attract the full FSL percentage
- monthly premiums for periods entirely within 2004 do not attract FSL charges
- monthly premiums for periods that cross the end of 2003 attract a proportional FSL charge

The auditor’s task was to confirm that the proportion of the full FSL rate that was charged to the public correctly used the coverage period within 2003. While some discrepancies were found, insurers were quick to correct these problems.

Some of the audit reports noted a propensity for problems with FSL charges on policies written via brokers. Some brokers occasionally forgot to reduce the FSL component, or forgot to recalculate the FSL component if they used different coverage dates from those quoted. Brokers represent the insured, not the insurer – so these problems are not a reflection upon the insurers that were involved. Nevertheless, insurers generally took the initiative to liaise with the broker to correct the FSL charge and return any overcharged amounts to the customer.

Figure 2: Profiteering Opportunities



While these audits served the purpose of confirming the correct reduction in FSL charges, they did not protect the public from a second possibility – that the FSL charge was correctly reduced, but that the premium did not reduce accordingly. When FSL was removed in South Australia, some consumers believed that insurers were still charging the same premiums and taking the FSL savings for themselves. The consumers' belief was subsequently shown to be incorrect by an independent study. The figure above shows a hypothetical situation in which such profiteering could occur. At each period, the FSL charge is correct, and would pass a quarterly audit.

This independent report is primarily concerned with confirming that profiteering, such as showing the figure above, does not occur. Our compliance measures are therefore broader than those of the quarterly audits. Nevertheless, the quarterly audits provided a greater level of protection for customers of the insurers who undertook the audit process. We have therefore split our "complying" status into two groups:

1. audited
2. not audited

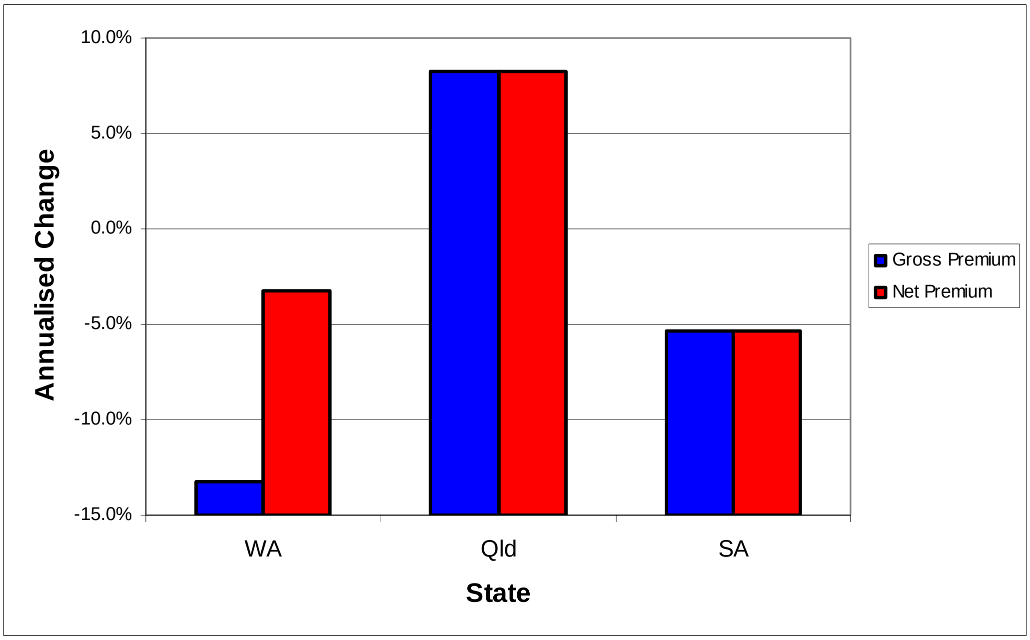
This split recognised the greater protection provided by those insurers who undertook the quarterly audits.

Industry Data

We have been supplied with industry statistics for personal insurances (house and contents) by Insurance Statistics Australia (ISA). Unfortunately the ISA industry statistics for commercial insurances premiums were not available at the time of writing this report.

The unavailability of industry data for ISA commercial property premiums means that we have had to use other means for determining a "normal" premium increase for commercial insurances. This is discussed later in this report.

Graph 3: House and Contents - Premium Increases by State

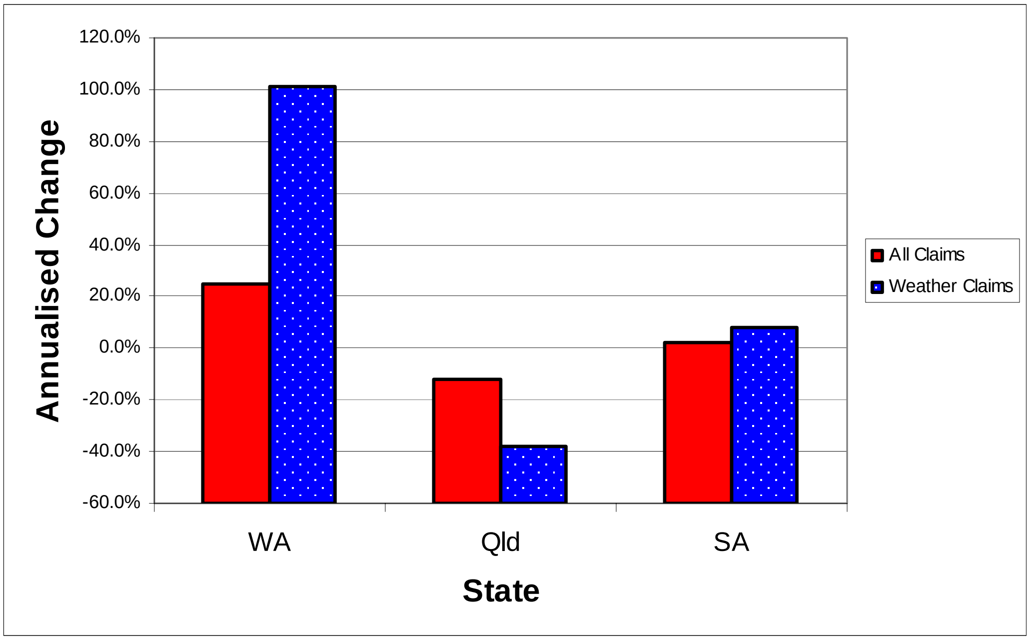


Home and contents premiums paid by the WA consumers to ISA insurers have dropped by an average of 13%. Net premiums (the premium less FSL, stamp duty and GST i.e. the amount going to insurers after tax) have increased in a manner similar to other states, lower than Queensland and higher than South Australia.

By comparing the premium increases between states, we obtain an estimate of the increase in premiums that the insurance industry has been applying where there has not been any change in government charges. We have used this normal range of annual premium increases (up to a 10% increase net of FSL for house and contents) as the basis for looking at individual insurers, to target for attention any insurers that have premium increases beyond this normal range. An insurer may have a premium increase that is greater than this amount and still be listed as complying, but we will need to have some other justification for granting a complying status in such situations. For example, if an insurer has had premium increases of 15%, but their average sum insured also increased by 15%, then we would consider the sum insured increase to be additional evidence justifying the premium increase.

One can conclude from these numbers that the insurance industry, in total, has passed on the savings of FSL for house and contents insurance. The net amount that they have charged has only increased within normal bounds.

Graph 4: House and Contents - Increased Claim Costs by State



The moderate reductions in premiums in Western Australia have been despite substantial increases in claims for house and contents. There has been an abnormal number of storms in recent years, and the amount paid out for storm claims has doubled. Overall, insurers are paying out 25% more in house and contents claims than in previous years. Claim costs in other states were static or even reduced. These extra costs for West Australia house and contents have not been passed on to consumers.

Analysis of Insurer Data

For each insurer's data, we followed the following procedure:

1. carry out a sensibility check on the data e.g. are gross premiums greater than net premiums, do totals add up?
2. check the proportional reduction in FSL over the year using the renewal sample policies and the company total statistics
3. calculate important statistics such as rates (premium expressed as a proportion of sum insured), premium increase, sum insured increase, rate increase
4. compare the statistics against our expectations, and check that the rate increase is below our maximum acceptance amounts
5. discuss any discrepancies or unusual results with the insurer
6. categorise the insurer as complying or not complying
7. if not complying, give the insurer the opportunity to correct the problem and become complying
8. internal peer review of the compliance result

For some insurers this was more of an iterative process, as discussions with insurers sometimes resulted in corrections to the data, which took us back to the first step.

Our analysis focused upon looking for FSL amounts that were not reducing in the correct proportion, and upon abnormal rate increases. The boom in the property industry over recent years has meant that people are now insuring buildings with a much greater value than in the past. This requires higher sums insured. One cannot just compare premiums from year to year when the sum insured has increased – it would be like comparing the price of 1 litre of milk with the price of 500 ml of milk. By measuring the premium rate (premium as a proportion of sum insured) we automatically adjust for increases in sum insured.

Considerations for Different Types Of Insurer

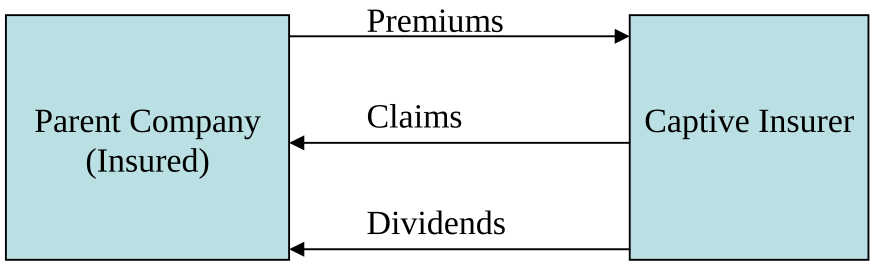
Large Insurers

The large insurers tend to write standard policies for standard prices. This, combined with the large number of policies involved, means that we can rely upon both statistical analysis and a review of individual policies.

Captive Insurers

A captive insurer is a company structure set up by a corporation to manage its own risk. Rather than buying insurance from external insurance companies, an internal insurer is set up that only insures risks within the corporate group.

Figure 3: Captive Insurer Structure



This structure guarantees that any FSL savings are returned to the insured. If the captive insurer does not return the savings by lowering premiums, then the savings end up becoming profits to the captive insurer, which then passes the money back to the parent via higher future dividend payments. Either way the savings are passed on to the insured.

There was no value in collecting detailed FSL compliance data from captive insurers because it would not change the conclusion that savings were being passed to the insured. We therefore automatically assigned a complying status to captive insurers.

Specialist Insurers

Specialist insurers are niche operators who exist to insure those people who have non-standard needs. This includes such business as the insurance of stamp collections. Unlike large insurers, specialist insurers do not always have standard prices, and price every individual according to their individual circumstances. The small number of policies written by these insurers means that sometimes a single policy can be large enough to affect the average values in the company statistics.

Totals and averages for these insurers can be unreliable for our purposes. For this reason we tended to focus upon the individual policy sample data provided by these insurers and give lower credibility to company totals or standard premium prices.

Corporate Package Insurers

Corporate package insurers are niche operators who exist to insure large corporations. Unlike large mainstream insurers, specialist insurers do not always have standard prices or standard covers, and price every individual corporation according to their claim history. Prices are determined by negotiation rather than standard premium tables. The small number of policies written by these insurers means that sometimes a single policy can be large enough to affect the average values in the company statistics. Because large corporations tend to have a number of properties spread over a wide geographic area all insured within a single policy, the premiums charged have less to do with where the properties are located than with the claim history of the corporation. There are often no separate premium amounts for the West Australian properties within the policy.

Totals and averages for these insurers can be unreliable for our purposes. For this reason we tended to focus upon the individual policy sample data provided by these insurers and give lower credibility to company totals or standard premium prices. In some cases we asked for sample policies that only covered West Australian property – this removed any bias.

Coinsurers, Lloyds and Other Overseas Insurers

Some FSL paying businesses are not insurers – they are underwriting agents. An underwriting agent is a business that acts like an insurance company accepting premiums and paying claims, but it does not ultimately bear the financial risk – the risk passed on to an insurer such as a Lloyds underwriter.

Many underwriting agents do not set their own prices. The prices are set by the insurer. In such cases we granted exemptions to the underwriting agent – they cannot be responsible for prices that they cannot change.

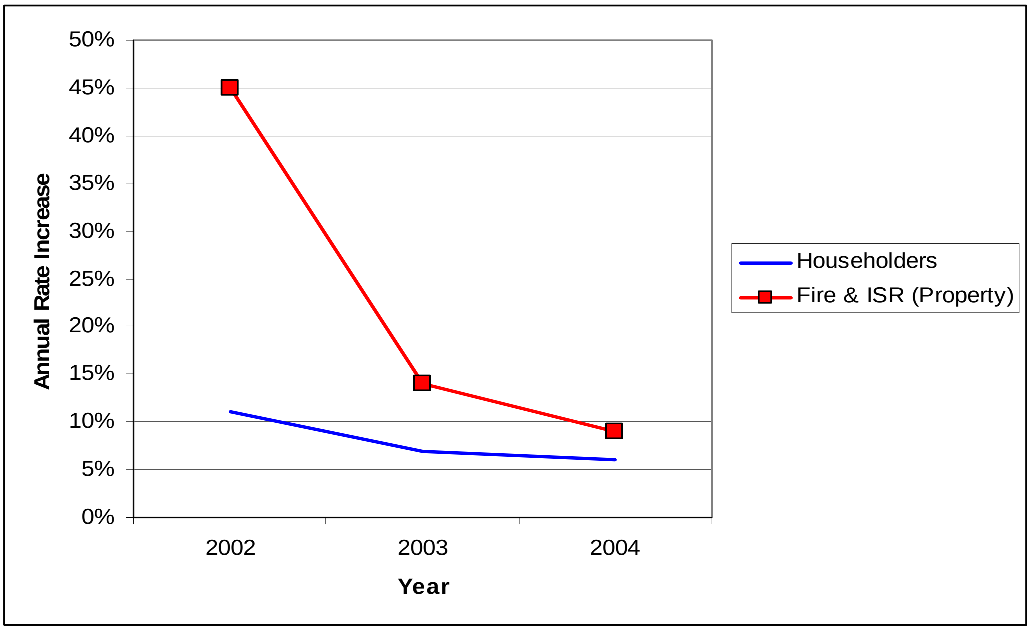
Other underwriting agents have some pricing powers. These businesses were reviewed for compliance in a similar manner to specialist and corporate insurers.

“Normal” Commercial Premium Increases

Without industry data comparing commercial premiums in West Australia to those of other states we had to find an alternate method to determine what a normal or fair premium increase would be. Unlike house and contents insurance, commercial property premiums are subject to market cycles and discounting by insurers.

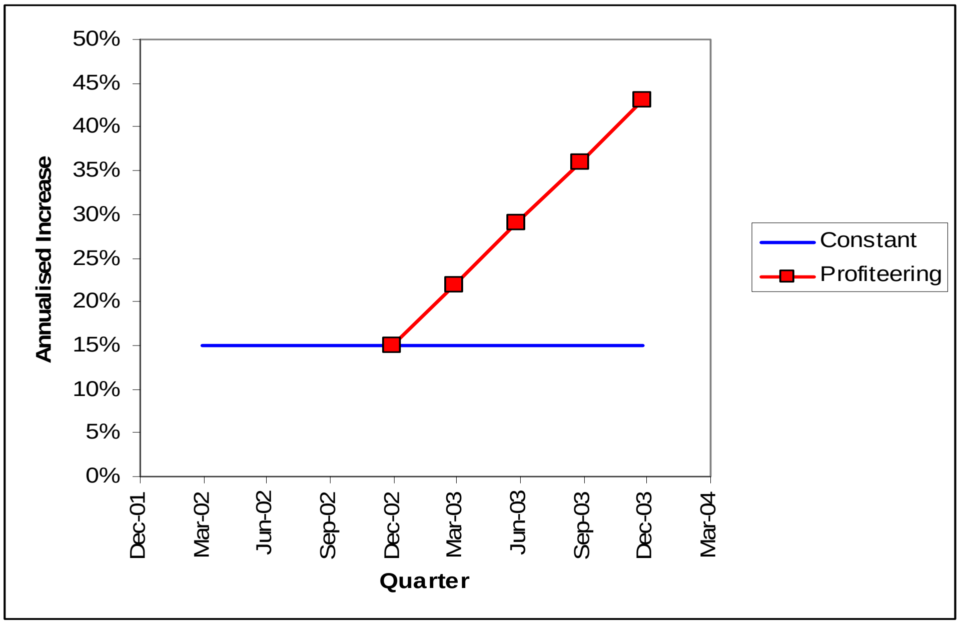
As many people would be aware, insurance prices in property and liability have been “hardening” over the past few years. Intense competition in the late 1990s had caused insurers to discount premiums well below profitable levels. The collapse of HIH and the subsequent tightening of the statutory solvency regime has prompted the insurance industry to move prices back to more prudent and sustainable levels. We are still in the upswing period of this insurance premium cycle – so commercial property premiums across Australia are increasing by more than the general consumer price index inflation levels.

Graph 5: Recent Premium Movements (source: JP Morgan)



As the graph above shows, premium rate increases in 2003 were much less than those in 2002. The rates movements for commercial property have been much more severe than for householders. This is a reflection of the underpricing that existed in the commercial property insurance market in the 1990s. While these figures were for Australia in total, we believe that the Western Australian insurance market would have undergone similar rate changes as the other states.

Graph 6: Comparing Premium Increases to Previous Years



If insurers were profiteering on commercial premiums, then the net rate increases would start to balance out the 28% FSL amount charged to commercial property in metropolitan Perth. On the other hand, we could conclude that profiteering was not occurring if the rate increases in 2003 resembled those of recent years.

We do not have rate histories for all insurers. But for those insurers that have been able to provide this data, the net rate increase in 2003 was less than the net rate increase in 2002 in all except one case. Based upon this relationship we have chosen a maximum 2003 rate increase of 18% for commercial property. We validated this rule of thumb against the Australian total rate movements obtained from the JP Morgan survey discussed earlier in this report. This maximum is then applied to all insurers and those that have had higher rate increases are then singled out for individual attention.

Industry Feedback

Our first step in this project was to talk to a number of insurers operating in West Australia. These discussions included the insurers' opinion of a draft data request, and a discussion of any issues that were specific to Western Australia or to that insurer. There were some common themes to what the insurers had to say:

- the cost of compliance with the new FSL regime was higher than they had planned for
- competition in the industry was still strong, especially for home and contents
- the run of storms over the past two years had wiped out any profits
- high reinsurance costs were causing large increases to the premiums for high value properties
- the data provided for checking compliance was commercially sensitive and was not to be published
- some insurers were worried that since their business was not standard that they'd have trouble showing that they had complied.

Our final data request was adjusted to allow for the concerns of the insurers. We have also been able to show compliance for the non-standard insurance by taking an individual approach for each of these insurers.

The process of testing compliance was sometimes approached with wariness by the insurers, but after we'd finished they were generally quite pleased with the process. After we'd helped an insurer refund FSL to a customer, one manager sent us an email saying:

> "I have to admit that although I was initially sceptical of the merits of this whole exercise, the proof is in the pudding"

Insurers were eager to refund any FSL charges to customers because it gave them more satisfied customers paying cheaper premiums.

Results

Table 1: Compliance Categories

Category	Count	Premium 2002 ($000)	Market Share
Complying & Audited	34	261,176	90%
Complying Only	29	16,646	6%
Exempted	47	10,483	4%

The are no businesses that have been categorised as "Not Complying".

A full list of businesses in each category can be found in Appendix C.

Changes to Premiums Over 2003

Fire Services Levy

As has already been discussed in this report, the fire services levy was phased out over 2003. This charge was typically 19% for house and contents and 28% for commercial property in the Perth metropolitan area. By the end of 2003 the charge became zero.

Stamp Duty

Stamp Duty on insurance was increased from 8% to 10% from 1st July 2003.

Terrorism Insurance

The federal government introduced a terrorism insurance scheme in the second half of 2003. This scheme is compulsory for certain types of commercial property and insurers pay a premium to the scheme for each of these properties.

Premium Rate Changes

Insurers regularly change the premiums chargeable for different policies. This may be in response to claim costs, the expenses of running an insurance company, or in response to changes in supply and demand.

Sums Insured

The premium charged on a policy can go up without the insurer changing their premium rates. Insurers typically increase house and contents sums insured at renewal time each year to allow for inflation. The recent boom in the property industry has also prompted people to increase their sums insured. When the sum insured increases, the insured is buying a greater amount of insurance, and will pay extra premium for the extra cover.

Summary: Personal Insurances

Table 2: Changes to House and Contents Premiums

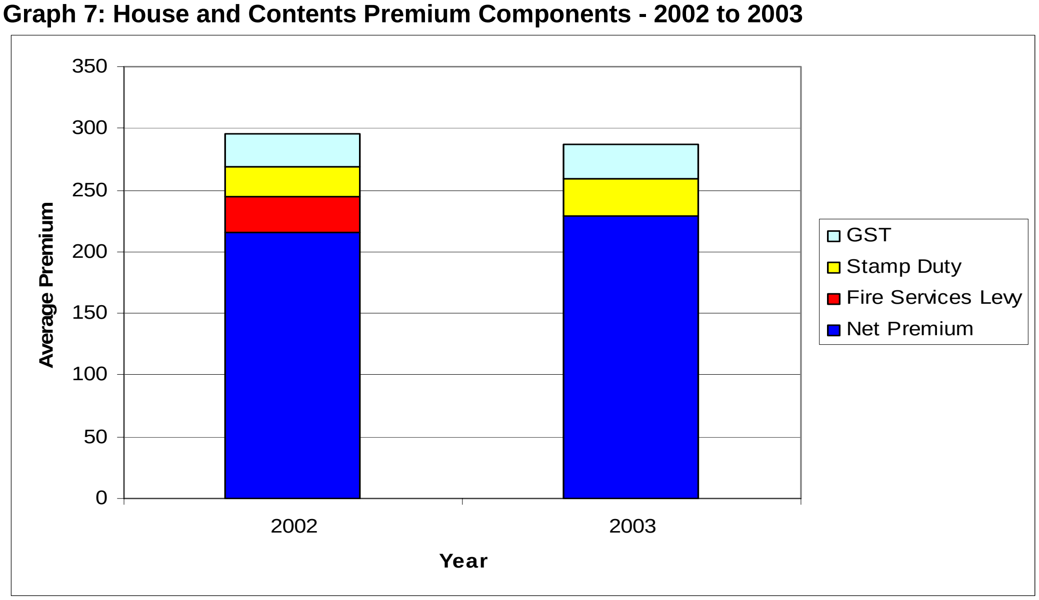
	Premium Amounts	Dollar Increase	Percentage Increase
Premium Dec 2002	$294.98		
Fire Services Levy		-$29.60	-10.0%
Stamp Duty		$6.22	2.1%
Terrorism Insurance		$0.00	0.0%
Premium Rate Changes		-$5.31	-1.8%
Sums Insured		$21.32	7.2%
Premium Dec 2003	$287.61		

Based upon the data from insurers that we have categorised as complying, the average insurance premium for house and contents dropped slightly over 2003.

The reduction in FSL caused savings of 10% for house and contents insurance premiums. On the other hand, when the government increased stamp duty, they added 2.1% to the cost of house and contents premiums. Changes to premium rates by insurers contributed a drop of 1.8% to the average premium.

Since these insurers dropped their premium rates for home and contents by even more than the amount of FSL savings, one can easily declare that they passed the FSL savings on to the public.

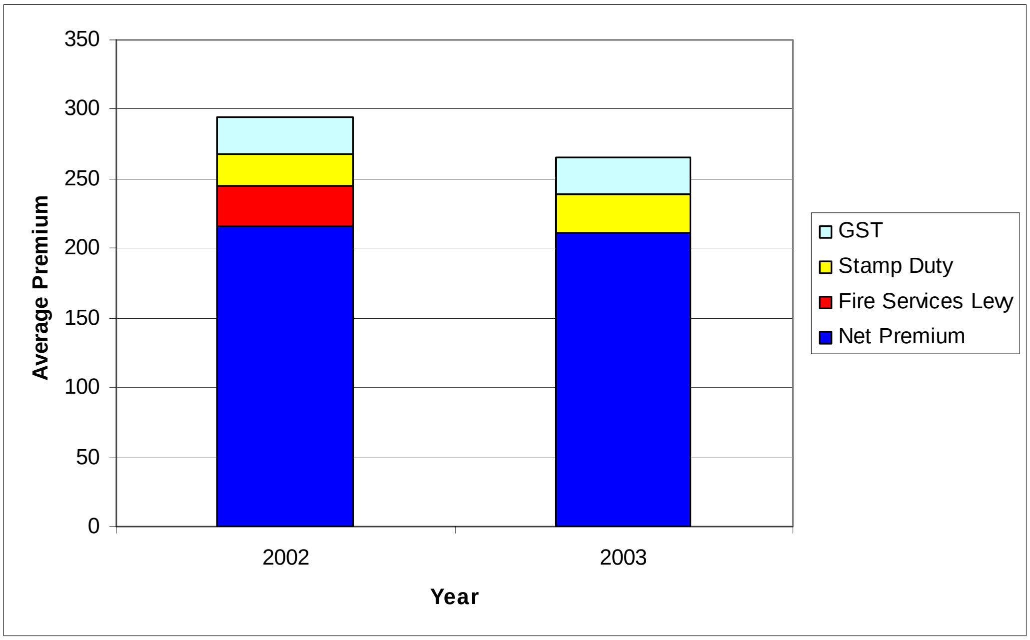
Graph 7: House and Contents Premium Components - 2002 to 2003



The reason that the net premium increased was because the sums insured were 7.2% higher than the previous year – people are buying greater amounts of house and contents insurance but for a lower total cost than in 2002.

In order to compare like with like, we have reconstructed the premium components supposing that the average sum insured had not increased. The results are shown below.

Graph 8: Home and Contents Premium Components - Constant Sum Insured



Summary: Commercial Insurances

Table 3: Changes to Commercial Property Premiums

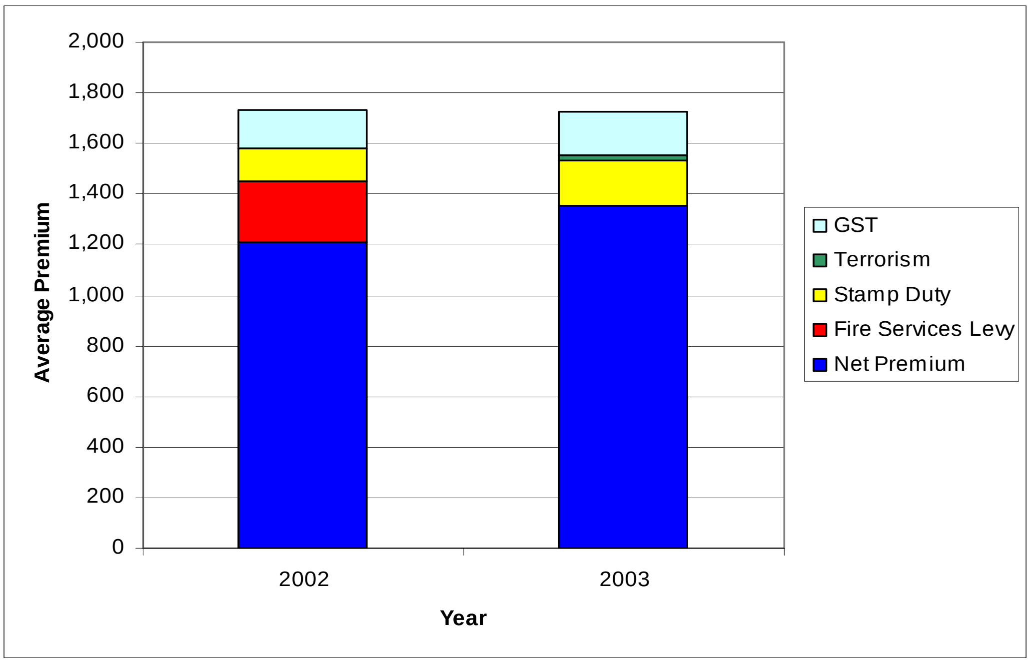
	Premium Amounts	Dollar Increase	Percentage Increase
Premium Dec 2002	$1,728.55		
Fire Services Levy		-$289.09	-16.7%
Stamp Duty		$40.89	2.4%
Terrorism Insurance		$16.67	1.0%
Premium Rate Changes		$41.14	2.4%
Sums Insured		$188.65	10.9%
Premium Dec 2003	$1,726.82		

Based upon the data from insurers that we have categorised as complying, the average insurance premium for commercial property dropped slightly over 2003.

The reduction in FSL caused savings of 16.7% for commercial property insurance premiums. On the other hand, when the government increased stamp duty, they added 2.4% to the cost of commercial property premiums.

Changes to premium rates by insurers contributed a moderate 2.4% to the cost of commerical property premiums. This is less than the rate increases that applied during 2002 and considerably less than the average rate increases applying to other states in Australia. The 2.4% average rate increase is small compared to the FSL savings of 16.7%. By applying this moderate rate increase, insurers ensured that the FSL savings were passed on to the public.

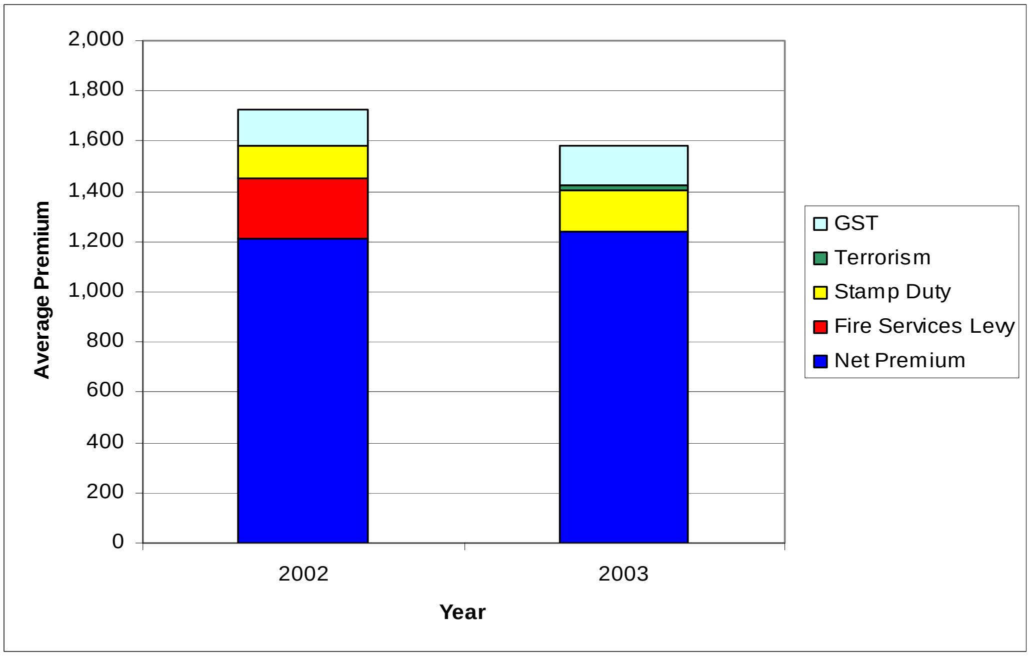
Graph 9: Commercial Property Premium Components - 2002 to 2003



The average net premium increased as a result of 10.9% growth in the sum insured. Businesses are buying greater amounts of commercial property insurance but for a lower total cost than in 2002.

In order to compare like with like, we have reconstructed the premium components supposing that the average sum insured had not increased. The results are shown below.

Graph 10: Commercial Property Premium Components - Constant Sum Insured



Summary

Insurers passed on FSL savings of 10.0% for home insurance and 16.7% for commercial property insurance. In addition the premium rate changes in WA were noticeably less than the Australian averages. We can therefore conclude that the industry pass on the FSL savings to consumers.

Appendix A: Data Request to Insurers

Sigma Plus Consulting Pty Ltd
A.C.N. 082 804 199
Level 23, 44 St Georges Terrace
Perth WA 6000

Phone: 08 9268 2587
Fax: 08 9268 2444
E-mail: info@sigmaplus.com.au
Web Page: www.sigmaplus.com.au

Dear Sir / Madam,

Re: Emergency Services Levy Compliance Review

As you may be aware, clause 18 of the insurers' Letter of Understanding refers to the intention of the WA Government to obtain an independent report for Parliament to determine whether the requirements of the funding system have been met. While the quarterly audits that you have been carrying out have a focus upon the process of calculating and charging Fire Services Levy (FSL), the independent report looks at the total premiums charged to consumers, with a particular focus upon the way in which the savings from FSL are passed on to customers (i.e. whether base premium rates are increased to balance out the reduction in FSL). Its key objectives are to:

4. identify whether individual insurers are in compliance (have passed on the savings to consumers)
5. assess the effect of FSL changes upon insurance premiums
6. identify and assess any other factors that have affected insurance premiums

We have chosen to focus on FSL as it applies to property.

When South Australia phased out FSL, some consumers claimed that insurers were profiteering from its removal by increasing their premiums to balance out the reduction in FSL. The South Australian government commissioned an independent report that showed that insurers had indeed passed on the savings. That report collected data from insurers in a form that has been the basis for this data request.

There are three sections to this request. Section A gives the insurer an opportunity to show why they should opt out of this data request (e.g. when the insurer is in No longer writing business) and any special circumstances. Section B, containing the request for premium statistics and quotes, should be completed for all the relevant classes of business that you write. If you have more than one set of rates applying within the West Australian market (e.g. if you write business via different companies for direct versus intermediary business) then we require separate premium quotes for each different set of rates. Section C is optional, and gives the insurer an opportunity to quantify some extraordinary factors that have contributed to rate changes (e.g. compliance costs).

The data that you provide is confidential, the same as any other data that you provide to FESA. No individual insurer's data will be published in the independent report, although some industry totals will be shown. However, individual insurers will be listed and categorised in the independent report as either:

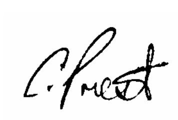
- complying
- non-complying
- not cooperating (with the independent report)
- exempted (e.g. in No longer writing business)

The legislation requires the Minister to table the independent report, which contains the list of insurers who are non-complying or not cooperating, in parliament. Once the report is been tabled in parliament, it is available to the public.

Since the independent report must be tabled in parliament by 30th April 2004, we will need to receive all of the insurers' data by 7th February 2004. Data can be sent to:

Email	info@sigmaplus.com.au
Facsimile (Sydney)	(02) 9437 1778
Facsimile (Perth)	(08) 9268 2444
Mail (Sydney)	PO Box 412 Crows Nest NSW 1585
Mail (Perth)	Level 23, 44 St Georges Terrace Perth WA 6000

Enquiries can also be made using the contact details above. We are willing to consider changes to the data requirements on a case by case basis, especially for those insurers who have written only small amounts of business attracting FSL.



Colin Priest
Director, Sigma Plus Consulting

Section A

Please indicate which applies to your business.

☐ Insurer
☐ Reinsurer
☐ Captive Insurer / Self Insurer
☐ Other (please describe) …………………………………………………

If you believe that this data request is not applicable for you, please indicate the reason below.

☐ No longer writing business
☐ No longer writing business in WA
☐ Not writing property insurance
☐ Other (please describe) …………………………………………………

Section B

Premium Statistics

All of the numbers in the report on this page are totals for all West Australian risks and are gross of outward reinsurance. Please provide separate totals for:

- Home Building
- Home Contents
- Commercial Fire
- Industrial Special Risks

Quarter Ending	Gross Premiums	Terrorism	FSL	GST	Stamp Duty	Net Premiums	Written Policies	Ave Sum Insured
Dec-01								
Mar-02								
Jun-02								
Sep-02								
Dec-02								
Mar-03								
Jun-03								
Sep-03								
Dec-03								

Gross Premiums is the total written premiums charged to clients.
Terrorism is the premium amount payable to the federal government's terrorism insurance scheme.
Net Premiums is the total written premiums less government charges and statutory terrorism costs.
Ave Sum Insured is the total written sums insured divided by the written policy count.

Sample Policy Renewals

The renewal reports require the insurer to provide selected details for 20 randomly sampled (it is suggested that you use some of the policies that were part of the quarterly FSL audits) policy renewals, with due dates falling within the 2003 calendar year, from each of the following classes:

Home Building
Home Contents
Commercial Fire
Industrial Special Risks

For each sample renewal, please provide the following information:

	2002 Policy Details	2003 Policy Details
Due Date		
Sum Insured		
Gross Premium		
Terrorism		
FSL		
GST		
Stamp Duty		
Net Premium		

For privacy reasons, please do not include any details that would identify the insured.

Premium Quotes

We require premium quotes at the start and end of the calendar year in order to measure the amount of premium changes that are due to rate changes rather than sum insured indexation or other causes. Values should be similar to what is shown on a policy schedule.

It is important that we compare like with like – so quotes for the beginning of the year should use the same rating factors as quotes for the end of the year.

For *metropolitan* risks, please select a postcode for an area in inner Perth.
For *country* risks, please select a rural postcode.

The *Comments on Changes* section provides a place for explaining any unusual circumstances or features. This will assist with any follow up required.

Quotes: Home Building Insurance

Home Building (Metropolitan)					
	Sum Insured				
	$75,000	$100,000	$150,000	$200,000	$300,000
31-Dec-02					
Premium					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
FSL					
GST					
Stamp Duty					
Total					

Home Building (Country)					
	Sum Insured				
	$75,000	$100,000	$150,000	$200,000	$300,000
31-Dec-02					
Premium					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
FSL					
GST					
Stamp Duty					
Total					

Comments on Changes

Quotes: Home Contents Insurance

Home Contents (Metropolitan)					
	Sum Insured				
	$30,000	$50,000	$75,000	$100,000	$150,000
31-Dec-02					
Premium					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
FSL					
GST					
Stamp Duty					
Total					

Home Contents (Country)					
	Sum Insured				
	$30,000	$50,000	$75,000	$100,000	$150,000
31-Dec-02					
Premium					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
FSL					
GST					
Stamp Duty					
Total					

Comments on Changes

Quotes: Commercial Fire

Commercial Fire (Metropolitan)					
	Sum Insured				
	$100,000	$300,000	$500,000	$750,000	$1,000,000
31-Dec-02					
Premium					
Terrorism					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
Terrorism					
FSL					
GST					
Stamp Duty					
Total					

Commercial Fire (Country)					
	Sum Insured				
	$100,000	$300,000	$500,000	$750,000	$1,000,000
31-Dec-02					
Premium					
Terrorism					
FSL					
GST					
Stamp Duty					
Total					
31-Dec-03					
Premium					
Terrorism					
FSL					
GST					
Stamp Duty					
Total					

Comments on Changes

Quotes: Industrial Special Risks

Note: we suggest that you choose a particular class of risk (e.g. light engineering) for this data.

Industrial Special Risks (Metropolitan)			
	Sum Insured		
	$5,000,000	$7,500,000	$10,000,000
31-Dec-02			
Premium			
Terrorism			
FSL			
GST			
Stamp Duty			
Total			
31-Dec-03			
Premium			
Terrorism			
FSL			
GST			
Stamp Duty			
Total			

Comments on Changes

Section C – Factors Contributing to Rates

Note: this section is optional

Compliance Costs

Some insurers have raised the issue of extra compliance costs in recent years. Please give an estimate of FSL and FSR compliance costs as a percentage of gross premiums below:

Compliance Cost Estimate: ______________________ % of premiums

Reinsurance Costs

Some insurers have suggested that reinsurance capacity has reduced and that this has placed pressure on rates. This section attempts to measure the extra costs due to changes in reinsurance.

Proportional Reinsurance

	2001	2002	2003
Percentage Retained			
Exchange Commission			

Non-Proportional Reinsurance

	2001	2002	2003
Excess			
Limit			
Reinsurance Premium as a % of Direct Premium			

Other

Please list details of any other factors that you wish to include.
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………
……………………………………………………………………………………

Appendix B: Insurers' Letter of Understanding

Dear

Re: <u>Fire Service Levies and Charges in Western Australia</u>

As you may already be aware, the Western Australian State Parliament has recently passed legislation to introduce a new system to fund fire services and the State Emergency Service in this State.

The ***Emergency Services Levy Bill 2002*** and the ***Fire and Emergency Services Legislation (Emergency Services Levy) Amendment Bill 2002*** currently await proclamation by the Governor of Western Australia. This is expected to occur before the end of 2002 to enable the legislation to come into effect from 1 January 2003.

The new system introduces a property-based Emergency Services Levy (ESL) to fully **replace** all existing funding arrangements. It will ensure that all property owners contribute fairly to these essential emergency services, removing the unfair financial burden that currently falls on the insured.

At the present time, 75% of the cost of the Career Fire and Rescue Services (Perth metropolitan area and major WA regional centres) is financed by the insurance industry, which raises this through levies and other charges placed on insurance premiums.

Under the new ESL, these charges must terminate on 31 December 2003. Accordingly, the insurance-based fire service levies will gradually be removed during 2003.

Policies that are issued after 1 January 2003 should only include the fire service levies and charges on the portion of the premium covering the period up to 31 December 2003. Any cover from 1 January 2004 onwards should not be subject to these charges. Furthermore, any levies/loading collected for periods beyond 31 December 2003 are to be refunded to policyholders.

For example, a policy for contents insurance for the twelve month period 1/07/03 to 1/07/04 will pay the fire service loading only on the period 1 July to 31 December 2003 (183 days). The remaining period will not be subject to the loading.

This transitional arrangement has been negotiated with the insurance industry through the Insurance Council of Australia (ICA). However, as we are advised that your company is not represented by the ICA, we are contacting you directly.

Under the agreed transitional arrangement, and in line with provisions in the enacting legislation, the insurance industry is required to contribute to the cost of the Career Fire and Rescue Service for the last time in 2003/04.

Accordingly, insurers that carry business in Western Australia will be required to contribute half (50%) of the 75% annual contribution. Individual insurers will be required to lodge their final Returns under Statutory Declaration for the period January 2002 to December 2002 by March 2003.

Please examine the attached *Letter of Understanding*, which sets out the requirements that have been agreed on behalf of the industry with the Western Australian Emergency Services Minister, and submit a completed and signed version of the return to this office by 31 December 2002.

Also attached is a copy of the standard letter and explanatory flier that has been agreed for communication with your policyholders (as referred to at D14 of the *Letter of Understanding*).

If you are not underwriting insurance in Western Australia then the *Letter of Understanding* may not applicable to you. In this case, you will not be required to return this document to us, however, we would appreciate a response in writing stating that you have understood the implications of the ESL and will comply with the legislation accordingly.

If you have any questions about these matters please contact Mr Dale Fulcher, FESA Senior Project Officer on (08) 9249 3632.

Yours sincerely

Mr Lindsay J Cuneo
FESA Director Funding Project

11 December 2002

LETTER OF UNDERSTANDING

From: Insurance Underwriters Operating in Western Australia
To: The Western Australian Minister for Emergency Services

Dear Minister

NEW FIRE AND EMERGENCY SERVICE FUNDING ARRANGEMENTS IN WESTERN AUSTRALIA
POLICY IMPLEMENTATION AND COMPLIANCE PROCEDURES

This letter confirms the agreement of ***[name of Insurer] (the Insurer)*** to the policy and implementation arrangements set out below which are associated with the new fire and emergency service funding arrangements and the introduction of the Emergency Services Levy (ESL) which is proposed to come into effect on 1 July 2003.

Broadly, under the present system (Fire Brigades Act 1942 – as amended), the cost of the Career Fire and Rescue Service (CFRS), which operates under the jurisdiction of the Fire and Emergency Services Authority of Western Australia (FESA) is funded by:

- Insurance companies, through internal loadings (premium loadings) or itemised Fire Service Levies (FSL) imposed on insurance policyholders of certain types of policies including, but not limited to, Fire policies, Industrial Special Risks policies, Contractors All Risk policies, Householders policies and Motor policies (Relevant Policies), and

- Local Governments; and

- The State Government.

Under the proposed new funding arrangements, all property owners in Western Australia will contribute to the cost of FESA services through the ESL, regardless of their property insurance arrangements. Hence, the Insurer understands that it is the States Government's intention that all policyholders should benefit from the introduction of the new arrangements in the following ways:

(a) by the refund of a proportionate amount of any premium loading/FSL component contained in prepaid insurance premiums relating to the period commencing on 31 December 2003; and

(b) as a direct consequence of the proposed funding changes, through a reduction in fire related insurance premiums for Relevant Policies continuing beyond 31 December 2003. This will be in the form of a gradual reduction over the period so that no polices extending beyond 31 December 2003 will attract any FSL..

This letter confirms the Insurer's commitment to the expected policy outcomes and also details how the Insurer will establish that it complies with Government's objectives at (a) and (b) above.

A. Final Contribution by Insurers in Period 2003/04

1. The Insurers final liability under the old funding arrangements will end on 31 December 2004. To determine this liability, Insurers will be required to contribute 50% of 75% of the actual cost of the CFRS for the financial year 2003/04;

2. Insurers will, on or before 31 March 2003, file a final return in relation to fire related insurance business written during the 12 months to 31 December 2002.

3. Insurers will contribute to the cost of the CFRS, as detailed in (1) above, based on the returns referred to in (2) above, in two equal instalments due within 28 days of 1 July 2003 and 28 days of 1 October 2003.

4. Insurers will, on or before 31 March 2004, file a final return in relation to fire related insurance business written during the 12 months to 31 December 2003.

5. accordance with existing practice, instalments will be based on approved FESA estimates of costs, and final adjustments will be effected at the completion of the 2003/04 financial year, based on actual costs. Accordingly, any final adjusting payment between the advance payments for 2003/04 and the final actual liability determined above for the Insurer, shall be payable by 31 December 2004.

B. Proportional Reduction of Insurance Loadings/FSL (Transitional Arrangements)

6. The Insurer will commence elimination of the existing premium loading/FSL from all policies commencing on 31 December 2002. No premium loading/FSL will attach to any policy that relates to the forward period commencing on 31 December 2003.

7. Elimination of the premium loading/FSL will occur on a pro-rata daily basis as set down below.

   In respect of **annual** policies with a commencement date that is on 31 December 2002, and ending on 31 December 2003, the full annual premium loading/FSL will be payable;

   - In respect of **annual** policies with a commencement date that is on 1 January 2003, and ending on 1 January 2004, 364/365^{ths} of the full annual premium loading/FSL will be payable. This calculation will be determined to 4 decimal points (0.9973);

- o Progressive elimination of the premium loading/FSL will occur over succeeding days on the same basis. Hence, in respect of **annual** policies with a commencement date that is on 30 December 2003, and ending on 30 December 2004, 1/365th of the full annual premium loading/FSL will be payable. This calculation will be determined to 4 decimal points (0.0027);

8. Where an underwriter is unable to progressively reduce the premium loading/FSL on a daily basis as outlined in clause 7 above, the Minister may agree to an alternative monthly basis of reduction, provided that the underwriter complies with the following:

- o That the monthly reduction strategy is made in advance. Hence, for example, all annual policies that have a commencement date of January 2003, 11/12ths of the full annual premium loading/FSL will be payable. Those will a commencement date of December 2003, no annual premium loading/FSL will be payable; and

- o That all policyholders receive a benefit from the change that is at least equal to that they would have received if the reduction strategy in clause 7 above had been adopted.

9. In relation to the progressive elimination of the existing CFRS charges on insurance policies mentioned in clauses 7 and 8 above, the Insurer notes and agrees that the premium loadings/FSL charges determined for the 2003 calendar period will need to reflect the financial impact of the pro-rata reduction process and the number and timing of policy renewals during the period 1 January 2003 to 31 December 2003. Hence, the monies raised from premium loadings/FSL in the period 1 July 2003 to 31 December 2003 should properly equate with the financial obligations of the insurance industry for 2003.

C. Refunds of Overpaid Premium Loading/FSL

10. The Insurer will, subject to, and in accordance with the provisions of this section, reimburse to policyholders of Relevant Policies a proportional amount of all prepaid premium loading/FSL which relates to the forward period commencing on 31 December 2003. As these payments would have been made prior to December 2002, such refunds should be made by 31 March 2003. The refunds will not include GST or Stamp Duty.

11. Prepaid premium loading/FSL "(R)" will be calculated in accordance with the following formula in respect of each Relevant Policy where there has been a prepayment of premium loading/FSL:
R = A/B x [F/C x P]

Where: R = the amount of the prepaid premium loading/FSL refund;

A = the total number of days by which a Relevant Policy issued by the Insurer extends beyond 31 December 2003 and in respect of which premium loading/FSL has been prepaid by a policyholder;

B = the total number of days for which a Relevant Policy has been issued by the Insurer;

C = 1 + F; where:

F = the percentage of FSL paid in respect of the Relevant Policy (expressed as, e.g. 0.18); and

P = the dollar value of that part of the total premium paid in respect of the Relevant Policy on which premium loading/FSL has been loaded (including FSL but excluding GST and Stamp Duty).

12. The percentage amount referred to as “F” in clause 11 above, will be the advisory FSL percentage as provided by the Insurance Council of Australia (ICA) to the Insurer as set down in Schedule A to this letter, OR, the percentage rates that apply to the FSL that has been explicitly identified on the renewal notice that relates to the period of insurance covered by the refund, OR, where no advisory percentage rates have been charged for a line of business, reductions will be based on the insurance contribution for fire services, as defined by the Fire Brigades Act 1942, divided between policies on the most equitable basis (i.e. the premium loading).

13. The Insurer will thereafter endeavour to refund all prepaid premium loading/FSL greater than or equal $1.00 by 31 March 2004. The Insurer will process refunds by issuing and sending cheques in the name of the respective policyholder to the mailing address held by the Insurer. The Insurer will, if refund cheques are not presented for encashment within a period of 60 days of the date of sending the cheque use reasonable endeavours to locate policyholders to enable refunds to be made. Should the Insurer be unable to locate policyholders by 30 June 2005, the amount of the unpresented refund cheque shall be deemed to be an unclaimed FSL refund and will be paid to the State by the Insurer in accordance with the requirements determined by the Minister.

14. Payment by the Insurer of unclaimed FSL refunds to the State in accordance with clause 13 above will fully discharge the legal obligations of the Insurer in respect of any claims by a policyholder in respect of such monies.

D. Communication With Policyholders

15. The Insurer in its written communications to policyholders concerning the new funding arrangements for FESA and in relation to the proportional elimination and refund of premium loading/FSL will adopt, in so far as it is practicable, standard wording as approved by the Minister.

16. Without limiting clause 15, the Insurer shall include information in the written communication to policyholders in relation to the values represented by "A", "B" and the total value of the premium loading/FSL that forms part of the premium referred to as [F/C x P) in clause 11.

E. Audit of Premium Loading/FSL Elimination and/or Refund

17. The Insurer shall procure an audit opinion from their external auditor on the extent of compliance with the undertakings on the proportional elimination of premium loading/FSL and/or any necessary refunds of overpaid premium loading/FSL. Such an opinion shall be contained in the annual accounts of the insurer and will be obtained at the Insurers cost. A copy of scope of the required audit opinion is shown at attachment A and the opinion shall be forwarded to FESA.

18. The Insurer notes that it is the intention of the Government to obtain an independent report, through an appropriate Minister, for Parliament to determine whether the requirements of the new funding system have been met. Such a report will be mandated in the enabling legislation and will be required to be tabled in the Parliament by 30 June 2004 and to highlight any areas of non-compliance.

19. The Insurer agrees to fully cooperate with the relevant party in the conduct of the review referred to in clause 18 above. Every opportunity will be given to the Insurer to respond to any potential adverse findings and to reply to any such issues before they are formally incorporated in any report.

F. Advance to FESA

20. The Insurer will contribute towards an industry cash advance of up to $15 million to FESA on 1 July 2003, to be made by certain insurers issuing Relevant Policies in Western Australia. This advance is to assist FESA with the implementation and initial cash flow requirements of the new funding arrangements.

21. The advance is to be repaid by or on behalf of FESA in full, without deduction or set off, by 3:00 pm local Western Australian time on 30 June 2004.

22. The Insurer notes that:

- o The ICA has agreed to coordinate the advance, for no charge, on the proviso that no liability will attach to the ICA for any unpaid amounts, which will be the responsibility of the industry as a whole to make good; and

The Insurer's contribution to the industry advance will be based on the same percentage contribution made to FESA by the Insurer in respect of the 2003/04 financial year.

Yours faithfully

Name of Insurer

For and On Behalf of Insurer

SCOPE OF THE AUDIT OPINION

The audit opinion is required to comment on the following:

Whether, having regard to:

a) The Fire and Emergency Services Legislation (Emergency Services Levy) Amendment Act 2002 which was enacted to eliminate the insurer's liability to any future contribution to the career fire and rescue service costs and which has been funded by the insurer from Fire Services Levies (FSL) and/or premium loadings on certain insurance policies; and

b) The amount contributed by the insured to these expenses via FSL and premium loadings on policies for the period 1 January 2002 to 31 December 2002.

there has been full and proper compliance with the implementation strategy as set down in the Letter of Understanding between the insurer and the Minister for Emergency Services.

To the extent that, in the opinion of the auditor, there has not been full and proper compliance as set down above, then the auditor should indicate:

c) The key areas of non-compliance; and

d) The estimated financial impact on policyholders.

This audit opinion is to be provided on a quarterly basis by the insurers to the Minister for Emergency Services by the 30th April 2003, 31st July 2003, 31st October 2003 and 28th February 2004.

END

Appendix C: Insurer Compliance Status

Insurer	Letter of Understanding	Status	Audited	Exempted Reason
Ace Insurance Limited	Signed	Complying	Yes	
Aioi Insurance Co Ltd	Signed	Complying	No	
Allianz Australia Insurance Ltd	Signed	Complying	Yes	
American Home Assurance Co	Signed	Complying	Yes	
American Re-insurance Co	Signed	Exempted	Yes	No longer writing business
AMP General Insurance		Complying	Yes	
AON Risk Services Non Scheme	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
AON Risk Services Scheme Ovid Sub	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
ARG Risk Management Limited	Signed	Complying	No	
Australian Alliance Insurance Co Ltd	Signed	Complying	Yes	
Australian International Insurance Ltd	Signed	Complying	Yes	
Australian Unity General Insurance Key Insure Mansions Aust Sub		Complying	No	
BHP Billiton Marine & General Insurance Pty Ltd	Signed	Complying	No	
Booker International Pty Ltd	Signed	Exempted	No	No longer writing business
Boral Limited		Exempted	No	No longer writing business
Budget Insurance Company Ltd	Signed	Exempted	Yes	Not writing property insurance
Castle Pacific Insurance Pty Ltd	Accepted	Complying	No	
Catholic Church Insurances Ltd	Signed	Complying	Yes	
CGU Insurance Limited	Signed	Complying	Yes	
CGU-VACC		Exempted	Yes	No longer writing business
Chambers Gallop McMahon	Signed	Exempted	No	Broker doesn't set prices
Chubb Insurance Co	Signed	Complying	Yes	
CNA Insurance (International Agencies) Pty Ltd	Signed	Complying	No	
Cobalt - AMP, Gordian, TGI		Exempted	No	No longer writing business
Coles Myer Ltd		Complying	No	

Insurer	Letter of Understanding	Status	Audited	Exempted Reason
Commonwealth Insurance Ltd (Comminsure)		Complying	No	
Corrvas Insurance C/- Aon Partners		Exempted	No	No longer writing business
CUMIS Insurance Society		Complying	No	
Dawes Motor Underwriting Group		Exempted	No	Not writing property insurance
Dawes Underwriting Australia Pty Ltd	Signed	Exempted	No	Not writing property insurance
Defence Service Homes Insurance		Complying	No	
EIG - Ansvar	Signed	Complying	Yes	
Elders Insurance	Signed	Complying	Yes	
Encompass Insurance Agency Heath Par	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
FM Insurance Co Ltd	Signed	Complying	Yes	
Fortron Insurance Group		Exempted	No	Not writing property insurance
Gerling Australia	Signed	Exempted	No	No longer writing business
GIO General Ltd AMP Par	Accepted	Complying	Yes	
Global Motor Underwriting Agency	Signed	Exempted	No	Not writing property insurance
Global Underwriting Services Pty Ltd	Signed	Complying	No	
Gordian Runoff Limited		Exempted	No	No longer writing business
Guardian Underwriting Services		Complying	No	
Guild Insurance Limited	Signed	Complying	Yes	
H W Wood Australia		Complying	No	
Hallmark General Insurance	Signed	Complying	Yes	
HBF	Signed	Complying	Yes	
Heath Lambert Australia Pty Ltd - HLG Australasia Encompass Ins Sub	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
HLG Australasia Pty Limited	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
Hollard Insurance	Signed	Complying	Yes	
Industrial & Commerical Insurance Brokers Ltd	Signed	Exempted	No	FSL is unchanged ($5,000 min)
Insurers Hotline Pty Ltd	Signed	Exempted	Yes	Not writing property insurance
Interpacific Underwriting Agencies Pty Ltd	Signed	Complying	No	
Jardine Lloyd Thompson Pty	Signed	Exempted	Yes	Corporate Australia-

Insurer	Letter of Understanding	Status	Audited	Exempted Reason
Ltd (Lloyds)				wide policies placed overseas
Jardine Lloyd Thompson Pty Ltd (Non-Lloyds)	Signed	Exempted	Yes	Coinsurance prices set by lead insurer
Jardine Lloyd Thompson Pty Ltd (Re Lloyds)	Signed	Exempted	Yes	Coinsurance prices set by lead insurer
JMD Ross Insurance Brokers Pty Ltd		Exempted	No	FSL is unchanged ($5,000 min)
JUA Underwriting Agency Pty Ltd	Signed	Complying	Yes	
Key Insurance Co Pty Ltd Australian Unity Par		Exempted	No	No longer writing business
Liberty International Underwriters	Signed	Complying	Yes	
Lumley General Insurance	Signed	Complying	Yes	
Mansions of Australia Ltd Australian Unity Par		Complying	No	
Marsh Pty Ltd (Lloyds & London)	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
Marsh Pty Ltd (Non-Lloyds)	Signed	Exempted	Yes	Corporate Australia-wide policies placed overseas
Marsh Pty Ltd (Sedgwick) (Non-Lloyds) Run Off see 68	Accepted	Exempted	Yes	No longer writing business
Mercantile Mutual Insurance		Exempted	No	No longer writing business
Millennium Underwriting Agencies Pty Ltd	Signed	Exempted	Yes	Not writing business in WA
Mitsui Sumitomo Insurance Co Ltd	Signed	Complying	Yes	
Munich Reinsurance Co of Australasia Ltd	Accepted	Complying	No	
Munich-American RiskPartners Australia Pty	Signed	Exempted	No	Not writing property insurance
National Transport Insurance Ltd		Exempted	No	Not writing property insurance
Nipponkoa Insurance Co Ltd	Signed	Complying	No	
NRMA Insurance Limited	Signed	Complying	Yes	
NZI Insurance Australia Ltd		Exempted	No	No longer writing business
Oceanic Underwriting		Exempted	No	No longer writing business
Orica Insurance Pty Ltd	Signed	Complying	Yes	
Ovoid Insurance Pty Ltd	Signed	Complying	No	
QBE Insurance Limited	Signed	Complying	Yes	
QBE Mercantile Mutual Insurance	Signed	Complying	Yes	
Qenos Pty Ltd		Exempted	No	Not writing property

Insurer	Letter of Understanding	Status	Audited	Exempted Reason
				insurance
RAC Insurance Pty Ltd	Signed	Complying	Yes	
Reward Insurance Limited	Signed	Exempted	No	No longer operating
Rio Tinto	Accepted	Complying	No	
SGIO Insurance Limited	Signed	Complying	Yes	
Shell Company of Australia Ltd		Complying	No	
Sompo Japan Insurance Inc	Signed	Complying	Yes	
Sportscover Australia Pty Ltd		Complying	No	
St Paul International Insurance	Signed	Exempted	No	No longer writing business
Stirling Risk Services Pty Ltd	Signed	Complying	No	
Sunarise Insurance Co Ltd		Exempted	No	Not writing business in WA
Suncorp Metway AMP Par	Accepted	Complying	Yes	
Swann Insurance	Signed	Exempted	Yes	Not writing property insurance
Taxi Insurance Co-operative Ltd		Exempted	No	Not writing property insurance
TGI Australia Limited		Exempted	No	No longer writing business
The Tokio Marine & Fire Insurance		Complying	No	
Times Properties Pty Ltd	Accepted	Complying	No	
Tourism Holdings Australia Pty Ltd C/- Willis NZ Ltd		Exempted	No	Not writing business in WA
Transport Industries Insurance		Exempted	No	No longer writing business
Underwriting Agencies of Australia Pty Ltd	Signed	Exempted	No	Not writing property insurance
Unilever Australasia	Accepted	Complying	No	
Unimutual	Signed	Complying	No	
Universal Underwriting Agencies		Complying	No	
Vero	Signed	Complying	Yes	
Wesfarmers Federation Insurance Limited	Signed	Complying	Yes	
Wesfarmers Risk Management Limited	Signed	Complying	No	
Western QBE Insurance Ltd - Tranport Sub	Signed	Complying	No	
Westpac General Insurance Limited	Signed	Complying	Yes	
Willis Australia (Lloyds & London)		Exempted	No	Corporate Australia-wide policies placed overseas
Willis Australia (Non Lloyds &		Exempted	No	Corporate Australia-

Insurer	Letter of Understanding	Status	Audited	Exempted Reason
London)				wide policies placed overseas
XL Insurance Company Limited	Signed	Complying	Yes	
Zurich Australian Insurance	Signed	Complying	Yes	

Appendix D: Hypothetical Sample Data

The following is an explanation of the steps we would take to test for compliance.

The initial step is to consider the classes of business that we would expect the insurer to write, and the size of the insurer. When the insurer supplies us with data we would check:

- whether they have supplied data for each class of business that they write
- whether the amount of premiums for each class of business is consistent with the amount of business that that write (based upon FESA and APRA statistics)

Premium Statistics

The insurer would provide us with a set of quarterly statistics in a format similar to the table below:

Table 4: Premium Statistics for Hypothetical Insurance Company

Home Building							
Quarter Ending	**Gross Premiums**	**FSL**	**GST**	**Stamp Duty**	**Net Premiums**	**Written Policies**	**Average Sum Insured**
Dec-01	1,188,505	155,380	100,214	92,263	840,648	3,170	151,992
Mar-02	1,338,670	175,145	112,926	103,017	947,582	3,487	154,744
Jun-02	1,419,656	185,748	119,765	109,198	1,004,945	3,712	156,406
Sep-02	1,341,806	175,576	113,198	103,121	949,911	3,458	158,372
Dec-02	1,284,213	167,992	108,357	98,986	908,878	3,322	159,589
Mar-03	1,398,168	148,033	117,931	107,936	1,024,268	3,601	166,063
Jun-03	1,606,020	121,132	133,325	147,134	1,204,430	4,153	169,729
Sep-03	1,364,131	57,577	113,402	129,817	1,063,336	3,678	172,792
Dec-03	1,354,605	16,348	112,747	128,942	1,096,569	3,746	138,075

Our first step is to run some sensibility checks on the data. We often found typographical errors when doing the sensibility checks. On several occasions we found that the insurer had misunderstood the data requirement and had provided values that were net of brokerage rather than net of government charges.

Table 5: Premium Statistics Sensibility Measures

Quarter Ending	Addition	FSL %	GST %	Stamp Duty %	Ave Gross	Ave Net	Ave Rate
Dec-01	0	18.48%	11.92%	10.98%	375	265	0.174
Mar-02	0	18.48%	11.92%	10.87%	384	272	0.176
Jun-02	0	18.48%	11.92%	10.87%	382	271	0.173
Sep-02	0	18.48%	11.92%	10.86%	388	275	0.173
Dec-02	0	18.48%	11.92%	10.89%	387	274	0.171
Mar-03	0	14.45%	11.51%	10.54%	388	284	0.171
Jun-03	0	10.06%	11.07%	12.22%	387	290	0.171
Sep-03	0	5.41%	10.66%	12.21%	371	289	0.167
Dec-03	0	1.49%	10.28%	11.76%	362	293	0.212

The addition column is a check that the components add to the total gross premium i.e. we expect Gross Premium – FSL – GST – Stamp Duty – Net Premium = 0. The FSL %, GST % and Stamp Duty % measures are all ratios against the Net Premiums. We expect to see:

- FSL% in the range of 8% to 15% for building and contents
- FSL% in the range 10% to 20% for commercial property
- GST% in the range 10% to 12%
- Stamp Duty % in the range 9.5% to 12.5%
- FSL% to be reducing towards zero over the final four quarters

The FSL percentages that we expect to see are lower than the 19% and 28% rates mentioned earlier in this report because most insurers only charge FSL for properties in metropolitan areas. Properties in rural areas do not usually attract FSL. Since a proportion of all properties are from rural areas, this gives an average FSL rate in the suggested range.

Ave Gross and Ave Net are the average gross premium (the amount charged to the consumer) and the average net premium (the amount that the insurer receives net of government charges) and are calculated by dividing the totals by the number of policies. Ave rate is a measure of the average amount of net premium per $100 of sum insured. These three measures should have:

- consistent orders of magnitude over time (e.g. ave gross should not be $200 one quarter and then $2,000 the next)
- values similar to industry averages (e.g. the ave gross for building should be closer to $300 than $3,000)

In the sample above, we would investigate the abnormal average rate for the December 2003 quarter, finding that the average sum insured was abnormally low for that quarter ($138k versus historical values of $160k). We would contact the insurer and check the value, asking for an explanation for the sudden change.

Our next step would be to calculate some measures of premium movement.

Table 6: Premium Statistics Premium Movement Measures

Quarter Ending	Quarterly Gross Increase	Quarterly Net Increase	Quarterly Rate Increase	Quarterly Sum Insured Increase	Annual Rate Increase	Annual Sum Insured Increase
Dec-01						
Mar-02	2.4%	2.5%	0.7%	1.81%		
Jun-02	-0.4%	-0.4%	-1.4%	1.07%		
Sep-02	1.4%	1.5%	0.2%	1.26%		
Dec-02	-0.4%	-0.4%	-1.2%	0.77%	-1.7%	5.0%
Mar-03	0.4%	4.0%	-0.1%	4.06%	-2.5%	7.3%
Jun-03	-0.4%	2.0%	-0.2%	2.21%	-1.3%	8.5%
Sep-03	-4.1%	-0.3%	-2.1%	1.80%	-3.5%	9.1%
Dec-03	-2.5%	1.2%	26.7%	-20.09%	23.7%	-13.5%

Once again, the abnormal sum insured figure for the December 2003 quarter has produced abnormal statistics for that quarter. This insurer has been slowly receiving higher premiums, but since the sum insured has increased too we can see that the average premium rate has actually dropped. The higher average premiums after government charges are because consumers are taking out greater amounts of cover, not because of any premium rate increases.

Based upon the premium statistics we would say that the insurer is complying:

- FSL % is reducing steadily towards zero
- average premium rates are actually dropping

Renewal Samples

The insurer would provide us with a number of sample renewals such as the one below:

Table 7: Renewal Sample for Hypothetical Insurance Company

2002 POLICY DETAILS						
DUE_DATE	**SUM_INSD**	**GROSS PREMIUM**	**FSL**	**GST**	**STMPS**	**NET PREMIUM**
27/05/2002	139,500	350.75	46.06	29.52	25.98	249.19

2003 POLICY DETAILS						
DUE_DATE	**SUM_INSD**	**GROSS PREMIUM**	**FSL**	**GST**	**STMPS**	**NET PREMIUM**
27/05/2003	145,100	369.15	30.16	31.07	27.34	280.58

Once again, our first step would be to run some sensibility checks on the data.

Table 8: Renewal Sample Sensibility Measures

Year	Addition	FSL %	GST %	Stamp Duty %	Ave Rate
2002	0.00	18.5%	11.8%	10.4%	0.179
2003	0.00	10.7%	11.1%	9.7%	0.193

The addition column is a check that the components add to the total gross premium i.e. we expect Gross Premium – FSL – GST – Stamp Duty – Net Premium = 0. The FSL %, GST % and Stamp Duty % measures are all ratios against the Net Premium. We expect to see:

- FSL% in the range of 18.5% to 19% for building and contents
- FSL% in the range 26% to 28% for commercial property
- GST% in the range 10% to 12%
- Stamp Duty % in the range 9.5% to 12.5%
- FSL% to be noticeably lower in 2003 than in 2002

Ave rate is a measure of the net premium per $100 of sum insured. This measure should have:

- consistent orders of magnitude between the two years (e.g. ave rate should not be 0.17 in 2002 and then 0.02 in 2003)
- values similar to industry averages (e.g. the ave rate for building should be closer to 0.15 than 0.01)

Similarly we would check that the sum insured is a similar order of magnitude between 2002 and 2003.

In several cases we found samples in which the premium changed orders of magnitude. Subsequent discussions with the insurers involved showed that the sample data had been for an endorsement transaction (a policy alteration) rather than a renewal transaction.

The sample passes these sensibility checks.

Our next step would be to check that the proportional reduction of FSL was calculated correctly. While many insurers had quarterly audits to check this calculation, some smaller operators did not undertake audits. In this step we sometimes found some incorrect FSL charges, and these amounts were subsequently refunded to consumers.

Table 9: Renewal Sample FSL Proportional Reduction

Base FSL%	18.5%
Due Date	27-May-03
Days to 31-Dec-2003	219
Divide by 365 days	60.0%
2003 FSL%	11.1%
cf FSL% charged	11.1%

This insurer's FSL percentage is 18.5%. There are 219 days of cover in 2003 beginning 27th May 2003 and ending 31st Dec 2003. To get the proportional FSL charge we divide 219 by 365. The calculated FSL is then 60% of the base rate. For this example the FSL charge matches the agreed proportional reduction.

Our next step would be to calculate some measures of premium movement.

Table 10: Renewal Sample Premium Movement Measures

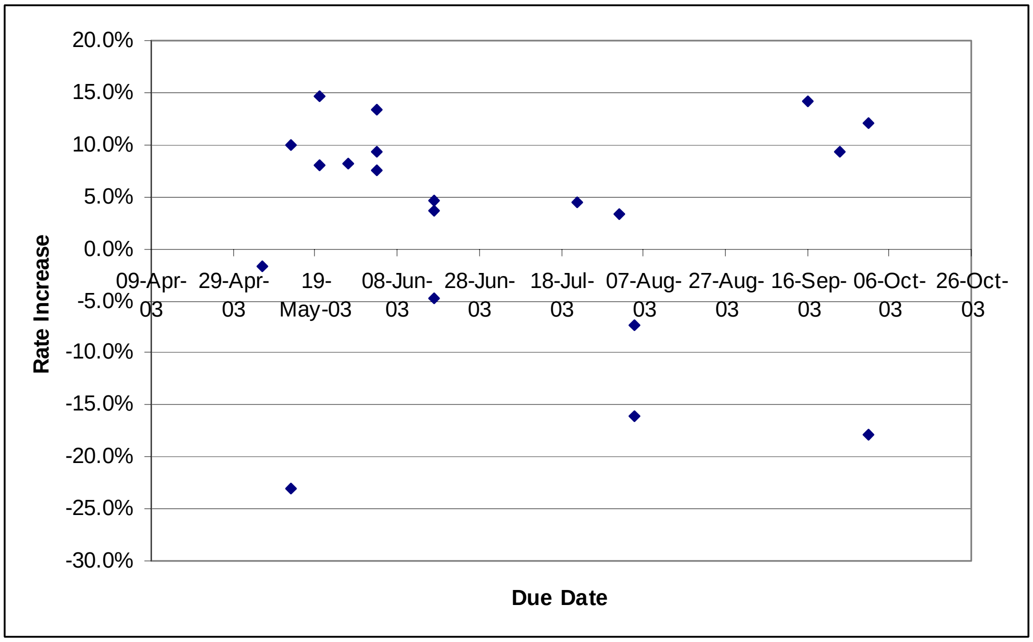
Annual Gross Increase	Annual Net Increase	Annual Rate Increase	Annual Sum Insured Increase
5.2%	12.6%	8.3%	4.0%

This particular policy has had a higher than average rate increase on renewal. We are more concerned with the average rate increase over a number of policies than over a single policy because the insurer may have changed their rating structure in a way that affects each policy differently.

We looked at the mix of rate increases over the full sample set. The characteristics that we looked for were:

- a mixture of positive and negative rate movements
- rate movements that did not gradually and consistently slope upward during the year (i.e. rate movements that did not offset the proportional reduction in FSL over the year)
- average rate movements that are consistent with our understanding of "normal" premium rating practice (as defined earlier in this report)

Table 11: Renewal Samples Mix of Rate Movements



Based upon the renewal sample we would say that the insurer is complying:

- rate increases are flat over the year
- there is a mixture of positive and negative rate movements
- the FSL charge is being reduced proportionally as expected

Premium Quotes

The insurer would provide us with sample premium quotes as at the start and the end of 2003. These quotes provided a cross check for the rate change estimates that we obtained from the premium statistics and the renewal samples.

Table 12: Premium Quotes for Hypothetical Insurance Company

HOME BUILDING (METROPOLITAN - 6000)					
	SUM INSURED				
	75,000	100,000	150,000	200,000	300,000
31-Dec-02					
PREMIUM	207.54	252.93	343.63	434.40	660.98
FSL	38.36	46.75	63.52	80.29	122.17
GST	24.59	29.96	40.71	51.46	78.31
STAMPS	21.64	26.36	35.83	45.29	68.91
TOTAL	292.13	356.00	483.69	611.44	930.38
31-Dec-03					
PREMIUM	228.29	265.57	343.63	390.96	561.83
FSL	0.00	0.00	0.00	0.00	0.00
GST	22.82	26.56	34.36	39.09	56.17
STAMPS	25.10	29.21	37.79	43.00	61.79
TOTAL	276.22	321.34	415.78	473.04	679.79

Once again, our first step would be to carry out sensibility checks on the data:

- the premiums should increase as the sum insured increases
- the FSL amount should be zero at 31st December 2003
- other than FSL, the amounts should be similar orders of magnitude between 31st December 2002 and 31st December 2003

Our next step would be to calculate the rate movements.

Table 13: Premium Quotes Rate Movement Measures

HOME BUILDING (METROPOLITAN - 6000)					
	SUM INSURED				
	75,000	100,000	150,000	200,000	300,000
Net Movement	10.0%	5.0%	0.0%	-10.0%	-15.0%
Gross Movement	-5.4%	-9.7%	-14.0%	-22.6%	-26.9%

A number of insurers have changed their premium rating. The sample from the hypothetical insurer shows that they have dropped their premiums for higher sums insured while increasing premiums for lower sums insured. The premium restructure explains why we saw such a range of rate changes in the renewal samples. The overall rate change for the insurer would depend upon the mixture of sums insured.