ECONOMIC DEVELOPMENT AND INFRASTRUCTURE COMMITTEE

Inquiry into state government taxation and debt

Sydney — 29 October 2009

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Mr D. Wellfare, senior advisor, economics and policy, Insurance Australia Group;

Mr A. Sanchez, general manager, and

Mr P. O'Sullivan, senior policy adviser, economics and taxation directorate, Insurance Council of Australia.

The CHAIR — I welcome you to this afternoon's hearing of public evidence on the parliamentary committee's inquiry into taxation. Would each of you please state your name, your position and, as we understand that you are all appearing in a professional and not a personal capacity, your professional business address? Thank you.

Mr SCOFIELD — I am Nicholas Scofield, general manager, corporate affairs, at Allianz Australia. Our address is 2 Market Street, Sydney.

Mr WELLFARE — I am David Wellfare, senior adviser, economics and policy, Insurance Australia Group, 388 George Street, Sydney.

Mr SANCHEZ — I am Alex Sanchez, general manager, economics and tax, at the Insurance Council of Australia. We are at level 4, 56 Pitt Street, Sydney.

Mr O'SULLIVAN — I am Phil O'Sullivan, senior policy adviser, economics and taxation directorate, at the Insurance Council of Australia, at the same address: level 4, 56 Pitt Street, Sydney.

The CHAIR — Thank you. Evidence will be taken by Hansard, and copies of the transcript will be provided to you within a fortnight. Your comments here are protected by parliamentary privilege; anything you say outside the room obviously is not. You can enjoy your 45 minutes of parliamentary privilege. It is over to whoever wishes to commence this afternoon.

Mr SANCHEZ — Firstly, thank you to the committee, and thank you for hosting us in Sydney; it made it easier all around. I do not propose to go through the submission; it stands alone. I assume it has been read, although of course I would be more than happy to answer, and would welcome, questions at the conclusion. I will make a couple of introductory remarks as the insurance council, which is the industry association for the general insurance sector, and then I might turn to two of our members on my right, who may add some remarks. Then we can turn to the questions side.

In terms of the submission overall, I just want to make a couple of observations about the nature of the submission and why we have prepared it in the way we have. We wanted to draw to the attention of the committee and take, if you like, a high taxation principles approach to the inquiry and look at some of the structural features of the tax system in Victoria. We have provided you with evidence which suggests that taxes are not the only component of revenue in Victoria. In fact they make up only about one in three dollars overall; the rest is made up from government grants. That is a significant share, and it has increased over the last odd decade.

The other key observation that we make is that Victoria has a different tax mix than other states, not only the states along the eastern seaboard. What I mean by tax mix is, for example, reliance on particular taxes versus others, even when you extract out the resource-rich states of Queensland and Victoria. For example, Victoria tends to have a lower rate of usage of payroll and land tax in its tax mix versus that in some of the other states, and that makes it distinctive, and consequently there is a higher reliance on what we would call transaction taxes. Of course they are not only the taxes on the general insurance sector but also general stamp duties on residential and non-residential conveyancing.

The third thing I want to talk about is that the submission highlights in Victoria what are the good and the bad taxes, if you look at it in terms of efficiency rankings. We spent a bit of time with Access Economics on this exercise, and not only for this one; we have also done similar submissions to the Henry tax review. I will get to how this fits into that review as well. Clearly the evidence is fairly strong on what are good taxes and what are bad taxes. Essentially the bad taxes are the stamp duties, the transaction taxes, and the better taxes are the ones that are less distortive — and, let us be honest, all taxes distort behaviour, but some distort it less than others. The better taxes are in fact payroll tax, land tax and gaming tax. Interestingly enough, as I made the observation, those are the very taxes that the Victorian state government relies less on, in the case of payroll and land.

The other thing the report suggests is that some of those taxes can be made even better. One of the reasons they can be made even better is that these taxes are afflicted by exemptions, and their efficiency is compromised as a result of those exemptions. With that in mind, we then turn to another question, and I think this is probably a different approach than you may have got from other submitters. Rather than walking in to see you and saying, ‘This is a bad tax. Please remove it’, we have an approach that looks at: how does one replace it?

We have spent a bit of time on modelling the effects of the changes to mixes. If you look at the remarks in recent times, in the Henry tax review that is exactly what he is onto: how does one maintain revenue capability but also improve efficiency at the same time? And the way you do that is by changing your state tax mix.

In our submission we go through a number of simulations about how one can change the mix. They range from modelling the recommendations of the Harvey tax review, which is replacing transaction taxes with land taxes, through to replacing transaction taxes with payroll tax, as it is currently structured — that is, with the current exemptions — through to replacing transaction taxes with gaming taxes and through to replacing transaction taxes with a new payroll tax system, which would have a broader base and a lower rate. We have done that, and the result is there on page 23 of the submission.

The one, obviously, that has the best effect is the payroll tax removing the exemptions. You will have noted in recent days Dr Henry has made some remarks about that. Needless to say, the modelling we have done in this exercise has also been undertaken for the Henry tax review and was also part of the work that we did in that submission. To some extent what Dr Henry has identified as a good state tax that has been compromised over years is given effect to in these simulations.

We then turned around and said, based on those, if you were to have a best tax-mix solution, what would it be? Table 11 on page 24 of the submission highlights what that is. We have given you two options there about what sort of additional revenue would need to be raised, taking into account — I will not go into too much detail — second-round effects, but let us say it is about what additional revenue needs to be raised to fund the reform of the transaction taxes that I have just mentioned, in those mixes, and what would be the effects. There are two options there for your consideration.

In the submission we also detailed a fair bit of work around non-insurance. I am sure you will have some questions about that in the context of your tragedy earlier this year and obviously the implications that has for the funding of the bi-systems, and there is a bit of an explanation about that as well in the submission. I would welcome questions on that, or indeed any other aspect of that event.

That is the basic theme. The theme was that we do not come here and tell you to get rid of things; we come here with some solutions. We have some proposals there. We also want to draw your attention to what are, on pure efficiency grounds, the better taxes and the not-so-good taxes and why they are such. From that, I am happy to conclude my remarks and any of my colleagues to the right might want to chime in.

Mr WELLFARE — I totally support, obviously, the Insurance Council’s submission to the committee inquiry. Insurance Australia Group also made a submission and our subsidiaries, CGU and RACV, which is a joint venture we have in Victoria, also made submissions. I think the theme running through those three submissions highlights to the committee that other studies or inquiries in other states have introduced reforms, so we have highlighted those to the committee to say these reforms have worked in other states and overseas. Reforms of insurance taxes have come from royal commission recommendations, independent pricing and regulatory tribunal recommendations. We have just highlighted those for the committee's consideration, again supporting that insurance tax is one of the most inefficient taxes and potentially is high up there for reform.

Mr SCOFIELD — I concur with what has been said but particularly highlight the fact that I think the timing of this particular inquiry is extremely useful. The insurance industry has been talking about insurance tax reform for many years and in particular about the fire services funding, the fire services levy reform, which has now been adopted in all states other than Victoria and New South Wales.

We talk in the context of the impact of taxes on the price of insurance in terms of its impact on the levels of non-insurance and the levels of underinsurance. Levels of non-insurance are relatively easy to discover, and some work that the Insurance Council has done over recent years has produced some quite valuable information on the levels of non-insurance.

The levels of underinsurance are much more difficult to discern. We have done some work, which is referred to in the submission, on the elasticity of demand for insurance in both the take-up of insurance and also in the amount of cover that people buy. But unfortunately the only time you get to really understand about underinsurance is when you have a large total loss tragedy or disaster, because you are not underinsured if someone comes in and steals your television and your home theatre system. You are not underinsured if the storm comes through and takes half your roof off. The only time people find out that they are underinsured is when they have a total loss.

What has surprised me, and it has shocked me in a sense because I always knew that it was a much bigger issue than we could ever really provide good, quantitative analysis around, has been the level of underinsurance that we have seen in relation to the Victorian bushfires. The evidence that I use to discern that is just to look at the proportion of claims for total loss of domestic buildings that have been cash settled.

The normal process of the relationship between the insurer and the insured in the event of a total loss is that the insurer will essentially take over the whole process for the customer, which means we will organise the building, we will organise all the things that go with getting the property built, put the person in temporary accommodation, and then hand them the keys at the end. Obviously they have a very large input into the design of the property and all the rest of it. That is not possible to do when someone is underinsured. When the quotes come back for the house and the rebuild is $250 000 and their insurance cover is $180 000, we cannot engage in the same way, so essentially we, what we would call, cash settle the claim which means we give them the $180 000 and then they go and work out how they are going to cope with the fact that they have not got enough money to rebuild what they had before.

The cash settlement rates are extremely high. I have got some figures from Allianz that I can provide later, but the cash settlement rates are very high, which suggest to me when I look at the industry-wide numbers that just about everybody has got the same experience that we have, which I obviously know more intimately, and that is that we have cash settled the vast majority of the total losses.

Mr ATKINSON — Can I ask, though, have you actually measured with people whether or not that was the reason that they were underinsured, or is it possible that in fact a lot of those people have been so horrified by the experience that basically one of the partners or both of the partners have said, 'No, we are not going back to put ourselves through this again'?

Mr SCOFIELD — That is obviously a part, yes. Obviously a proportion of people do not want to rebuild there for very good reason.

Mr DAVIS — The horror factor, really.

Mr ATKINSON — Or they need time to adjust and to grieve.

Mr SCOFIELD — They may have lost family members at that place.

Mr ATKINSON — Have you extrapolated out that aspect?

Mr SCOFIELD — We have not. I have not had it done to a fine degree of numbers, but from discussions with claims managers, that is a very small number. That explains a handful of the cash settlements, not the vast majority of them, which has been the vast majority of our claims.

Mr DAVIS — Just to understand where you do a cash settlement, if they are underinsured, you would work through it with them to an extent, if they were contributing the wedge that they are underinsured, or would you just generally do the cash settlement?

Mr SCOFIELD — No, we just provide the cash settlement. You just get into a whole different sort of ball game where in a sense you are going into a financial partnership with someone to rebuild a property, and you are reliant on them having the money.

Mr DAVIS — It is variable.

Mr SCOFIELD — You can get into the building process or complete the building process — or you could in theory — and find they are unable to fund their contribution. What do you do then? Do you sue them? It just gets extremely messy, and it is just not a place where most insurers tend to go.

Mr DAVIS — I am trying to understand this, because obviously it is of great interest to Victorians. At these points is there a relationship with the authority, the fund? Do they assist at any of those junctures with people? Is there some mechanism to work through applications at that point?

Mr SCOFIELD — The fund has provided money to people whether they have been insured or not. I think $35 000 was given to people who lost homes, and from memory $15 000 was given to people who lost contents. That was a sort of starting point. I think there was a facility for people to seek additional money in particular circumstances as a starting point. The other aspect of course is the fact that in the process the building standards have been changed, and that has increased the price of the properties that are in the very vulnerable fire zones.

Mr DAVIS — Have you quantified that at all?

Mr SCOFIELD — We have not done it ourselves, but from what I have read, for people who are in the highest risk zone it is of the order of around $30 000 to comply with the new standard, which means that even if someone was fully insured in the first place, they may find they cannot rebuild to the new standard.

Mr DAVIS — Fully insured at the point of the fire, but not fully insured at the time they actually come to reconstruct?

Mr SCOFIELD — That is right, yes.

The CHAIR — Can I begin by saying congratulations to the Insurance Council of Australia, not only for saying what should be deleted from taxes or amended, but for trying to do what I did not think an insurance council would do — and that is to look at the whole quantum. In itself that is very impressive, and I presume you will get other comments at a federal level on how pleasantly surprised people are that you went to that extent.

I have listened to people today talk about payroll tax and fire services levies and other taxes, and to people suggesting what needs to occur and what some governments do until they are hit with the political ramifications of going down a particular path. With the nature of politics —

government and opposition — if a government of whatever complexion decided to go down the way of increasing those taxes that are involved in paying payroll tax, my guess would be that the opposition, of whatever political persuasion, would come in, beat the drum, get business on side, get workers on side and say, 'Payroll tax is a tax on jobs'.

Given you guys have been around long enough to know the political realities of some of your proposals — and my compliments to you for doing so — have you got any observations on the political ramifications and those that would be likely to come on board, other than the Insurance Council of Australia, as a third-party commentator who would talk to opposition or government or the media?

Mr SCOFIELD — I guess my only comment in the context of that question is that we would look at the state insurance tax regime in two parts, one being the stamp duty. Obviously if the stamp duty is removed, there is a hole in the budget, and if it is not replaced, then expenditure has to be reduced or deficits have to be increased or whatever. Clearly your question goes to that, and we fully understand the sensitivities around payroll tax.

In relation to the fire services levy, the model that is being mostly put by the industry and which has been adopted in Queensland, South Australia and Western Australia is the shift, as you would know; the levy, if you like, off insurance and on to rates. Where it is a broader base, it is more equitable because people who are not insured still pay, which they do not now. People who are underinsured, whether intentionally or inadvertently, by virtue of being underinsured do not pay the amount of fire services levy that theoretically they should. It is resolved through the rates-based system. Certainly one option is for a switch from one place to another, which does not have any adverse impact on government revenue.

The CHAIR — So watch this space in our report for a recommendation from some that stamp duty be replaced by such and such, whether we can even reach agreement in this committee let alone between a government and an opposition.

Mr WELLFARE — Just on that, following on from what Nicholas said in terms of broadening the base, not only does it broaden the base by bringing into the net people who currently are not paying, it also removes or changes the funding mix from insurance to property. It also impacts upon affordability.

The CHAIR — I think everybody understands the argument in relation to the fire services levy. It is crystal clear, particularly in Victoria after the bushfires. If there is ever a time to do it, it is a time when people have made a lot of comments in the media and there is a high level of understanding of the inequity of some paying and others not.

Mr SANCHEZ — I just want to make a couple of observations about the first part of your question.

The CHAIR — The political ramifications?

Mr SANCHEZ — On the political ramifications. I think you need to read our submission on the dimension of economic efficiency. All taxes decrease welfare, full stop. They all do it; some do it more than others, that is the point. But that is only one dimension of the tax question. The other dimension of the tax question is equity, fairness et cetera, and they are judgement calls. What we are looking at here is what are the more efficient taxes economically versus the others.

The CHAIR — Mr Sanchez, please do not read into my question that I was having a go at you. I was complimenting you. I am just sort of saying, 'Wow!' from this side of the table. It is not just a matter of simply balancing the equation; there are also the political realities that we have to navigate.

Mr SANCHEZ — That is right, I agree.

The CHAIR — And which stage in the electoral cycle such things are done is also a factor.

Mr SANCHEZ — Absolutely, and I am not discounting any of those considerations by any means. This is one component of the thing.

The CHAIR — That is very true.

Mr SANCHEZ — I guess the other observation I want to make is — and this might be challenging for the states — there is a sense that the only action that can take place on tax reform has to be at the federal level. What this submission tries to say is that some state action can make a big difference. Now whether that action is taken is a matter for judgement, but it can be and it is possible. Again it is a matter of judgement for decision-makers and policy-makers as to whether or not they move down those paths, but potentially it can be done.

Nicholas made the observation about changes to the fire services levy in some states versus the others. That action was not done at the federal level; that action was done indigenously within the states themselves. So state actions can make a difference.

The CHAIR — They do, yes.

Mr SANCHEZ — I guess the third observation I want to make is that the Victorian government itself has argued that exemptions from commonwealth taxes dilute their efficiency.

Mr DAVIS — They are distortive.

Mr SANCHEZ — And they point to what are known as tax expenditures in their submission to the Henry tax review in which they make that claim. However, when addressing those same exemptions that apply to their own tax bases, they treat that problem differently. The broad model is that the broader the base, the lower the rate, the better the tax. And there are state taxes that fall into that realm.

Mr DAVIS — Can I start by complimenting you on this submission. That is the first thing. I think it is, as has been pointed out, a very comprehensive submission and I just want to step through some bits of it to make sure I have it absolutely clear.

Mr SANCHEZ — Sure.

Mr DAVIS — Essentially what you argue in table 11 is that there are significant economic benefits to rejigging the tax mix, and you say for option 1, 1.27 per cent, and those benefits would, on your submission, roll into the future as well; and for option 2, 1.68 per cent, and I guess that is a significant amount to be realised by the state economy. As I say, I am thankful for the thorough work that has gone into all of that.

There are a couple of points that we need to think through. Whilst it is true that at a state level this can be done by itself, and I note also at the end of that page you point to the national competition policy example, the truth is that when reforms of various types are undertaken the benefits accrue to several levels of government.

Mr SANCHEZ — Right.

Mr DAVIS — It is also, I guess, as part of those reforms that you would want to work out the apportionment of those advantages.

Mr SANCHEZ — Sure.

Mr DAVIS — Do you have a view as to what share of the economic efficiency gains would accrue to the different levels of government if, say, either your option 1 or option 2 were to be put into place?

Mr SANCHEZ — Mr Davis, I think what you are saying is how much will accrue in federal gains versus how much will accrue to the state, and those questions of distribution are important. We did not model that for this exercise, but we did do that modelling — and regrettably I do not have it with me at the moment — as part of the Henry tax review to examine where these second-round effects would accrue to, what level of government. I am happy to get you that work.

Mr O'SULLIVAN — They were small to the other levels of government, because Access uses a general equilibrium model. So as part of their output they did provide us with the percentage change to welfare for other states.

Mr SANCHEZ — That is right. On that one, yes.

Mr O'SULLIVAN — I think New South Wales was a negative welfare benefit so that is most probably something positive for the Victorians. But the impact on the other states was close to zero.

Mr DAVIS — And the impact on the commonwealth?

Mr O'SULLIVAN — We did not do that, no. We did not do the commonwealth; we only did the states because this is an impact on consumption spending, welfare, on a jurisdictional basis. So by covering the states and territories, we have covered the commonwealth as well. This is not a statement on the impact on revenue to the commonwealth.

Mr DAVIS — But there would be revenue impacts on the commonwealth.

Mr SANCHEZ — Yes. I think we are talking at cross-purposes. This is the consumption effect, the welfare effects, and another one is the distribution effects on revenue. We did that one for the revenue for the Henry tax review because they were in the second-round effects and the like. As Phil says, this was on the jurisdictional level on consumption. One of the reasons they are bigger in Victoria than in other states is exactly the reason I said at the beginning: because you have greater reliance on transaction taxes in those states vis-a-vis other states. Of course you would accrue a bigger welfare effect in the event that you were to take those away and rely on the other taxes. That is a very pointy-headed debate.

Let me return to what I think the theme of the question is, which is: should this be done on a national level? The answer to that is that in our submission to the Henry tax review we actually recommended that the commonwealth examine returning payroll tax back to the commonwealth as a commonwealth tax. I do not know if the committee is aware of this, but in 1971 payroll tax was a commonwealth tax. It was given to the states as a growth tax, and at the time it had very few exemptions. If you think about it, the last growth tax that was awarded was the GST. Similar debates took place around vertical fiscal — VFI — revenue raising at the national level versus the state level, subrogation and all those similar sorts of things, and it was returned.

What we have said is that there is now an even stronger case to do that, because the ATO through the ABN system can do it quite efficiently, administratively at least, and they can return the payroll revenue back to the states according to the actual payrolls. It would not even go back through the grants commission process.

Mr DAVIS — You would be against it going back through the grants commission?

Mr SANCHEZ — I would have to think about this, but it is about how many tickets get punched in Victoria and you get that amount.

The CHAIR — You are winning us so far.

Mr SANCHEZ — I think that is what the Henry tax review is considering.

Mr DAVIS — Just let me come back to where — as you detected — I was heading. On whatever model of change to payroll tax — in either of these versions — there would actually be benefits to the commonwealth.

Mr SANCHEZ — Absolutely.

Mr O'SULLIVAN — Through the GST.

Mr SANCHEZ — Because with economic growth it will accrue back in terms of other stuff — commonwealth taxes. These are the second-round effects. Let us say hypothetically that you broaden out the tax base; A, you lower the rate and you get an economic impact which then accrues in GST or whatever, which then rolls back into the states, so you may be able to have the rate even lower than you would have otherwise hitherto expected as part of those second-round effects. That is quite clear.

Mr DAVIS — The commonwealth may also pick up income tax benefits.

Mr SANCHEZ — Absolutely.

Mr O'SULLIVAN — That is their main benefit, because the GST would flow straight back to the states anyway.

Mr DAVIS — Yes, but not necessarily to the state it is collected in.

Mr O'SULLIVAN — No.

Mr SANCHEZ — It will flow through the grants commission process; that is right. But a rising tide will lift all boats. These are the second-round effects that are in the Henry tax submission which I am happy to get for you with the Access model. Obviously we did not do that because we were not modelling a national payroll tax for Victoria; we were modelling a reformed Victorian payroll tax for Victoria.

Mr SCOFIELD — Is it also true with these numbers — for example, the 1.68 — that is the output of the model in terms of the welfare gain in Victoria?

Mr DAVIS — Yes.

Mr SCOFIELD — Obviously there would be flow-on effects to other revenues in other levels of government in other jurisdictions or whatever, but they would be additional to the 1.68 in those locations, if you like. Is it true — I am sort of asking Alex to confirm this before I tell you — what I am saying is that the 1.68 is not — —

Mr DAVIS — It stands alone; that is what you are saying.

Mr SCOFIELD — It is not a gain in welfare that has to be shared by Victoria with others. There are other gains in welfare on top.

Mr DAVIS — But my point is that if you accept this set of figures, and I am impressed by your figure work, there will be a flow-on into commonwealth revenues.

Mr SANCHEZ — Yes, which will not detract from that gain.

Mr DAVIS — My point, picking up from the national competition policy model, is that arguably it would be shared sensibly on that former model between jurisdictions.

Mr SANCHEZ — That is right. If you get a 1.68 per cent increase in Victorian welfare that will accrue in terms of GST which will get distributed to some other states.

Mr DAVIS — And in income tax.

Mr SANCHEZ — That stands to reason. But that is 1.68 for Victoria alone. It is one brick and then another brick on top.

Mr SCOFIELD — The model would already have distributed those other gains.

Mr DAVIS — I am making a separate point.

The CHAIR — Before we move to the next question I am going to put in a plea, and that is that if it is humanly possible we try to get this table into evidence so that those who are reading the evidence will be able to work their way through the maze of references to figures.

Mr SANCHEZ — The submission is already public.

The CHAIR — I know, but not everybody has the benefit of pages 23 and 24 beside them when they are reading the evidence.

Mr DAVIS — May I just ask a very quick question?

The CHAIR — Are you still on this section?

Mr DAVIS — It is related, but a very tiny little point of base terminology. it is just on the fire services levy. It is in fact a tax.

Mr SCOFIELD — It is a tax. We have legal advice to that effect, which I think we could provide.

Mr DAVIS — That would be very welcome.

Mr SCOFIELD — We note there is a difference of opinion in the minds of some people.

Mr DAVIS — In some jurisdictions. We would love that legal advice.

Mr SCOFIELD — In particular about the fact that — —

The CHAIR — I am sure Mr Davis, who is the Leader of the Opposition in our upper house, would love that advice.

Mr SCOFIELD — I will just say that it is subject to the Insurance Council, because it is Insurance Council advice and not Allianz advice.

The CHAIR — I will let you work that out. I have a question in relation to the fire services levy, as I will call it. In the jurisdictions where it has been removed and put in as a universal tax by local government, have you got evidence that private insurance has in fact increased, and if so, would it be possible for you either to provide that evidence or to point us in the direction of where we can find it?

Mr SANCHEZ — In the two states where recent changes have been made there have been reviews undertaken by the Treasury to do this. In Western Australia the Western Australian Treasury contracted Signet Consulting to examine this very question, and their conclusion was that the difference was absorbed in terms of higher cover.

The CHAIR — But any more cover — and I am probably looking at Allianz here? After the fire services levy was removed were you able to identify either increases in the number or the quantum of insurance taken out?

Mr SCOFIELD — We have not done that sort of analysis ourselves, but the report to which Alex refers found that insurance premiums reduced by even more than the removal of the levy would have suggested they should, and that people did increase the level of cover they bought.

The CHAIR — Do you operate in WA?

Mr SCOFIELD — We do, yes.

The CHAIR — But you do not have that documentation.

Mr SCOFIELD — We have never done the analysis. I think it would be a little bit difficult in terms of just looking at insurance company data, because we will index people's sum insured every year so they do not become underinsured just by virtue of inflation.

The CHAIR — But would you not be able to know from one year to the next whether more housing insurance policies have been taken out, and if there were quite a spike after the fire services levy was removed, you would be able to identify that?

Mr SCOFIELD — The effect that was found in that report was increasing levels of cover; it was not more policies being taken out. It was not an issue of a large impact on non-insurance, but an impact on underinsurance to the extent that higher levels of cover were taken out.

The CHAIR — The evidence we have received from some people has claimed that more people will take out insurance on their own if the levy is removed, and I am yet to see that kind of evidence from a company. Forgive my cynicism, but often consultants can provide the results that those who engage them would like to have provided.

Mr SANCHEZ — We did an elasticity study on demand for house and contents insurance using the household expenditure survey, which was the best source of data that was available, and that is in the document about the forecast reduction in non-insurance if you reduce the FSL or remove the FSL and stamp duty. We are very honest here. With the household expenditure survey — and Phil is the fellow who does most of this work using the confidential unit record files — we were able to identify those households which really do need building insurance. They do not pay owner-occupier fees — they pay through the body corporate — and they are owner-occupiers in the sense that we would exclude investment properties. We try to reduce the sample to the real need, if you like. From the survey we claim there are around about 50 000 of those households in Victoria that do not have building insurance — not contents, but building — so they do not cover their asset. If you were to remove the FSL, we estimate that that would be cut by about a half.

The CHAIR — I am trying to find an insurance company that can give me an example of a state that removed it and as a result the number of premiums increased.

Mr O'SULLIVAN — The anecdotal evidence in Victoria would suggest that that would be the case because Victoria is unique — —

The CHAIR — Yes, but that is all suggestion.

Mr O'SULLIVAN — Yes, but Victoria is unique from the point of view that you have an FSL rate that is applied to metropolitan Melbourne and an FSL rate that is applied to regional Victoria. It is at least 10 per cent higher in regional Victoria than it is in metropolitan Melbourne. I think the non-insurance rate is around about 4-odd per cent for the whole of the state.

Mr DAVIS — It is about what, sorry?

Mr O'SULLIVAN — About 4 per cent.

Mr DAVIS — In building?

Mr O'SULLIVAN — In building. But the figures we have seen from the bushfires earlier this year showed that the non-insurance rate was around about 28 per cent in that area. It is reasonable to conclude that part of the reason it is so much higher compared to the state average is because of the increased cost.

The CHAIR — Okay, let us presume we accept that 100 per cent. I just want some evidence from the insurance providers of a state where there has been an increase in the numbers.

Mr SCOFIELD — Can I just answer that question by explaining why it is very difficult to do it from an insurance company point of view? The simple reason is that unfortunately in the markets we operate in we have competitors and — —

The CHAIR — I thought that was healthy?

Mr SCOFIELD — It is healthy.

Mr ATKINSON — But Graeme Samuel does not like them to compare notes.

Mr SCOFIELD — My point is that our market share can move around for any variety of reasons. If we stopped advertising on TV for three months or we doubled our spend for three months, that would have more of an impact on our market share in that particular period than probably anything else.

Mr WELLFARE — To isolate the effect is very difficult because it might be — —

Mr SCOFIELD — That is right. You cannot isolate the effect out of everything else that goes on.

Mr WELLFARE — It is very difficult, because it might be IAG or SGIO that might be taking market share from Allianz or QBE, or it might be a government incentive that somehow, as we have seen recently, encourages first home owners into the market so the proportion of first home owners jumps substantially from 17 per cent to 30 per cent and therefore the take-up of insurance jumps.

Mr SCOFIELD — Because there is a direct correlation between mortgages and building insurance.

Mr WELLFARE — There is a requirement for financial institutions to safeguard their assets. To actually say, 'Well, if we took off the FSL and 12 months later premiums increased, it was solely because of that and not because of increased or decreased market share or removal of a player, collapse of an insurance company' — —

Mr SCOFIELD — For example, one of the reasons Victoria had a slightly lower level of non-insurance in that work that was done a few years ago compared to some other states was because it had a higher level of home ownership. There are myriad factors that impact on the take-up of insurance as well as the amount of insurance people will buy.

The CHAIR — You have convinced me on the equity. You have not convinced me that more people will take up insurance.

Mr O'SULLIVAN — They would, though. Given the fact that the report does indicate that the quantum of insurance was taken up, at the very least it reduced the amount of underinsurance, which in some cases is just as important as not being insured at all.

The CHAIR — That is good, very good. That is true.

Mr SCOFIELD — The elasticity study did show that. It is not an elasticity study just done on the basis of a theoretical community, some of which have insurance and some of which do not. It is done on the basis of an econometric analysis. It is done on the basis of the actual take-up of insurance in different jurisdictions which have different tax rates. The elasticity showed that there is an impact on the take-up of insurance due to the fire services levy.

Mr WELLFARE — Can I just add on that that the Western Australian reform — when it did reform — led to the insurance companies agreeing to open their books to demonstrate to the government that there was that corresponding reduction in premiums and that the benefits of the removal of the FSL were passed on. We said, 'Come and look at us. We are passing it on. We are not keeping any of it'.

Mr ATKINSON — You said 28 per cent non-insurance afterwards.

Mr SANCHEZ — That is a crudish number to the extent that it is a marrying of different data sources. It is a marrying of our claims data versus the marrying of data that came from — —

Mr SCOFIELD — I think it was the police, wasn't it?

Mr SANCHEZ — The police and emergency services.

Mr SCOFIELD — They just flew over the place counting what they thought were burnt dwellings.

Mr SANCHEZ — Correct.

Mr ATKINSON — My question comes back to what one of you said before about the correlation between mortgages and insurance. It occurred to me previously — and I was going to ask it beforehand — that there must be quite a few people who are actually in breach of their mortgage agreements by not taking out insurance. Is that data quantified anywhere?

Mr O'SULLIVAN — Yes. I am using the household expenditure survey data — I think we can. The likelihood of you having insurance is greater if you do have a mortgage. If you are an owner-occupier and you have a mortgage, there is a greater likelihood of you having insurance than if you do not have a mortgage. We can quantify it.

The CHAIR — But it is not obligatory.

Mr O'SULLIVAN — No. That is the point; it is not obligatory.

Mr ATKINSON — It usually is for the mortgage.

Mr WELLFARE — Generally when you go and get your mortgage they will not give you the funds until you get the insurance, but after the 12 months they do not keep checking up on it.

Mr ATKINSON — But then people let it lapse.

Mr SCOFIELD — That is right. The banks do not follow up and people let it lapse.

The CHAIR — If you were writing our report, would you make a comment in that regard?

Mr SANCHEZ — I have looked at this question. Phil is right to the extent that the files that we have can look at the household expenditure survey and overlap these things, but that is a point-in-time study and the question is that you would have to look at how it tracks over time. In the case of the Victorian tragedy we did look at that and the extent to which people follow it up, but it really is a question for the banks more than it is for us.

Mr SCOFIELD — Absolutely.

The CHAIR — It seems to me that if banks are constantly looking at risk, you would almost think it was an obligation on taking out a particular loan for whatever reason.

Mr WELLFARE — Yes, but there comes a crossover point in the mortgage where you obviously pay off what the value of the property is in terms of the physical structure and then the land kicks in. At what point is the bank interested in continuing to show an interest? It has already covered its liability.

Mr SCOFIELD — I do get a letter from my bank every year that basically says, 'Do you remember that it is a responsibility that you have your property insured?'. It never does what it did when I first got the loan — that is to say, 'Send me a certificate of currency and a policy number'. There is a role for banks to be enforcing what is in effect their own policy.

The CHAIR — And it is in their shareholders' interests, you would think.

Mr SCOFIELD — That is right. Some people will have mortgage insurance and so in the end there are other things the banks can fall back on, but it is their policy that the property be insured if there is a mortgage on it and that the bank be noted on the insurance policy as having an interest. They just do not seem to stringently enforce that in the same way they did many years ago.

The CHAIR — Thank you very much. We appreciate the four of you coming today. We will be providing you with copies of the transcript. You are free to correct typographical errors, but not the substance of your submission. If it is humanly possible we will try to put tables 10 and 11 in so those reading the evidence will have some indication of those figures. Thank you.

Mr SANCHEZ — Please do not hesitate to ask for anything else that we can provide. We will do so.

The CHAIR — Thank you, Alex.

Mr SANCHEZ — Those submissions to the Henry tax review are on our website. If you need to access them quickly, just let me know and I will do it the slow way by email!

The CHAIR — Thank you.

Witnesses withdrew.