



Royal Commission into Misconduct in the Banking,  
Superannuation and Financial Services Industry

# **Some Features of the General and Life Insurance Industries**

**Background Paper 26**

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## 1. Purpose of this paper

The purpose of this paper is to discuss some of the factors that influence how insurers provide general and life insurance to consumers to assist consumers manage risk. It also discusses the size and composition of the general and life insurance industries, and the main industry participants. How the industry says customers will be treated if they make a claim is also considered.

This paper shows that:

- The general insurance industry earned \$23.1 billion from consumer-oriented insurance products in 2017.
- In 2017, the life insurance industry earned \$18.1 billion in premiums from life insurance policy holders in 2017.
- Both the general insurance and life insurance industries are dominated by a few large insurers.
- When taking out general insurance, consumers may interact with an insurance broker or an insurance agent, as well as the insurer.
- Many consumers of life insurance obtain that product in a group policy that is organised as part of their superannuation arrangements.
- Both the general and life insurance industries have adopted codes of conduct that provide for claims management processes. A further code applies to insurance provided as part of superannuation.

## 2. Insurance and risk

Insurance is a method of managing risk or uncertainty. Effective insurance arrangements can diversify and spread the risk away from those that are unable or unwilling to bear that risk or uncertainty toward those that are willing to bear the risk or uncertainty. Insurance can also encourage insured persons to minimise or avoid risks, and can provide an indicator to society of the price that should be attached to specific risks. For example, the Insurance Council of Australia has suggested that:

*In the broader economy, risk based pricing is integral in ensuring that resources are allocated efficiently and that behaviours are adjusted in response to the price signal. In the case of natural peril risk, risk based pricing motivates land use managers and owners to adjust planning and development arrangements to mitigate against future risk and thereby reduce the overall cost of natural disaster perils. Risk based pricing in personal injury provides the basis under which firms and households adjust their practices to limit injury and the overall social cost of disability and injury.<sup>1</sup>*

There are several ways that people and societies can deal with risk and uncertainty. Insurance provided by the market is one method. In addition to market insurance, individuals may self-insure or society, through governments, may—either explicitly or implicitly—bear the risk of certain events.

Whether insurance against a specific risk is provided by the market is influenced by whether the market finds it economical to provide that insurance. Governments in Australia have intervened in some insurance markets to increase the likelihood that it will be economical for the market to provide insurance for certain risks.

At times, governments have directly provided insurance to cover some risks. For other risks, society, through governments, has effectively become the insurer through formal and informal social protection schemes.

### 2.1. Adverse selection and moral hazard

Two phenomena widely recognised in economics have a significant impact upon the provision of insurance by the market: adverse selection and moral

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<sup>1</sup> Insurance Council of Australia, *Submission to Financial System Inquiry Interim Report* (August 2014) 6 <[http://fsi.gov.au/files/2014/08/Insurance\\_Council\\_of\\_Australia.pdf](http://fsi.gov.au/files/2014/08/Insurance_Council_of_Australia.pdf)>.

hazard. Both may result in the provision of insurance by the market being less than socially optimal, or preventing provision of insurance by the market at all.

When a person seeking insurance has more information about the risks they face than the prospective insurer, this creates asymmetric information in insurance markets. As the prospective insurer cannot distinguish between those people that exhibit higher risk and those that exhibit lower risk, the insurer can only offer the same insurance, at the same price, to whoever applies.<sup>2</sup>

People who know they face higher risks will then be more likely to obtain the insurance than people that know that they face lower risk; meaning that the pool of insured people is more risky than the whole population. This effect is known as **adverse selection**.<sup>3</sup>

The capacity of an insurance company, however, to price insurance to reflect the higher risk within the pool of insured persons is limited. As the Nobel Prize winning economist George Akerlof noted,<sup>4</sup> writing in the context of the US health insurance market:

*It is a well-known fact that people over 65 have great difficulty in buying medical insurance. The natural question arises: why doesn't the price rise to match the risk?*

*...as the price level rises the people who insure themselves will be those who are increasingly certain that they will need the insurance...*

*The result is that the average medical condition of insurance applicants deteriorates as the price level rises - **with the result that no insurance sales may take place at any price.***<sup>5</sup>

In insurance markets where adverse selection is pronounced, the market may not provide any insurance at all.

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<sup>2</sup> Insurance Council of Australia, *Submission to Financial System Inquiry* (March 2014) 19 <[http://fsi.gov.au/files/2014/04/Insurance\\_Council\\_of\\_Australia.pdf](http://fsi.gov.au/files/2014/04/Insurance_Council_of_Australia.pdf)>.

<sup>3</sup> George A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism,' (1970) 84(3) *The Quarterly Journal of Economics*, 488, 493.

<sup>4</sup> The Nobel Prize, *George A. Akerlof: facts* <<http://www.nobelprize.org/prizes/uncategorized/all-prizes-in-economic-sciences/>>.

<sup>5</sup> George Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism,' (1970) 84(3) *The Quarterly Journal of Economics* 488, 492-3 (emphasis added).

In the context of insurance markets, **moral hazard**<sup>6</sup> refers to the possibility that the insured, because they are insured, will engage in risky activities or behaviours that they would not engage in without insurance. Perversely, where moral hazard exists, insurance increases the overall level of risk incurred by society.

For an insurer, there is an incentive to prevent morally hazardous behaviour by those which it insures. For example, insurers may require that an insured person bear some portion of any claim via an excess or deductible.<sup>7</sup> While an excess requires an insured person to bear some part of any loss arising under an insurance contract and a deductible is an amount that is deducted from the value of a claim made under an insurance contract, the practical effect of an excess and a deductible is the same.<sup>8</sup>

## 2.2. Types of risk management

Market insurance is one of several ways that individuals and society can manage risk. Self-insurance is used to manage risks that are either small enough for the individual to bear, or where the market is unwilling to provide insurance. Market insurance allows individuals to transfer certain categories of risk away from themselves to an insurer for a cost. Market insurance, however, does not cover all categories of risk. Social protection arrangements, whether formal or informal, can also be used to deal with risks that are not able to be effectively insured by the market. These types of risk management are discussed below.

**Self-insurance** is where a person bears the risk or uncertainty of an event themselves. Formally, self-insurance involves setting aside funds (provisioning) in anticipation of an event occurring.<sup>9</sup> The Productivity Commission has noted that:

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<sup>6</sup> For a history of the term, see: David Rowell, Luke Connelly, 'A History of the Term "Moral Hazard"' (2012) 79(4) *Journal of Risk and Insurance* 1051.

<sup>7</sup> Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report* (17 December 2014) vol 2, 353 <<http://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume2.pdf>>; Insurance Council of Australia, *Submission to the Financial System Inquiry* (March 2014) 13 <[http://fsi.gov.au/files/2014/04/Insurance\\_Council\\_of\\_Australia.pdf](http://fsi.gov.au/files/2014/04/Insurance_Council_of_Australia.pdf)>.

<sup>8</sup> Lloyd's, *Glossary and Acronyms* <<http://www.lloyds.com/help-and-glossary/glossary-and-acronyms>>.

<sup>9</sup> The Productivity Commission argues self-insurance requires provisioning, or the *ex ante* setting aside of funds. No provisioning reflects that there is no insurance: see Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report* (17 December 2014) vol 2, 415 <<http://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume2.pdf>>.

*[S]elf-insurance can be a more efficient outcome in a number of cases. For example, self-insurance could be more efficient if market or government distortions drive up the cost of commercial insurance, making self-insurance a more affordable option. Self-insurance might also be a better option (or the only option) where insurance companies will not offer insurance, such as where information asymmetries result in the asset owner having a better understanding of the risk than insurers. Asset owners might also be better off self-insuring where losses can be reliably predicted, or where they have high frequency and low severity.<sup>10</sup>*

The unwillingness of the market to provide insurance can also reflect the risks faced by a person being too high, and provide an incentive for that person to reduce their exposure to (mitigate) those risks.<sup>11</sup>

**Market insurance** is where an insurer agrees to incur a risk in return for a fee from the insured. The process of taking on the risk is known as ‘underwriting’ the risk.<sup>12</sup> By underwriting many people and many different classes of risks, insurers are able to diversify risk between people and across different classes of risk so that the variability of claims is reduced.

The Commonwealth has legislative power over insurance,<sup>13</sup> and has enacted legislation that affects the provision types of insurance by the market.<sup>14</sup> Generally, however, insurers are free to determine what types of risk they are willing to underwrite and at what prices.

**Social protection** occurs where a risk is borne by the community generally, either through explicit schemes, or through *ad hoc* arrangements. For example, in Australia, healthcare is provided under a universal health insurance scheme known as Medicare.<sup>15</sup> For other risks, such as natural disasters, often governments in Australia have provided assistance on an

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<sup>10</sup> Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report* (17 December 2014) 415, vol 2 <<http://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume2.pdf>>.

<sup>11</sup> *Ibid.*

<sup>12</sup> Lloyd's, *Glossary and Acronyms* (2018) <<http://www.lloyds.com/help-and-glossary/glossary-and-acronyms>>.

<sup>13</sup> *Constitution*, sub-s 51(xiv) grants legislative power to the Commonwealth with respect to ‘insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned’.

<sup>14</sup> For example, *Insurance Act 1973*, *Insurance Contracts Act 1984* and the *Life Insurance Act 1995*.

<sup>15</sup> Health Direct, *What is Medicare?* (January 2018) <<http://www.healthdirect.gov.au/what-is-medicare>>.

*ad hoc* basis. As the 2012 *Review of the Insurance Arrangements of State and Territory Governments under the Natural Disaster Relief and Recovery Arrangements Determination 2011* noted:

*Historically, most governments, in Australia and overseas, have financed the costs associated with natural disasters only after a catastrophic event has taken place. Measures such as reallocating existing funds, increasing taxes, accessing domestic and international credit markets, borrowing from multilateral financial institutions or applying for international aid have been used.*<sup>16</sup>

Social protection schemes can complement the market provision of insurance by allowing a government effectively to act as an ‘insurer of last resort’ for risks that are too large for the insurance market to bear alone.<sup>17</sup>

### **2.3. Policy interventions in insurance markets**

For some risks, the insurance available combines aspects of self, market, and social protection because governments have implemented policies that alter the way market insurance is provided. For example, policy interventions by governments have:

- required that market insurance be obtained (e.g. third party motor insurance is compulsory in all states and territories);<sup>18</sup>
- required that market insurance cover specific risks (e.g. complying private hospital health insurance must provide minimum levels of insurance for psychiatric care, rehabilitation, and palliative care);<sup>19</sup>
- required standard terms in contracts for insurance (e.g. standard definition of flood);

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<sup>16</sup> Department of Finance and Deregulation, *Review of the Insurance Arrangements of State and Territory Governments under the Natural Disaster Relief and Recovery Arrangements Determination 2011* (September 2012) 19 <[http://www.finance.gov.au/sites/default/files/ndrra-finance-phase-2-report-sep-2012\\_0.pdf](http://www.finance.gov.au/sites/default/files/ndrra-finance-phase-2-report-sep-2012_0.pdf)>.

<sup>17</sup> Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report* (17 December 2014) vol 2, 416 <<http://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume2.pdf>>.

<sup>18</sup> Dr Andrew Fronsco & Alan Woodroffe, ‘Public vs. Private underwriting and administration of personal injury statutory insurance schemes’ (Paper presented to the Actuaries Institute Injury & Disability Schemes Seminar 12 – 14 November 2017) 3 <<http://www.actuaries.asn.au/Library/Events/%20InjuryDisabilitySchemesSeminar/2017/PublicVsPrivatePaper.pdf>>.

<sup>19</sup> *Private Health Insurance Act 2007*, s 72-1.

- directly underwritten certain types of insurance (e.g. workers compensation schemes);<sup>20</sup> and
- provided reinsurance to support the market provision of insurance (e.g. reinsurance in relation to terrorism).<sup>21</sup>

### 3. The consumer general insurance market

The size of the general insurance market in Australia can be measured by the total amount of insurance premium earned by insurers from general insurance policy holders in a given year; known as the **gross earned premium**.<sup>22</sup> Gross earned premium is, in effect, what purchasers of insurance have paid for general insurance in the relevant period.

Total gross earned premium in the entire general insurance industry (consumer and commercial) in the year ending 31 March 2018, excluding reinsurance, was \$45.3 billion.<sup>23</sup> The gross earned premium in the year ending 31 March 2018 for the five categories of insurance that are oriented towards consumers (discussed below) was \$23.2 billion. The consumer insurance industry, therefore, comprises about half of the Australian general insurance industry; with the other half oriented towards commercial insurance.

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<sup>20</sup> Workers compensation schemes are publically underwritten in New South Wales, Victoria, Queensland and for Commonwealth employees and defence personnel, see: Dr Andrew Fronso & Alan Woodroffe, 'Public vs. Private Underwriting and Administration of Personal Injury Statutory Insurance Schemes' (Paper presented to the Actuaries Institute Injury & Disability Schemes Seminar 12 – 14 November 2017) 16  
<<http://www.actuaries.asn.au/Library/Events/%20InjuryDisabilitySchemesSeminar/2017/PublicVsPrivatePaper.pdf>>

<sup>21</sup> The Australian Reinsurance Pool Corporation provides reinsurance for terrorism events: see Terrorism Insurance Bill 2002 Revised Explanatory Memorandum, 2  
<<http://www.legislation.gov.au/Details/C2004B01185/04b0d868-7531-4c89-8229-45bfab044c19>>.

<sup>22</sup> Gross earned premium also includes government levies, such as fire service and similar levies that are levies imposed by all states and the Australian Capital Territory, see: APRA, *Annual General Insurance Institution-level Statistics Glossary* (24 May 2018)  
<<http://www.apra.gov.au/sites/default/files/giils20glossary1.pdf>>; NSW Treasury, *Interstate Comparison of Taxes 2017-18* (April 2018) 25-7  
<<http://www.treasury.nsw.gov.au/sites/default/files/2018-04/TRP18-01%20Interstate%20Comparison%20of%20Taxes%202017-18.pdf>>.

<sup>23</sup> APRA, *Quarterly General Insurance Performance Statistics March 2018* (24 May 2018)  
<<http://www.apra.gov.au/publications/quarterly-general-insurance-performance-statistics>>.

### 3.1. Types of general insurance available to consumers

APRA provides definitions of different categories of insurance that might be offered by insurers.<sup>24</sup> Five of those categories of insurance are oriented towards the needs of consumers. Those categories of insurance are:

- **Domestic motor vehicle insurance** — insurance that covers the ‘private use motor vehicles including utilities and lorries, motor cycles, private caravans, box and boat trailers, and other vehicles not normally covered by business or commercial policies.’<sup>25</sup> It does not include any commercial use of motor vehicles, and does not include **compulsory third party motor vehicle insurance**, which is a distinct category of insurance.<sup>26</sup>
- **Houseowners and householders insurance** — insurance for risks that are commonly included in household policies, such as insurance for building, house contents, personal property, arson and burglary.<sup>27</sup>
- **Travel insurance** — ‘[i]nsurance against losses associated with travel, including loss of baggage and personal effects, losses on flight cancellations and overseas medical costs.’<sup>28</sup>
- **Consumer Credit insurance** — which protects ‘a consumer’s ability to meet the loan repayments on personal loans and credit card finance in the event of death or loss of income due to injury, illness or unemployment.’<sup>29</sup>

Chart 1 shows the value of gross earned premiums in the year to 31 March 2018 for each of the five types of insurance discussed above.

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<sup>24</sup> APRA, *Prudential Standard GPS 001: Definitions* (January 2015) 11 <<http://www.apra.gov.au/sites/default/files/141120-GPS-001.pdf>>.

<sup>25</sup> Ibid.

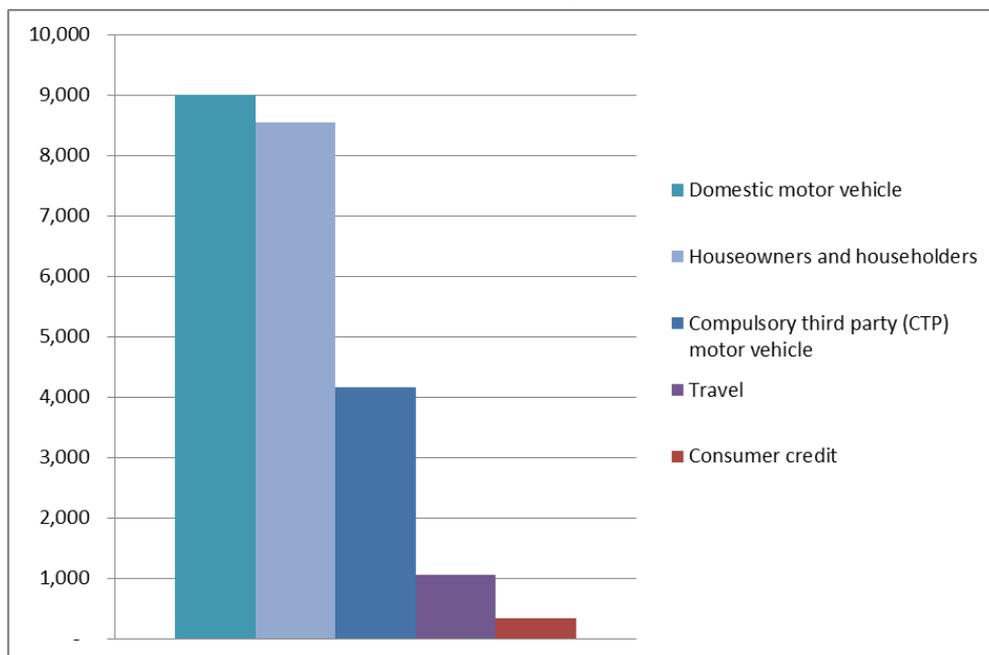
<sup>26</sup> Ibid, 11, 13.

<sup>27</sup> Ibid, 11.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid, 12.

**Chart 1: Gross earned premium across five categories of consumer-oriented general insurance, year ending 31 March 2018, \$'m**



Source: APRA, *Quarterly General Insurance Performance Database March 2018* (24 May 2018).

In the year ending 31 March 2018, domestic motor vehicle insurance was the largest of the five types of consumer-oriented insurance, earning \$9.2 billion in gross earned premium. Houseowners and householders was the next largest segment in the year ending 31 March 2018, earning \$8.6 billion in gross earned premium. Consumer credit insurance was the smallest category of consumer-oriented insurance, and earned the least gross earned premium in the year ending 31 March at \$331 million.

### 3.2. Insurers offering general insurance to consumers

At 30 June 2018, there were 95 entities licenced to provide general insurance in Australia.<sup>30</sup> However, not all insurers were licensed to provide all types of insurance, and some general insurers concentrated primarily on commercial, not consumer-oriented, insurance.<sup>31</sup> It is likely therefore, that at

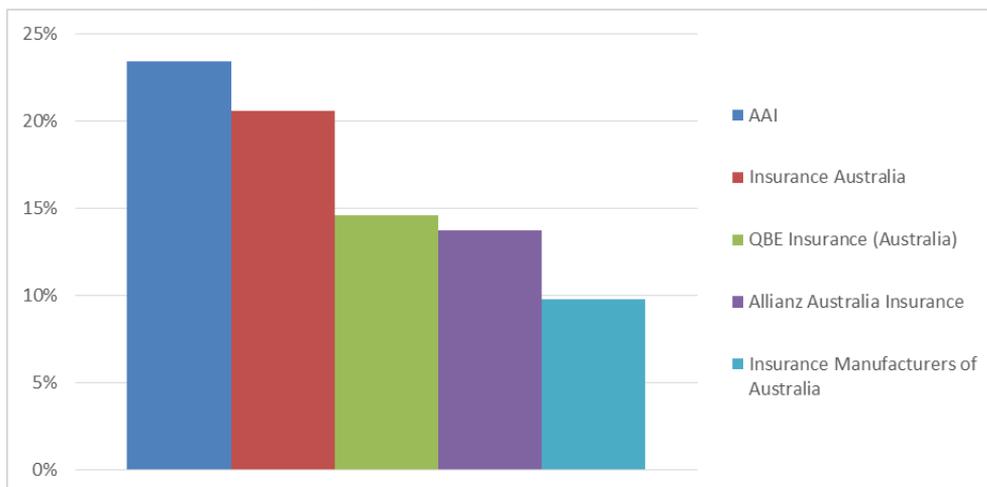
<sup>30</sup> APRA, *Quarterly General Insurance Statistics March 2018* (24 May 2018) <[http://www.apra.gov.au/sites/default/files/0518-QGIILS-March-2018-Database\\_0.xlsx](http://www.apra.gov.au/sites/default/files/0518-QGIILS-March-2018-Database_0.xlsx)>.

<sup>31</sup> For example, two insurer's licences restricted those insurers to providing insurance to an associated corporate group (captive insurers), four insurers were licensed only to provide lenders' mortgage insurance (lenders' mortgage insurers), and 14 licenced insurers were restricted from writing any new insurance business (run-off insurers); further, nine licenced

30 June 2018 there were no more than 34<sup>32</sup> insurers providing general insurance to consumers. However, the general insurance market for consumers may be more concentrated than the total number of general insurers licensed, or willing, to provide consumer oriented-insurance might imply.

Chart 2 shows gross earned premium of the top five consumer-oriented general insurers in 2017-18, as a percentage of total gross earned premium by the 34<sup>33</sup> insurers identified above.

**Chart 2: Five largest consumer-oriented general insurers, by percentage of gross earned premium, 2017-18**



Source: APRA, *Quarterly General Insurance Institution-level Statistics March 2018* (24 May 2018).

Chart 2 shows that in 2017-18, five insurance companies together earned 82% of gross earned premiums of 34 consumer-oriented general insurers.<sup>34</sup> Those five companies were: AAI (23%), Insurance Australia (21%), QBE

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insurers operated primarily in the reinsurance market (reinsurers), and 32 licenced insurers primarily sold commercial insurance (commercial lines insurance), some insurers were included in more than two of the preceding categories, see: APRA, *Quarterly General Insurance Institution-level Statistics June 2018* (August 2018)

<<https://www.apra.gov.au/sites/default/files/0818-qgiils-june-2018-database.xlsx>>.

<sup>32</sup> Total of insurers that held unrestricted licences that did not operate in the commercial lines or reinsurance segments.

<sup>33</sup> Progressive Direct Insurance operated in the September 2017 and December 2017 quarters and is also included in the total, see APRA, *Quarterly General Insurance Institution-level Statistics June 2018* (August 2018) <<https://www.apra.gov.au/sites/default/files/0818-qgiils-june-2018-database.xlsx>>.

<sup>34</sup> APRA, *Quarterly General Insurance Institution-level Statistics June 2018* (August 2018), <<https://www.apra.gov.au/sites/default/files/0818-qgiils-june-2018-database.xlsx>>.

Insurance (Australia) (15%), Allianz (14%), and Insurance Manufacturers of Australia (10%).

### 3.3. Reinsurance

Reinsurance allows an insurance company to write insurance policies with consumers, but relieve itself of some of the risk associated with those policies by obtaining insurance for its own liability with another entity (the reinsurer). Reinsurance performs an important function in the insurance industry by allowing insurers to 'reduce risk concentrations and diversify their risk' which can 'reduce volatility in their net underwriting income and leave insurers more resilient to claims arising from large-scale events such as natural catastrophes.'<sup>35</sup>

Reinsurance arrangements can be either proportional, or non-proportional. In a proportional reinsurance arrangement, the insurer and reinsurer share, in proportion, both the premium from the insurance that is reinsured, and any losses from that insurance.<sup>36</sup> In a non-proportional reinsurance arrangement, the reinsurer covers losses on the insurance that is reinsured above a certain threshold.<sup>37</sup>

### 3.4. General insurance intermediaries

General insurance intermediaries are Australian financial service licence (AFSL) holders whose licence authorises them to provide general insurance products to retail clients.<sup>38</sup> If a licenced insurer wants to provide a financial product such as insurance to retail clients, it too will need to hold an AFSL.<sup>39</sup> In the six months to 31 December 2017, there were 753 intermediaries who placed insurance business with APRA-authorized general insurers.<sup>40</sup> An AFSL holder may have many authorised representatives that operate under the one AFSL.

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<sup>35</sup> RBA, *Financial Stability Review September 2011* 23

<<http://www.rba.gov.au/publications/fsr/2011/sep/pdf/0911.pdf>>.

<sup>36</sup> APRA, 'Glossary,' *General Insurance Institution Level Statistics* 8 November 2017

<<http://www.apra.gov.au/sites/default/files/giils20glossary1.pdf>>; APRA, *Prudential Standard GPS 001: Definitions*, January 2015, 14, <<http://www.apra.gov.au/sites/default/files/141120-GPS-001.pdf>>.

<sup>37</sup> Ibid.

<sup>38</sup> APRA, 'Glossary,' *Intermediated General Insurance Statistics December 2017* (7 March 2018)

<<http://www.apra.gov.au/publications/intermediated-general-insurance-statistics>>.

<sup>39</sup> ASIC, *Do you need an AFS licence* <<http://asic.gov.au/for-finance-professionals/afs-licensees/do-you-need-an-afs-licence/>>.

<sup>40</sup> APRA, *Intermediated General Insurance Statistics December 2017* (7 March 2018) 2

<<http://www.apra.gov.au/sites/default/files/0318-IGIS-Highlights.pdf>>.

General insurance intermediaries may be either agents of general insurers, or brokers that operate on behalf of the person seeking insurance; although 'the distinction between the two is often blurred.'<sup>41</sup>

**Agents** may be tied to a particular insurer, and may be employees of that insurer.<sup>42</sup> Alternatively, an agent may operate on behalf of multiple insurers; receiving a commission from each for any insurance arranged.<sup>43</sup>

**Brokers**, on the other hand, operate on behalf of the insured. A broker may provide advice on the nature and quantum of the cover required, in addition to obtaining insurance from an appropriate insurer at a competitive price.<sup>44</sup> A more complex relationship is a '**binder**' arrangement where a broker is delegated the power to grant final cover or settle claims.<sup>45</sup> Despite notionally acting for the insured, a broker operating under a binder arrangement is also acting as an agent of the insurer.<sup>46</sup>

### 3.5. Benefits for consumers of general insurance

One measure of the performance of the general insurance industry is the **net loss ratio**. The net loss ratio is the value of net claims incurred divided by net earned premium.<sup>47</sup> As net amounts, the ratio excludes revenues from, and expenses related to, reinsurance. The net loss ratio shows the proportion of net premiums earned in a given year that are returned to policy holders as claims (net incurred claims) in a given year.<sup>48</sup>

Chart 3 shows the net loss ratio for the five categories of consumer-oriented insurance between the September quarter 2010 and the March quarter 2018.

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<sup>41</sup> Julie-Anne Tarr, 'The Regulation of Insurance Intermediaries in the Australian Financial Services Market' (2010) *Australian Business Law Review* 38(6) 332, 334.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid.

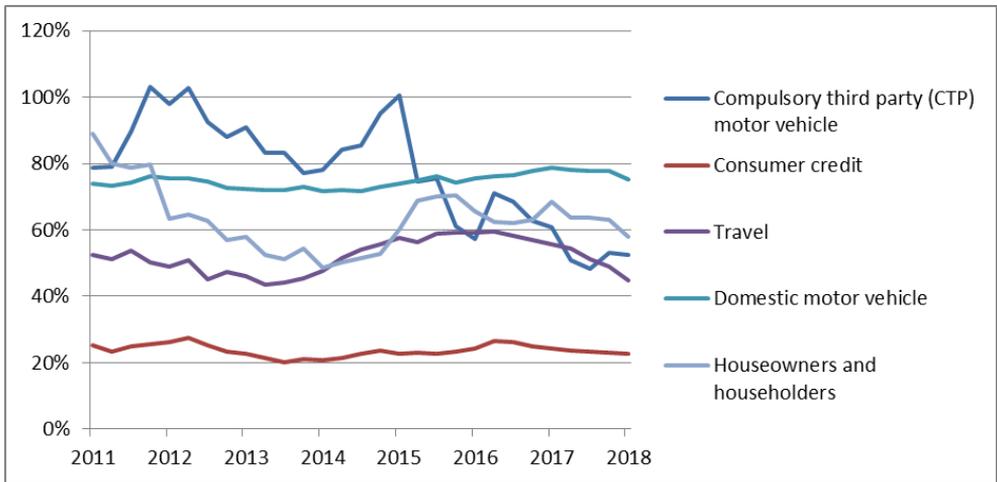
<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

<sup>47</sup> APRA, 'Glossary,' *General Insurance Institution Level Statistics* (8 November 2017) <<http://www.apra.gov.au/sites/default/files/giils20glossary1.pdf>>.

<sup>48</sup> Ibid.

**Chart 3: Net loss ratio by category of consumer-oriented general insurance  
September quarter 2010 to March quarter 2018 (4-quarter rolling average)**



Source: APRA, *Quarterly General Insurance Performance Database March 2018* (24 May 2018).

Chart 3 shows that between the 2011 and 2017 years, there has been some variance in the net loss ratio within specific segments of the consumer general insurance industry. For example, CTP insurance at some points had a net loss ratio over 100%, indicating that net incurred claims was larger in that year than net earned premiums. The net loss ratio for CTP insurance has generally declined since 2015.<sup>49</sup> By contrast, the consumer credit segment has maintained a relatively stable annual net loss ratio.

## 4. The life insurance market

In the year ending 31 March 2018, life insurers in Australia earned \$18.3 billion in direct premiums from consumers.<sup>50</sup> At 31 March 2018, the value of total assets held by life insurance companies in Australia was \$230.1 billion.<sup>51</sup>

### 4.1. Types of life insurance

What constitutes life insurance is determined by the *Life Insurance Act 1995* (the Life Insurance Act). Sections 9 and 9A of the Life Insurance Act provide

<sup>49</sup> APRA, *Quarterly General Insurance Performance Database March 2018* (24 May 2018) <<http://www.apra.gov.au/publications/quarterly-general-insurance-performance-statistics>>.

<sup>50</sup> APRA, *Quarterly Life Insurance Performance Statistics March 2018* (24 May 2018) <<http://www.apra.gov.au/publications/quarterly-life-insurance-performance-statistics>>.

<sup>51</sup> Ibid.

broad definitions of a 'life policy' and 'continuous disability policy' respectively.

Under section 9 of the Life Insurance Act, an insurance policy that charges premiums, or pays a benefit, depending upon the continued life of, or the death of, the insured person is a 'life policy,' and subject to the Life Insurance Act.

Additionally, under section 9A of the Life Insurance Act, certain insurance policies of more than three years that provide cover against death, the incurring of an injury or acquiring of a disability because of an accident or sickness, or provide cover upon being found to have a stated condition or disease, are taken to be insurance policies for continuous disability. Paragraph 9(1)(e) of the Life Insurance Act includes continuous disability policies in the definition of a life policy in section 9.

Some forms of insurance that would otherwise be life cover are specifically excluded from the Life Insurance Act. For example, certain superannuation benefits, certain pensions or payments to employees or their dependants on retirement,<sup>52</sup> and the payment of benefits for, or the provision of, a funeral, burial or cremation<sup>53</sup> are excluded from the operation of the Life Insurance Act.

The most common life insurance products currently offered by the Australian life insurance industry are outlined below:

- **Term life insurance**, also known as life cover or death cover, pays a set amount of money to nominated beneficiaries when the insured person dies. Depending on the terms of the policy, a terminal illness benefit may be payable, where part of the life cover is paid out in advance if the insured has been medically certified as being terminally ill within a defined period.<sup>54</sup>
- **Trauma cover**, also known as critical illness insurance, pays a set amount on the diagnosis of a specified illness or injury such as cancer, heart attack or stroke.<sup>55</sup>

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<sup>52</sup> *Life Insurance Act 1995*, para 11(3)(c).

<sup>53</sup> *Life Insurance Act 1995*, para 11(3)(e).

<sup>54</sup> ASIC, *Report 498: Life Insurance Claims: An Industry Review* (October 2016) 31 <<http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>>.

<sup>55</sup> *Ibid*, 31-2.

The benefits paid under this cover can be used for costs, including those relating to:

- medical costs above those covered by health insurance;
  - the ongoing cost of therapy special transport costs;
  - adjustment expenses relating to housing and lifestyle changes; or
  - debt repayments.<sup>56</sup>
- **Total and permanent disability ('TPD')** insurance provides cover when the insured becomes totally and permanently disabled and is unable to work again (either in their own occupation or in any occupation, depending on the terms of the insurance policy).<sup>57</sup>

The benefits paid under TPD cover can be used for costs relating to:

- rehabilitation;
- debt repayments; and
- the future cost of living.<sup>58</sup>

ASIC has observed that this type of insurance is 'almost always' purchased with term life insurance.<sup>59</sup>

- **Income protection insurance** replaces the income lost through the insured's inability to work due to injury or sickness.<sup>60</sup>

Although the life insurance products can be purchased on a 'stand-alone' basis, they are often purchased together in some combination as a 'bundled' product.<sup>61</sup>

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<sup>56</sup> ASIC, *Trauma Cover: Cover for Critical Illness* (10 October 2017)

<<http://www.moneysmart.gov.au/insurance/life-insurance/trauma-cover>>.

<sup>57</sup> ASIC, *Report 498: Life Insurance Claims: An Industry Review* (October 2016) 31

<<http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>>.

<sup>58</sup> ASIC, *Total and permanent disability cover* (10 October 2017)

<<http://www.moneysmart.gov.au/insurance/life-insurance/total-and-permanent-disability-cover>>.

<sup>59</sup> Ibid.

<sup>60</sup> ASIC, *Report 498: Life Insurance Claims: An Industry Review* (October 2016) 32

<<http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>>.

<sup>61</sup> Ibid.

## 4.2. Risk and investment-linked life insurance products

A further distinction can be drawn between 'risk' life insurance products, and 'investment-linked' life insurance products:

- **Risk business** relates to life insurance contracts that 'provide for benefits to be paid to policy owners on the death or disability of the life insured, or if the life insured is found to have a specific disease or injury.'<sup>62</sup> Life insurance under a risk policy provides cover against an event occurring, or, in the case of death, when that event may occur. At 31 December 2017, there were 14.9 million risk policies.<sup>63</sup>
- **Investment-linked business** relates to the provision of a benefit, the value of which is determined by the value of a class of assets that are held by the life insurer upon death, or on some specified date or dates prior to death.<sup>64</sup> Investment-linked life insurance has some features of investing in that it provides both protection from the insured event, or, if that event does not occur before a specified date, a benefit determined by returns on investments. At 31 December 2017, there were 2.0 million investment linked policies.<sup>65</sup>

APRA data shows that total assets attributable to life insurance policies that were investment-linked were \$128.1 billion at 31 March 2018 and total assets attributable to life insurance policies that were not investment-linked were \$97.2 billion at 31 March 2018.<sup>66</sup>

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<sup>62</sup> APRA, *Prudential Standard LPS 001: Definitions* (January 2015) 10  
<[https://www.apra.gov.au/sites/default/files/141120-LPS-001\\_1.pdf](https://www.apra.gov.au/sites/default/files/141120-LPS-001_1.pdf)>.

<sup>63</sup> APRA, *Life Insurance Supplementary Statistical Tables December 2017* (19 June 2018)  
<<https://www.apra.gov.au/sites/default/files/documents/0618-lisst-20171231.xlsx>>

<sup>64</sup> *Life Insurance Act 1995*, sub-s 14(2).

<sup>65</sup> APRA, *Life Insurance Supplementary Statistical Tables December 2017* (19 June 2018)  
<<https://www.apra.gov.au/sites/default/files/documents/0618-lisst-20171231.xlsx>>.

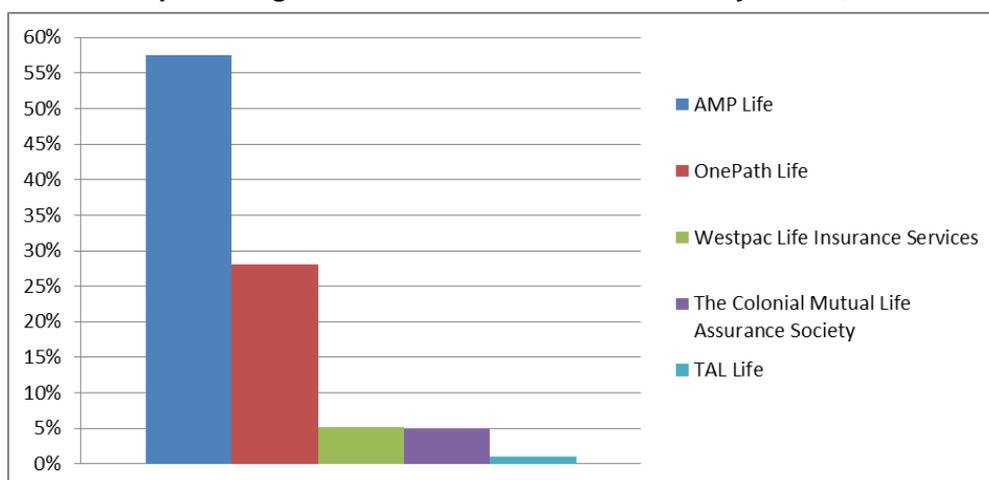
<sup>66</sup> APRA, *Quarterly Life Insurance Performance Statistics March 2018* (24 May 2018)  
<<https://www.apra.gov.au/publications/quarterly-life-insurance-performance-statistics>>;  
Investment linked and risk business figures do not add up to the total statutory funds figures due to eliminations between statutory funds.

### 4.3. Life insurers

There were 29 authorised life insurance companies as at 8 February 2018.<sup>67</sup>

Chart 4 shows the five largest life insurers in the investment-linked life insurance sector by percentage of investment-linked industry total assets.

**Chart 4: Five largest Investment-linked life insurers, by total entity assets as a percentage of total investment-linked industry assets, 2017**



Source: APRA *Life Insurance Institution-level Statistics December 2017* (19 June 2018).

The five largest life insurers by total investment-linked industry assets for financial years ending in the 12 months to December 2017 were AMP Life (58%), OnePath Life (28%), Westpac Life Insurance Services (5%), the Colonial Mutual Life Assurance Society (5%) and TAL Life (1%). The two largest insurers have 86% of total investment-linked industry assets, and the top five combined have 97% of total investment-linked industry assets.<sup>68</sup>

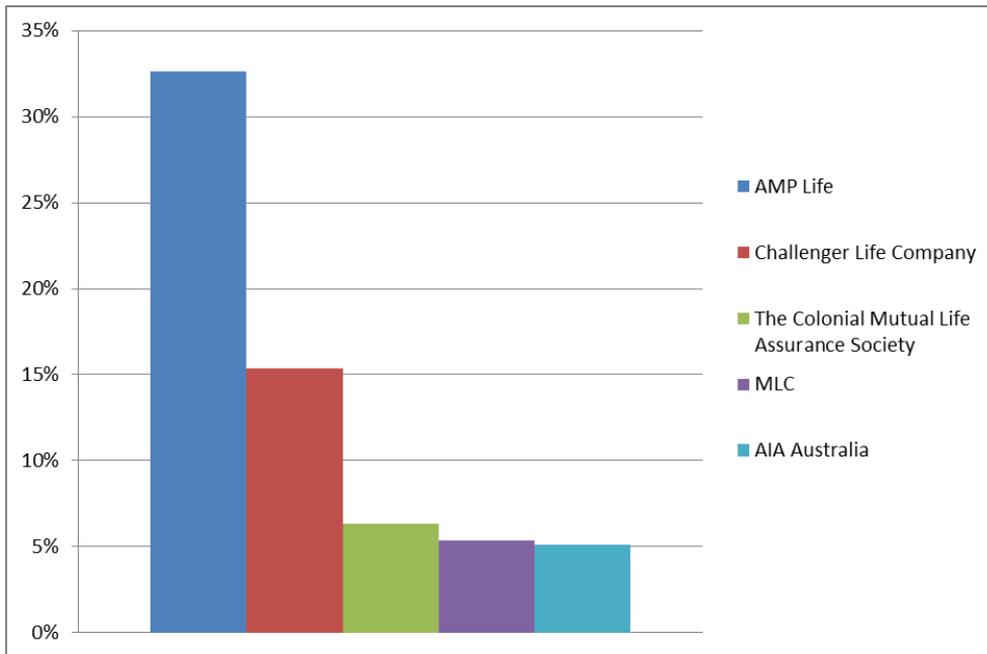
Chart 5 shows the five largest life insurers in the non-investment-linked (risk-based) life insurance sector as a percentage of non-investment-linked industry total assets.

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<sup>67</sup> APRA, *Register of life insurance companies* (8 February 2018) <<http://www.apra.gov.au/register-life-insurance-companies>>.

<sup>68</sup> APRA, *Life Insurance Institution-Level Statistics December 2017* (19 June 2018) <<https://www.apra.gov.au/publications/life-insurance-institution-level-statistics>>.

**Chart 5: Five largest life insurers in the non-investment-linked (risk-based) life insurance sector by total assets as a percentage of total non-investment-linked industry assets, 2017**



Source: APRA, *Life Insurance Institution-level Statistics December 2017* (19 June 2018).

AMP is the largest insurer in the risk-based life insurance sector with 33% of total assets in the sector. However, the non-investment linked life insurance sector is less concentrated than the investment linked sector, with the top five entities having only 65% of total assets.

#### 4.4. Life insurance intermediaries and distribution channels

There are three main channels through which life insurance may be obtained. Those three channels are as follows:

- **intermediated** channel, where insurance is obtained upon the advice of a financial adviser or planner;<sup>69</sup>
- **direct** channel, where a consumer obtains a policy from an insurance company without the involvement of a financial adviser or

<sup>69</sup> Wayne Kenafacke and John King, 'Are direct channels helping life insurers and consumers to address underinsurance?' (Paper presented to the Institute of Actuaries of Australia 5th Financial Services Forum (13 – 14 May 2010 Sydney) 3 <[http://actuaries.asn.au/Library/FSF10\\_Paper\\_Kenafacke\\_King.pdf](http://actuaries.asn.au/Library/FSF10_Paper_Kenafacke_King.pdf)>.

other intermediary, though often an intermediary is involved in referring the insurer to the customer;<sup>70</sup> and

- **group** channel, where bulk policies are distributed via not-for-profit superannuation funds, employers and retail master trusts.<sup>71</sup>

According to information published by ASIC, in 2015, there were 3.9 million life insurance policies sold through the direct distributional channel, 4 million life insurance policies sold through the intermediated distributional channel, and 14 million members through the group distributional channel.<sup>72</sup>

As at August 2017, more than 70% of Australian life insurance policies (more than 13.5 million separate policies) are held through superannuation funds, and approximately 17,000 disability benefits and approximately 46,000 death benefits paid under insurance policies are held through superannuation.<sup>73</sup>

#### **4.5. Benefits from life insurance**

Chart 6 shows the net loss ratio for both investment-linked and non-investment-linked (risk-based) life insurance since the June quarter 2008, the earliest period for which data is available.

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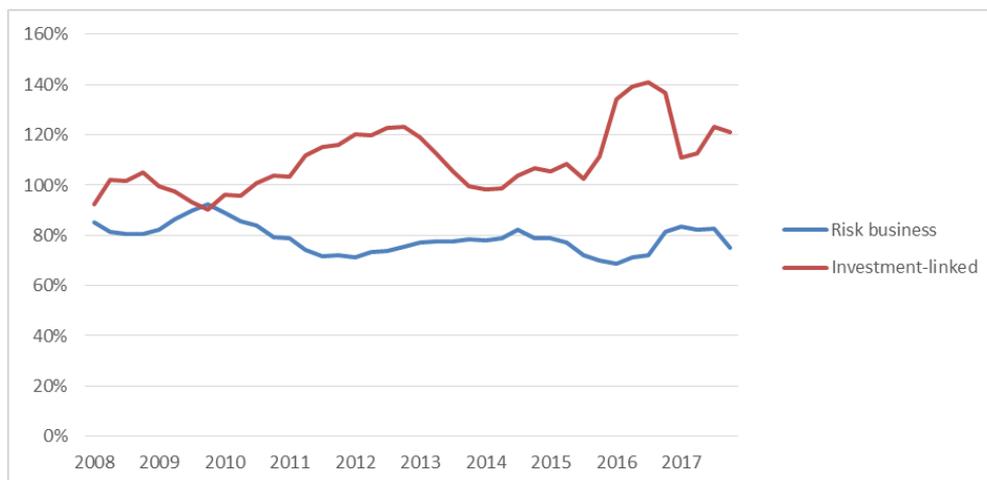
<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

<sup>72</sup> ASIC, *Report 498: Life Insurance Claims: An Industry Review* (October 2016) 105 <<http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>>.

<sup>73</sup> See Peter Kell, 'Insurance in Super: The Regulators — What Do They Think?' (Speech delivered at the Association of Superannuation Funds of Australia Spotlight on Insurance, Sydney, Australia, 27 February 2018) <<http://download.asic.gov.au/media/4662106/peter-kell-asfa-spotlight-on-insurance-published-6-march-2018.pdf>>.

**Chart 6: Ratio of net premiums to net policy payments, June Q 2008 to March Q 2018**



Source: APRA, *Quarterly Life insurance Performance Statistics March 2018* (24 May 2018); four quarter rolling average. Investment linked omits September 2016 quarter data, which was distorted by the effect of a fund transfer (data adjusted accordingly).

Chart 6 shows that since the June quarter 2008, non-investment-linked (risk based) life insurance has returned around 79% of net premiums to policy holders, however this has varied from year to year. Over the same period, investment-linked life insurance has returned more to policy holders than the net premiums received (around 111%); possibly because of the earnings of the underlying investments.

## 5. Claims management and dispute resolution

Both the general insurance and life insurance industries have adopted codes of practice for the handling of claims within their respective industries: the General Insurance Code of Practice<sup>74</sup> and Life Insurance Code of Practice.<sup>75</sup> The Insurance in Superannuation Voluntary Code of Practice applies to life insurance obtained in group policies as part of superannuation.<sup>76</sup>

<sup>74</sup> Insurance Council of Australia, *General Insurance Code of Practice* (July 2014) <[http://codeofpractice.com.au/assets/pdf/Code\\_of\\_Practice.pdf](http://codeofpractice.com.au/assets/pdf/Code_of_Practice.pdf)>.

<sup>75</sup> Financial Services Council, *Life insurance code of practice* <<https://www.fos.org.au/about-us/codes-of-practice/life-insurance-code-of-practice/>>.

<sup>76</sup> Insurance in Superannuation Working Group (Australian Institute of Superannuation Trustees, the Association of Superannuation Funds of Australia and the Financial Services Council), *Insurance in Superannuation Voluntary Code of Practice* (18 December 2017) <[http://www.aist.asn.au/media/1099546/insurance\\_in\\_superannuation\\_voluntary\\_code.pdf](http://www.aist.asn.au/media/1099546/insurance_in_superannuation_voluntary_code.pdf)>.

## 5.1. General Insurance Code of Practice

The current General Insurance Code of Practice was issued by the Insurance Council of Australia on 1 July 2014, but insurers were allowed until 30 June 2015 to transition to the Code. The Code operates on an opt in basis, as it applies to those who have chosen to subscribe to it.<sup>77</sup>

The General Insurance Code of Practice sets out minimum standards that general insurers 'must meet when providing services to their customers, such as being open, fair and honest'.<sup>78</sup> The Code's standards detail customers' rights when dealing with an insurer, including 'when buying insurance, what to expect when making a claim, including timeframes for making a claim decision, and processes for making complaints.'<sup>79</sup>

The General Insurance Code of Practice does not apply to CTP insurance, but does apply to the four other types of consumer-oriented general insurance discussed above.<sup>80</sup>

Section 7 of the General Insurance Code of Practice deals with claims. The Code notes that a customer is entitled to a decision on the acceptance or denial of the claim within ten business days of receipt.<sup>81</sup> Further, if the insurer seeks further information on the claim, the claimant should be notified of what information is required within ten days of the claim and advised of an estimate timetable and the process for assessing and deciding on the claim.<sup>82</sup> The Code requires that an insurer keep an applicant informed of the progress of their claim every 20 days.<sup>83</sup> The Code provides that, if a policy holder is in urgent financial need because of a loss or damage that will result in an insurance claim, insurers can fast-track a claim, or pay an advance payment, within five business days.<sup>84</sup>

The General Insurance Code of Practice requires subscribers to have an internal dispute resolution process. If a customer is unhappy with the

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<sup>77</sup> Insurance Council of Australia, *General Insurance Code of Practice* (July 2014) 3 <[http://codeofpractice.com.au/assets/pdf/Code\\_of\\_Practice.pdf](http://codeofpractice.com.au/assets/pdf/Code_of_Practice.pdf)>.

<sup>78</sup> *Ibid.*, 2.

<sup>79</sup> Financial Ombudsman Service Australia, *General insurance code of practice* <<https://www.fos.org.au/about-us/codes-of-practice/gi-code-of-practice/>>.

<sup>80</sup> Insurance Council of Australia, *Types of insurance covered* (2018) <<http://codeofpractice.com.au/about-the-code/types-of-insurance-covered/>>.

<sup>81</sup> Insurance Council of Australia, *General Insurance Code of Practice* (July 2014) 7 <[http://codeofpractice.com.au/assets/pdf/Code\\_of\\_Practice.pdf](http://codeofpractice.com.au/assets/pdf/Code_of_Practice.pdf)>.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*, 8.

<sup>84</sup> *Ibid.*, 7.

outcome from that process they can take their complaint to the Financial Ombudsman Service (or to the Australian Financial Complaints Authority from 1 November 2018),<sup>85</sup> or seek independent legal advice.<sup>86</sup>

According to the latest publicly available data for 2016-17 from the Code Governance Committee's *General Insurance in Australia 2016-17* report, there was a 9% increase in claims from 2015-16 due to 'the greater impact of catastrophes'.<sup>87</sup> The report uses General Insurance Code of Practice subscribers' data.<sup>88</sup>

That report also suggested an increasing number of General Insurance Code of Practice subscribers were utilising external service suppliers such as investigators, loss assessors and collection agents.<sup>89</sup>

## 5.2. Life Insurance Code of Practice

The Life Insurance Code of Practice is owned and managed by the Financial Services Council (FSC). All life insurers that are members of the FSC are required to comply with the Life Insurance Code. The Life Insurance Code requires life insurers and those offering life insurance products service their customers in a 'timely, honest, fair and transparent way'.<sup>90</sup>

Much like the General Insurance Code of Practice, the Life Insurance Code of Practice outlines standard of the customer's relationship with their insurer, 'including when buying insurance, what to expect when making a claim, including timeframes for making a claim decision, and processes for making complaints'.<sup>91</sup> Specifically, the Code requires that a life insurer needs to explain the claims process to the customer within 10 business days of the making of a claim, and keep the customer informed about the

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<sup>85</sup> Financial Ombudsman Service Australia, *AFCA information for consumers* (2018) <<https://www.fos.org.au/consumers/afca-information-for-consumers>>; Australian Financial Complaints Authority, *About AFCA* (2018) <<https://www.afca.org.au/about-afca/>>.

<sup>86</sup> Insurance Council of Australia, *General Insurance Code of Practice* (July 2014) 15 <[http://codeofpractice.com.au/assets/pdf/Code\\_of\\_Practice.pdf](http://codeofpractice.com.au/assets/pdf/Code_of_Practice.pdf)>.

<sup>87</sup> General Insurance Code Governance Committee, *General Insurance in Australia 2016-17: Industry Practice and Code Compliance*, (March 2018) 2 <<https://www.fos.org.au/custom/files/docs/cgc-report-general-insurance-in-australia-201617.pdf>>.

<sup>88</sup> Ibid, 1.

<sup>89</sup> Ibid, 3.

<sup>90</sup> Financial Services Ombudsman Service Australia, *Life Insurance code of practice* <<https://www.fos.org.au/about-us/codes-of-practice/life-insurance-code-of-practice/>>.

<sup>91</sup> Ibid.

progress of a claim at least every 20 days.<sup>92</sup> The Code also requires that requests for information by the consumer are to be responded to in ten business days.<sup>93</sup>

ASIC's examination of the life insurance sector found that 90% of life insurance claims and 96% of death claims were paid in the first instance.<sup>94</sup> However, it was also found that some claims were being declined on 'technical or contractual' grounds that were not in line with the 'spirit' or 'intent' of the policy, leaving ASIC to conclude that 'a key challenge for the life insurance sector is how to deal with that small number of claims that may not technically be covered under the 'fine print', but under any reasonable consumer or community expectation should be paid.'<sup>95</sup>

### 5.3. Insurance in Superannuation Voluntary Code of Practice

The Insurance in Superannuation Voluntary Code of Practice is owned and managed by three entities: Australian Institute of Superannuation Trustees, the Association of Superannuation Funds of Australia and the Financial Services Council.<sup>96</sup> The Code was released in December 2017.<sup>97</sup> The Code applies to superannuation funds that choose to adopt the Code.<sup>98</sup> The Code commenced on 1 July 2018, but superannuation funds that have adopted the Code have until 30 June 2021 to comply with the Code.<sup>99</sup>

One of the objectives of the Insurance in Superannuation Voluntary Code of Practice is that '[i]nsurance offered on an automatic basis in superannuation must be appropriate and affordable, and must not **inappropriately erode** retirement income.'<sup>100</sup>

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<sup>92</sup> Financial Services Council, *Life Insurance Code of Practice* 15 <<https://www.fsc.org.au/policy/life-insurance/code-of-practice/life-code-of-practice.pdf>>.

<sup>93</sup> Ibid.

<sup>94</sup> ASIC, *Report 498: Life Insurance Claims, An Industry Review* (October 2016) 6 <<https://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>>.

<sup>95</sup> Ibid.

<sup>96</sup> Australian Institute of Superannuation Trustees, *Insurance in superannuation voluntary code of practice* <<http://www.aist.asn.au/policy/insurance-in-superannuation-voluntary-code-of-practice/insurance-in-superannuation-voluntary-code-of-practice.aspx>>.

<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

<sup>99</sup> Australian Institute of Superannuation Trustees, *Insurance in Superannuation Voluntary Code of Practice* 3 <[http://www.aist.asn.au/media/1099546/insurance\\_in\\_superannuation\\_voluntary\\_code.pdf](http://www.aist.asn.au/media/1099546/insurance_in_superannuation_voluntary_code.pdf)>.

<sup>100</sup> Ibid, 2 (emphasis in original).