



26 August 2014

Mr David Murray  
Chair  
Financial System Inquiry  
GPO Box 89  
SYDNEY 2001

Dear Mr Murray

### **RESPONSE TO PANEL'S INTERIM REPORT**

The Brotherhood of St Laurence welcomes the opportunity to provide a submission to the Financial System Inquiry Panel's Interim Report.

The submission addresses the key questions posed by the Panel in relation to insurance coverage and credit access. It is informed by comments you offered in the 18 August meeting I attended with other community group representatives.

Should the Panel wish to discuss the submission please do not hesitate to contact me on (03) 9445 2425 or via email at [TRobinson@bsl.org.au](mailto:TRobinson@bsl.org.au).

Yours sincerely

**TONY ROBINSON**  
Senior Manager, Financial Inclusion  
Brotherhood of St Laurence

## Insurance coverage

*Does Australia have a problem with under-insurance that warrants some form of policy response?*

The Brotherhood of St Laurence believes that evidence strongly supports this question being answered in the affirmative.

A number of recent reports point to non-insurance being a significant issue in Australia. These include:

- NAB's 2014 Financial Exclusion report provided a breakdown of the adult Australian population by key determinants, one being general insurance coverage. It can be deduced from the report that 18.6 per cent of the population lacked general insurance coverage.
- ANZ's Survey of Adult Financial Literacy 2011 found that while health, income protection and comprehensive car insurance levels increased since 2008, a slight fall was recorded in the proportion of home owners with building insurance (from 80 per cent to 79 per cent).
- A 2011 BSL report (Collins, *Reducing the risks*) found that 23 per cent of Australians did not have any home contents insurance, with much higher figures for particular groups.

By way of international comparison Australia's position appears to be replicated in the United Kingdom, a 1998 Policy Studies Institute report finding that 20 per cent of households lacked contents insurance coverage.

Research has identified affordability as a key driver in the decision by consumers not to purchase insurance, especially low income consumers. The 2011 BSL report referred to above found that 42 per cent of low-income Australians desired greater insurance coverage, something their limited income did not permit.

While under-insurance exists in a number of areas a compelling argument for policy intervention is most apparent in respect of building insurance. Houses represent the single biggest investment in the lives of most adult Australians. As such the family home represents a financial anchor, providing security into retirement as well as the means to access credit through increasingly diversified mortgage products. Given the significance of houses in the lives of Australians any level of non or under-insurance is undesirable.

What is most surprising about the statistical evidence of non-insurance is the extent to which adult Australians do not insure their homes. Notwithstanding, in most cases, the comparatively small cost of building insurance, one in five owners is prepared to risk considerable financial loss through the absence of coverage. This decision forces government, whether it wishes or not, to act as the insurer of last resort, forcing onto taxpayers a significant cost that could have been mitigated by insurance.

The problem of non-insurance is compounded by the incidence of under-insurance. The 2003 Canberra bushfires were instructive in this regard. A subsequent ASIC report identified that only six of 488 houses destroyed were uninsured (1.2 per cent), a rate lower than the national incidence, estimated at between 2 and 15 per cent. But coverage does not equate to *adequate coverage*. ASIC

found that affected homeowners were underinsured, on average, by between 27 per cent and 40 per cent. ASIC further noted that the consumer price index (CPI) increase was not a sufficient guide to adequacy: while CPI rose by 17 per cent between 2000 and 2005, building costs were estimated to have risen by 33 per cent.

The problem does not stop there. Natural disasters usually inflict concentrated loss, the aftermath of which is a localised inflationary rebuilding phase due to the high demand placed on local workforces and resources. ASIC's report found that the simultaneous rebuilding of many homes rapidly pushed up building costs; in the case of Cyclone Larry the escalation was estimated to be 50 per cent.

While insurable events inflict an immediate loss, recovery is hindered by specific micro-inflationary pressures that the insurance industry is unable to control. Even homeowners who act prudently and increase their coverage can find themselves covered for significantly less than replacement cost. The fact that their loss may be less than had they not acted prudently is of little comfort when their capacity to resume their lives is seriously compromised.

Under-insurance presents a profound challenge for the industry as well as consumers. While at least one insurer in recent years has used the experience of natural disaster induced under-insurance to design an 'all costs' policy, the product factors in an estimated inflationary rebuilding cost. This creates upwards price pressure and as memories of the under-insurance experience fade the product's attractiveness to consumers inevitably diminishes. Over time it is highly likely consumers and the industry will come to regard product price as the sole guide to product value, thus ensuring a repetition of the under-insurance experience.

The home insurance market can therefore be seen to live with its own Gordian Knot. Efforts to address under-insurance through policy extension inevitably make products less affordable, aggravating consumer sentiment and the level of non-insurance. Focussing instead on affordability leads to contracted coverage which aggravates the incidence of under-insurance. Over many years the industry has been unable to resolve this conundrum.

The Brotherhood of St Laurence believes that this intractable problem warrants a public policy. Without government intervention the problem will remain, exposing homeowners and taxpayers to recurring loss.

The Brotherhood's support for government intervention is based on a belief that houses will continue to be the prime assets of adult Australians and serve as an anchor for financial security through the remainder of their lives. It is highly desirable that houses continue to serve this valuable role which can only be achieved when insurance is maintained. In view of the community benefit that arises from higher levels of insurance coverage the Brotherhood believes some form of universal housing insurance is a justifiable objective.

The possible involvement of the Commonwealth government in housing insurance would follow earlier government interventions which have addressed similar public policy challenges while still permitting the operation of successful and competitive private insurance markets. Public health insurance, for example, has been a mandated feature of Australian life for most of the period since the establishment of Medibank in 1975. This has not, however, prevented a large private health insurance market from delivering a range of products that augment the universal public scheme.

Similarly, Australia's compulsory superannuation system provides life insurance in the form of savings transfers on the death of the fund member. Alongside the system operates a large, successful and competitive optional life insurance market.

A government presence in the home building insurance market, however it is constructed, offers a notable additional benefit. Government efforts to mitigate bushfire and flood risks are strengthened when government can use insurance to raise awareness of risk and stimulate mitigation measures. This is the trademark of universal public insurance schemes such as that run by Victoria's Transport Accident Commission. The TAC is governed by the *Transport Accident Act 1986*, section 11 of which requires it to 'ensure that the transport accident scheme emphasise accident prevention and effective rehabilitation'. Likewise the functions of the Commission oblige it, amongst other things 'to promote the prevention of transport accidents and safety in the use of transport'.

An ongoing program of advertising, policy change and road treatments, all informed by statistical evidence, has helped achieve a spectacular decline in road accident fatalities and injuries over the past 45 years, the fatality rate falling from 31.2 per 100,000 Victorians in 1970 to 5.3 in 2010. The six-fold reduction delivers an enormous annual saving to the Victorian community and demonstrates the valuable role that public schemes with dedicated risk mitigation/educative roles can play. The Panel's interest in international best practice should not distract it from acknowledging the pre-eminence of local examples where they exist, the TAC being regarded as possibly the best risk mitigator of its kind in the world.

The educative role of statutory schemes is not replicated by private insurers for two key reasons. Firstly, there is no legislated obligation imposed on private insurers to externalise the evidence and success of risk and mitigation strategies. Insurers would understandably be nervous about adopting this approach voluntarily, as consumers are less likely to seek insurance coverage if they believe the risk of loss is decreasing. Even if an obligation to educate were imposed on insurers it would not necessarily be undertaken efficiently by the numerous competing entities to which it applied. This highlights a second profound challenge for private insurers in respect of risk mitigation: commercial reality engrains a reluctance to share information that might, even in a small way, be of benefit to a competitor.

Beyond the point of acknowledging the need for the government to intervene in the home insurance market to address the incidence of non-insurance and under-insurance, consideration ought to be given to both the specific objective(s) of the intervention and the means that should be adopted to achieve it/them. The government could, for example, set as its goal a universal minimum level of building insurance coverage. It could seek to moderate or eliminate the under-insurance gap that arises in the aftermath of natural disasters. A third objective could be the active mitigation of risk through the funding of infrastructure works that reduce the incidence of loss. Alternatively, all three objectives along with others could be pursued.

Just as the government can pursue one or more public policy objectives, so it can employ a range of facilitating measures. Funding could be provided for a reinsurance pool that would address upward price pressures in the retail market. The health insurance model could be adopted in which people who take out home insurance policies are supported by a government rebate. Equally, the government might establish a last resort policy for specific risks that the private market is not

prepared to service, the likelihood of which grows as enhanced data becomes available to the industry and granular pricing is adopted.

Regardless of the way in which the government chooses to act in support of the objective(s) it sets, the fairest way for it to facilitate its role is through a universal charge. Again, this idea is hardly radical. Australia's national health insurance system operates on the same principle. So do a number of state-based fire services funding schemes. The value of universality is that capability can be established quickly through a small charge due to the very large number of properties to which the charge applies. Universality's other benefit is that it creates a comprehensive means of information dissemination, thus maximising the educative role necessary to achieve meaningful risk mitigation.

## Access to credit

*Is there a role for government and/or industry to facilitate further development of microfinance initiatives in collaboration with the not for profit and community sector? To what extent would this improve access to small amount credit?*

The Brotherhood of St Laurence believes this question should also be answered in the affirmative.

In our earlier submission, commentary was provided about the inability of existing concessional loan programs to meet the needs of low-income Australians. Two examples were provided: unequal geographic access to the No Interest Loan Scheme (NILS) and the inability of low-income consumers to access reliable vehicles. The following advice provides a more detailed picture of unmet demand in Australia in respect of reliable vehicles as well as examples of alternative approaches in the United States.

Australia today is characterised by large sprawling cities in which a growing share of population lives in outer suburban communities. These households, on average, are in receipt of lower incomes and are more reliant on private transport. Outer suburban employment is more aligned with lower skilled occupations including higher levels of casual and shift work. For these reasons the role of the private vehicle in optimising employment and household income is critical.

The Brotherhood of St Laurence's investigations reveal a coincidence of older and inherently less reliable vehicles in outer suburbs. In the Shire of Yarra Ranges, for example, 53 per cent of registered vehicles are more than ten years old. Ageing vehicles cost more to run and where multiple vehicles are operated by a low-income family the household budget impact is considerable.

Upgrading vehicles is an option many low-income families do not have, as this requires access to credit well beyond what both the mainstream financial system and concessional loans currently offer. As mentioned in our earlier submission, the largest most commonly available concessional product in Australia is the \$3000 NAB Step Up loan. Once statutory charges are accounted for, this loan typically purchases a vehicle that is around 15 years old, has travelled more than 150,000 kilometres, and is consequently far less reliable than a newer vehicle. The gap between what the financial system offers low-income households and what is required for reliable transportation is enormous and there is little if any likelihood of this situation changing at the volition of credit providers.

In contrast to Australia, international experience demonstrates that productive and sustainable solutions are possible. The United States has featured a variety of affordable car provision programs over the past thirty five years, the largest of which are *Ways to Work* and *More than Wheels*. *Ways to Work* operates 44 offices and describes itself as a non-profit financial empowerment loan program helping working families increase their self-sufficiency through access to reliable transport and financial education. The program offers low-interest loans for vehicle purchase. Since its establishment *Ways to Work* has provided loans to over 34,000 families totalling almost \$80 million.

*More than Wheels* is based in New Hampshire and grew out of a mid-1980s motor industry initiative. It assists low-income clients to purchase vehicles and through the course of the loan repayment helps build greater financial resilience and a strengthened credit rating. A six weekly, two-hour

'Financial Fitness' course is a compulsory feature of a client loan. The results of the programs are impressive:

- 75% of clients experienced decreased expenditure on car repairs
- 73% of clients reported an improved financial outlook
- 50% of clients reported improved access to employment
- 52% of clients reported better access to health care
- 38% of clients reported improved access to nutritious food options.

The US programs carefully select clients, which assists in minimising loan defaults. Published research consistently points to the improved credit rating of clients.

Notwithstanding the ample evidence of the success of affordable and reliable car provision over more than two decades, Australia's financial system has not followed suit. To be fair, neither has Australia's not-for-profit sector. What is equally surprising in view of the employment benefits that affordable car provision can deliver has been the lack of awareness and interest shown by governments across Australia.

As mentioned in our earlier submission, the Brotherhood of St Laurence is currently investigating the viability of an affordable car provision service. While the solution envisaged by BSL may not require new micro-credit products as such, it will require the active involvement of the government, corporations and the community sector. A key challenge is how collaboration is stimulated. The community sector alone cannot secure the involvement of credit providers without seed funding. At the same time Australia's financial system does not lend itself to investing readily in unproven product and service innovations for the benefit of low-income consumers. This is not to deny that credit providers and the community sector can initiate innovative programs without government assistance; Saver Plus and NILS are testaments to that capability. However, for every partnership that does succeed many others never germinate.

In our earlier submission BSL suggested that the Commonwealth Government could facilitate greater collaboration between industry and the community sector through the establishment of the Stewardship Principle: a recognition that those entities licensed to provide banking services have a responsibility to ensure that the products and services they alone can offer cater for the reasonable needs of low-income and vulnerable consumers. Alongside this the government could provide contestable funding for innovative pilot programs. BSL believes that these two measures would go a long way to ensure greater collaboration between industry and the community sector resulting in the more rapid development of needed financial products and services to serve the interests of Australia's low-income and vulnerable consumers.

A model already exists that demonstrates the impact of competitive funding on collaboration and innovation. Financial Literacy Australia's recent funding round attracted in excess of 200 applications, of which less than 30 were supported. The experience of BSL has been that competitive bidding processes like this accelerate collaboration and, even in the absence of funding support, encourage further communication between the two sectors with a view to future partnerships.

A decision by government to act as an instigator of micro-finance innovation is one the Brotherhood of St Laurence would strongly support. Even a modest program of contestable grants would allow valuable work to be undertaken much more frequently than currently occurs. A program of this kind would not only stimulate collaboration between the financial sector and the non-government sector but also allow the government to encourage innovative effort in the areas in which it is most needed.