18th August 2019

ACCC Northern Australia Insurance Inquiry
GPO Box 520
MELBOURNE VIC 3001

RE: Northern Australia Insurance Inquiry
Measures to improve affordability and availability

To Whom It May Concern,

Following the release of the Northern Australia Insurance Inquiry ("NAII") second update and your request for submissions in relation to "Measures to improve affordability and availability" we would like to provide a submission for your consideration.

To date it has been our view that most of the recommendations the NAII have made in their first two reports, while admirable, will have a minimal impact on premiums payable as they do not go far enough to address premium differences of up to 800% more properties pay for insurance in Northern Australia. We are pleased to hear you are now extending your consideration to other measures as it has been our long-held view that a government led reinsurance option is the most viable solution.

About Strata Insurance Solutions

In 2011 Managing Director Tyrone Shandiman established a broking practice specialising in Strata Insurance. Since then, the business has grown to service over 500 clients (including in North Queensland), with a team of three. In 2013 Strata Insurance Solutions became the endorsed broker of the Unit Owners Association Queensland.

Recommended Measure

It is our view that the measure that has the greatest potential to improve insurance affordability is extending the jurisdiction of the Australian Reinsurance Pool Corporation ("ARPC") to provide re-insurance to private insurance companies for the peril of Cyclone and covering this by way of a levy comparable to the current levy model the ARPC has in place for terrorism re-insurance.

In addition to this, (possibly outside of the NAII scope), we also believe further consideration should be given to extending the scope of the ARPC to address other areas in the insurance market where insurance is either unattainable or severely unaffordable. We believe consideration should be given to extending the ARPC jurisdiction to covering the perils flood and storm surge. Subsequently, the current terrorism insurance levy should be re-named to be the Australian Re-Insurance Levy.

Current Role of the ARPC

Following a crisis after the September 11, 2001 terrorist attacks, insurers suffered major losses and subsequently were not willing to offer cover for terrorism. The ARPC was established to ensure Australians were provided cover for terrorism, by way of providing government backed re-insurance to private insurance companies. When purchasing a policy for fixed property, policy holders (who meet a

ARPC guidelines) were required to pay their insurer a terrorism levy which the insurer passes on to the ARPC – in exchange, those policy holders were provided cover for terrorism events with no provisions to opt out of the levy or cover. In the event of a terrorist attack, the insurer manages and pays for a claim and is later reimbursed by the ARPC as a re-insurance claim – these claims are funded by levies collected. The Australian Government (i.e. tax payers) backs the ARPC in the event it has not collected enough levies to cover the cost of claims.

Key Advantages of using a Reinsurance Pool

It is our view that establishing a re-insurance offering by way of a levy will provide the following benefits:

1. Ability to "spread the risk" to a broader range of policy holders

Traditionally, the role of insurance has been a model of "spread the risk" – whereby everyone pays into the "insurance pool" and only some (who have claims) take out of the "insurance pool".

As technological advances have allowed insurers to become more sophisticated in how they assess the risk of a property, insurers are now moving to a "risk selection" model which plays an important part of the insurer's appetite for business and more importantly price of insurance.

As insurers are for profit entities that work in the interest of shareholders, the better they are at underwriting selection, the more advantageous it is to their underwriting result and thus more profitable they are for shareholders.

As insurers are now able to charge a premium based on specific address, it means under a "risk selection" model, higher risk clients are impacted the most and this is evident with the current Northern Australia insurance crises. A "risk selection" model, while it benefits the majority not in low risk areas, the minority in higher risk areas are severely impacted.

As the insurance market is profit driven, private insurers are simply not able to move to a "spread the risk" model that provides lower premiums for higher risk clients and higher premiums for low risk clients because the likely outcome will see that other insurers working on a "risk-selection" model will pick up lower risk clients, because they will be more competitively priced, while the "spread the risk" insurer will pick up the high risk clients at an unsustainable premium as they do not have enough low risk clients to support providing premium to cover the high risk clients.

Risk selection is failing policy holders who are in identifiably high-risk locations as it means they pay premiums proportionate to their risk, which is often unaffordable or in some instances insurers simply are not willing to offer cover.

The benefit of using a government backed re-insurance pool where the government is the sole provider of re-insurance for the peril of Cyclone in Australia is that the government is able to charge a levy of that is appropriate to cover the cost of claims associated with a specific peril to all policy holders whether they are in a high or low/no risk area. This means less focus on "risk selection" and returns pricing of insurance to a "spread the risk" model across a wider set of policy holders.

2. Provide for fairer and more proportionate levels of commission

As commissions are based on a percentage of the premium collected, it means that in the instance where the premium for building in Northern Australia is say 800% the cost of a comparable property in other parts of Australia, commissions are disproportionate (800% more).

While there may be some additional work imposed on the insurance broker or strata manager in administering a higher number of catastrophe claims, arguably the additional work is not necessarily proportionate to the higher commissions earned (e.g. 800% more).

As levies do not receive a commission, by collecting a levy for the peril of cyclone (and possibly other perils such as flood and storm surge), it in effect means that commission levels are more proportionate for buildings irrespective of whether they are or are not in Northern Australia (or other high risk areas).

3. Ability to provide government a mechanism to respond faster market failures in the insurance industry

While Northern Australia insurance might be a market failure today – in future, other perils might pose an issue for consumers from the perspective of affordability or insurability. By using the ARPC to address market failures related to the perils of cyclone, flood and storm surge, it gives government a mechanism to act more quickly for any future market failures in the insurance industry.

4. Government are able to subsidise re-insurance to provide further relief to policy holders

Using the ARPC to provide re-insurance for the peril of cyclone, can also provide the government (at their discretion), the ability to provide funding to the ARPC for the express purpose of reducing the cost of levies for policy holders.

How Should Measures be Structured

1. Which risk/perils should the measure(s) apply to?

It is our view the ARPC should provide re-insurance for the peril of Cyclone to cover the immediate need and concern of affordability in North Queensland (in addition to covering terrorism currently).

We also believe the ARPC should consider extending their measure of providing re-insurance other "risk-selected" perils where affordability or insurability are a problem for consumers. It is our view that the government review of extending the jurisdiction of the ARPC should extend to:

- Flood (unaffordable & uninsurable) – clients in high risk flood areas are affected by high premiums that match the risk of their property flood. For example, a $500,000 property in a one in twenty-year flood exposure may be required to pay a premium in excess of $25,000 p.a. – that is more than the cost of their mortgage and simply unaffordable for most Australians and many policy holders simply elect not to take the cover;
- Storm Surge (not available) - Storm surge is one of the most difficult covers obtain on the market, particularly for policy holders located within close proximity of the sea. We have recently been asked to quote storm surge for one of our large strata clients with over 100 units and have had to approach hard to place insurers in Lloyds of London to arrange cover at premiums that are simply unaffordable. This approach is unattainable for mum and dad homeowners.
- Other insurance covers where affordability or insurability is causing a problem for consumers such as providing professional indemnity for cladding activities for building certifiers and surveyors (further information: https://www.insurancenews.com.au/local/pi-crisis-as-insurers-retreat-from-cladding-risk).

With climate change being a real threat, other weather-related events may become more frequent in the future and cause the same issues that cyclone is currently causing for North Queensland. By setting a precedent for the perils of cyclone, flood and storm surge, it gives government the ability to respond more quickly if insurance becomes unaffordable or uninsurable for other perils.

2. What geographic area should the measure(s) apply to (e.g. only northern Australia, or all of Australia)?

This measure should be provided Australia Wide in both the collection of levies and cover provided, however, in principal, those in lower risk areas should pay a lower levy, while those in higher risk areas should pay a higher levy. By including all of Australia in the re-insurance levy will mean that there are more policy holders that contribute to the levy and thus reduce the burden on high-risk policy holders.

Furthermore, the levy should apply to all fixed property whether commercial or domestic policy holders. High premiums in North Queensland are impacting economies in those regions. Limiting cover to domestic homeowners only will still mean higher costs for businesses and thus continue to impact the economies in Northern Australia properties as the high cost of insurance is passed on to consumers.

3. How should eligibility for assistance under the measure(s) (if it is targeted directly at consumers) be determined?

It is our view that the government should follow the current model of the Terrorism reinsurance offered by the ARPC and make it mandatory for all policy holders with fixed property to pay the levy and receive the cover for the perils insured, with no provision to opt out. All policies covering fixed property should pay the levy that is charged on a tiered basis depending on their risk/exposure (similar to the Terrorism Levy - Tier A being high risk, Tier B being moderate risk & Tier C being low risk).

4. What other considerations are important for the design of the measure(s)?

Mitigation

Mitigation is frequently mentioned as the most sustainable way to reduce premiums in the NAII. What is not clear however is who should fund the mitigation measures – for example the policy holder, the insurer or government.

Currently, there is no incentive for insurers or re-insurers to fund mitigation, because they are not guaranteed of retaining the client after they finalise mitigation to see the benefit of their investment in mitigation.

If the ARPC were the sole provider of re-insurance for cyclone in Australia it would mean they would in effect be the sole beneficiary of any mitigation measures they pay for, therefore the ARPC would have more incentive to fund mitigation.

Subsequently, we are of the view that the ARPC's jurisdiction should also extend to funding mitigation measures (on a cost/benefit basis) that would have a direct impact on lowering claim expenses incurred by the ARPC and ultimately lower levies. Examples of mitigation measures that could be funded include (but are not limited to):

- Making properties more cyclone proof or paying extra to upgrade properties to make them cyclone proof at the time of a claim (cyclone);
- Relocating homes in high risk areas after a major event (cyclone, flood, storm surge).
- Funding flood mitigation infrastructure (flood);

Flood & storm surge would require more complex rating

If the re-insurance levy were extended to include flood and storm surge on a Tier A, B & C level based on risk, the levy for these perils would be more complex as they would need to be address based as two properties in the same post code (or even same street) can have vastly different exposures. It would mean the ARPC & would need to provide a risk address tier for these specific perils and this would take more time than a post code driven levy that would be relevant for Terrorism or Cyclone.

<u>A levy that only covers "cyclone" might be politically difficult to implement</u>

As this enquiry focuses on affordability of insurance in Northern Australia, it is important to consider that a "Cyclone" re-insurance levy that is established primarily to benefit policy holders in Northern Australia but paid for by policy holders everywhere in Australia including those in not at-risk areas might be politically difficult to implement. That is why, a "re-insurance" levy that covers a broader scope of perils affecting policy holders in more locations (Cyclone, Terrorism, Flood & Storm Surge) would be politically easier to implement as it would impact more people who pay for the levy and not be seen to be benefiting a specific region.

<u>What would be the cost of the measure(s)?</u>

As the re-insurance model works to "spread the risk" across a broader set of policy holders, ultimately the cost would be borne by policy holders who have a lower exposure to cyclone. This model is currently in force for the terrorism re-insurance arrangement whereby, people in low risk areas (including policy holders in Northern Australia) are effectively funding terrorism insurance for capital cities who are most likely to have a terrorism event.

By implementing a levy that funds a re-insurance program for cyclone (and possibly terrorism, flood and storm surge) it will essentially mean that premiums for those in high risk areas will reduce, but premiums in low risk areas would increase. Applying a tiered system would reduce the impact of premium increases and provide more fairness – for example for the peril of Cyclone, a low risk policy holder may have a levy of 1%-2% of their premium, whereby a policy holder in a higher risk area might have a levy of 50% - which would still be a significantly better outcome for the policy holder than current premium loadings that can be in excess of 800%. The same approach can be applied for other perils so that a low risk policy holder may only pay a 5% levy for all perils.

<u>How should the measures be funded?</u>

It is our view the measures should be funded by a levy similar to the way that the current Terrorism Insurance Levy works.

The ARPC should be responsible for setting the levies in consultation actuaries who are best qualified to fairly determine appropriate pricing to cover levies.

In principal, levies should be based on the idea that that those in low risk areas have a lower levy (but still make some contribution) and those in higher risk areas pay a higher levy.

The current Terrorism Insurance Levy model that imposes a Tier A (16%), B (5.3%) & C (2.6%) levy depending on risk is a fair model and this pricing model could be applied similarly to the other perils included in the re-insurance levy, of course with different % for each tier determined by an actuary.

<u>What Impact would the measure have on:</u>

<u>Premiums</u>

The idea of this reinsurance measure is to significantly reduce the premium payable for those in the minority who have properties in high risk areas (such as North Queensland) and impose a minor increased cost (levy) on the majority who are not in high risk areas.

In addition, current re-insurance arrangements private insurance companies enter into with "for profit" reinsurers, sees premiums factoring in a profit margin for the re-insurer. As the ARPC is a not for profit entity, it might mean the cost of re-insurance is lower, as it doesn't factor in a profit for the re-insurer and thus effectively reduces the cost of premiums to the end consumer.

Insurance Availability

A cyclone re-insurance levy that is mandatory for all properties in both payment of the levy and cover, would mean that no policy holder would be uninsurable. Likewise, if the levy was extended to cover the perils of flood and storm surge it would drastically provide significant relief for policy holders unable to insure their property for flood & storm surge due to affordability or insurability.

Competition in, or the operation of, insurance markets

As the sole reason insurers have exited the market in North Queensland is due to losses sustained by cyclone, providing a compulsory insurance levy for re-insurance would mean that insurers would not be exposed to cyclone losses in North Queensland. This would then mean that more insurers would enter the market in North Queensland and thus create more competition.

Prior to implementing the levy, the Federal Government should consult with insurers who currently do not insure in North Queensland to determine whether imposing a re-insurance measure would encourage them to re-enter the market.

Regulatory Burden on Insurers

As insurers currently already collect levies (such as the terrorism levy & NSW Fire Service Levy) we do not believe imposing a new levy will impose a higher regulatory burden on insurers – insurers are already paying levies to the APRC in exchange for re-insurance for Terrorism Insurance.

Would the benefits of the measure(s) be passed through to consumers? Would any safeguards be required to ensure that this occurred?

Given the current structure of the Terrorism Levy, we believe there would be no issue with measures not being passed on to consumers and the safeguards that would need to be implemented should match the safeguards already in place under the Terrorism Levy. By providing compulsory re-insurance, it would encourage competition in the market for business in North Queensland which would provide a safeguard to ensure that the benefits are passed on to insurers. Insurers who did not pass on the benefits to customers would lose clients to other insurers that did.

Are there any similar international measures that the ACCC should consider?

It is our view that the current model the ARPC have in place for Terrorism is a fit for purpose model for other perils. The ARPC (who have qualified actuaries) should come up with the modelling for Tier A, B & C levy for each peril and furthermore should also review models of the United Kingdom Flood Re &/or Japanese Earthquake Reinsurance Company to determine if there are further considerations for enhancing the re-insurance offering.

How long should any measure(s) be in place for and where relevant how should they be phased out?

The ARPC and Australian Government should be required to review the need for offering re-insurance every three years (as they currently do with terrorism insurance). While cyclones continue to be a problem in Northern Australia, the re-insurance levy would remain relevant.

However, for other re-insurance measures, such as offering a Professional Indemnity offer covering cladding activities for building certifiers and surveyors could be phased out if governments were to address rectification of defective cladding.

Conclusion

The government has a role to play in protecting its citizens from major financial peril and ensuring prosperity for all Australians.

The cost of insurance in Northern Australia is having a major impact on economies in effected regions. Insurance should be available and affordable for all Australians irrespective of where they live.

Likewise, if a consumer takes out a policy to cover major losses – then there should be no option for an insurer to exclude cover for cyclone, flood & storm surge. Making cover mandatory, would prevent governments from having to deal with aggrieved policy holders who have lost everything at the time of a major event.

Given the success the government has had in implementing cover for terrorism through the ARPC and the market failure of insurance in North Queensland (and other perils of flood, storm surge and insurance for building certifiers and surveyors) the government should extend the jurisdiction of the ARPC to provide re-insurance for problem areas that the insurance market is failing consumers due to affordability or insurability.

With climate change causing more catastrophic events (and the likelihood of it getting worse) the issue of affordability and accessibility to insurance will only become more problematic for policy holders – the Federal Government should act now.

Thank you for taking the opportunity to review this submission.

Kind Regards

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