20th October 2014

PRODUCTIVITY COMMISSION – DRAFT REPORT – INSURANCE AND NATURAL DISASTERS

Dear Sir/Madam,

I refer to the above mentioned document and thank you for the opportunity to respond.

I wish to focus purely on the comments and issues as outlined under Section 6 – Insurance and Natural Disasters and in particular the current market and social conditions being experienced by people living north of the Tropic of Capricorn or the 26th Parallel.

I would therefore respond on certain comments and exerts from the report as follows :

"Insurance plays an important role in helping households, businesses and governments manage natural disaster risks. This supplementary paper discusses current insurance arrangements, whether these arrangements are consistent with effective natural disaster risk management, and potential solutions to problems identified." Page 365.

This opening comment is correct and highlights immediately the issues being faced by people living in NQ. Due to the recent astronomic increases in premiums on property insurances North of the 26th Parallel, coupled with insurers withdrawing from this market, cover is both unavailable and unaffordable.

- ***"Evidence on the extent to which non insurance and underinsurance are a problem is limited. While a significant proportion of households appear to be underinsured, it is not known how many are making a rational choice and how many are underinsured due to market distortions or cognitive barriers." Page 366***

I am dealing with people on a daily basis, who are making the decision to either not insure either all or part of their belongings or in some cases not insure at all, due to the cost of insuring being too high. In the event of a catastrophic cyclone hitting NQ, their expectation is that Governments, either State or Federal will come to their assistance. I do not believe that this is a correct assumption.

"The unavailability of insurance also sends an important signal to parties. Where markets are working well, not being able to get insurance communicates to the party that their natural disaster risk is too high, and provides an incentive to undertake risk modification measures." Page 367

This draws out the issue of Risk Mitigation for property risks in relation to cyclone damage. It is generally recognised, that buildings built after 1985 or have been upgraded to meet the relevant codes, in most cases as a result of cyclone damage, would be less prone to damage than property built prior to 1985 or have not been upgraded to the latest code. So how and who should bear the cost of upgrading these properties in an attempt to mitigate damage from cyclones ? Should Governments be proactive in this regard as they have done with Flood mitigation projects in Western Queensland?

"States and territories have made changes to the taxes and levies imposed on insurance premiums in recent years. Some states and territories have recently increased stamp duties, such as Queensland, which increased stamp duty from 7.5 per cent to 9 per cent in August 2013 (QOSR 2014)."Page 376

"As taxes increase the price of insurance, inquiry participants also argued that taxes lead to reduced insurance affordability, and potentially underinsurance and non-insurance (for example, IAG, sub. 24; Suncorp Group, sub. 71; Treasury, sub. 91). While there are few studies on the effect of taxes on insurance coverage, there is some limited evidence that insurance taxes lead to underinsurance. Tooth (2012), using a survey of 1200 households, found that some households would underinsure or not insure if taxes were increased. In an earlier study, Tooth (2008), using data from the ABS Household Expenditure Survey and state tax data from the Insurance Council of Australia, found that non-insurance was correlated with state taxes. In addition, Tooth and Barker (2007) observed that states with higher taxes tended to have higher rates of non-insurance." Page 377

Compounding the rate increases over the last three years, has been the Queensland State Governments decision to increase Stamp Duties to 9% with effect from the 1st August 2013. Motor had been 5% and Property 7.5%. As pointed out by the ICA, this had an additional effect of increasing the total premium payable compounded by GST being "a tax on a tax", making affordability of insurance further out of reach and pushing insureds to reduce their covers, compounding the underinsurance issue.

"The Australian Government is currently considering options to increase the number of insurers that participate in the north Queensland building and strata-title insurance markets. An option being considered is changing regulations to allow foreign insurers to participate in the Australian market. The north Queensland market is discussed in more detail below and in section 6.5."Page 381

It is interesting to note, that the Federal Government are considering making changes to legislation to allow more foreign insurers to participate in the Australian Market. Of the World's top 10 insurers, currently three, Zurich, AIG and Allianz are operating in Australia. Of these, none will write Farm and Body Corporate covers in NQ and Allianz will write Home cover, but at uncompetitive premiums.

"The Insurance Council of Australia (sub. 57) also argued that mitigation at the property level can reduce insurance costs where credible data can be obtained." Page 382

Cyclone building codes

There is evidence that cyclone building codes have reduced insurance premiums. Analysis of damage to buildings from Cyclone Yasi indicated that buildings constructed to requirements introduced in the 1980s sustained much less damage compared with older buildings. Insurance Australia Group's cyclone premiums have been discounted for post-1980 buildings (IAG, sub. 24).Page 383

The issue of mitigation for property risks, i.e. building to code, is a major issue in relation to properties built prior to 1985 or not to code. Governments may need to look at what can be done to assist insureds to upgrade their properties, as has been previously commented as was done with Flood mitigation in Western Queensland.

Competition in the insurance market

Competition drives efficient outcomes for price, quality and innovation. A lack of competition (or contestability) in the market can lead to increased prices and decreased choice of insurance products, reducing the effectiveness of price signals as a risk management tool. Page 387

A lack of competition has been raised as a possible reason for significant price increases in north Queensland in recent years (Treasury 2014a). For example, between 2007 and 2012, residential strata-title property insurance premiums increased by an average of 200 per cent (Treasury, sub. 91). Evidence exists that competition in the north Queensland market is more limited than in other parts of Australia. For example, fewer insurance companies participate in the north Queensland market (Treasury 2014a). In addition, the Australian Government Actuary (2012) concluded that the residential strata-title insurance market in north Queensland is not deep, and supply has been affected by the withdrawal of some insurers from the market. Treasury (2014a) also argued that contestability is lower in the north Queensland market, due to less information about the significant natural disasters risks that the area faces. Page 388

The lack of competition in NQ is a real issue. In some sectors, only limited options exist as follows :

- Body Corporate/Strata Risks – Currently 3 insurers – SUU(CGU), Longitude (Vero) and Brooklyn (Lloyds) are offering cover for Strata Title /Body Corporates in NQ

- Only CGU, QBE and Elders (QBE) are covering Farm risks in NQ. WFI are still offering renewals, however after having been purchased by IAG, the WFI business is to be merged into the CGU business.

However, the Australian Government Actuary (2012, 2014) found that prices in the north Queensland residential strata-title insurance market are not unreasonably high when assessed against the underlying risk. And the residential strata-title insurance market has

not experienced significant profits in recent years, indicating that insurers are not price gouging. It found that other factors have contributed to the price rises, including historical under-pricing, increasing reinsurance costs and losses from recent natural disasters.

The Treasury (2014a) has asked for feedback on a number of proposed changes aimed at improving affordability in north Queensland, including:

- ***developing a comparison or 'aggregator' website for consumers to compare available insurance products***
- ***facilitating engineering assessments of strata-title properties to identify improvements that can be made to reduce risk and possibly insurance premiums***
- ***expanding the market by encouraging participation from foreign insurers.***

I have previously responded to Treasury in relation to these comments and attach a copy of that submission. In summary I would comment as follows :

- The aggregator website would not increase market participation and subsequently reduced pricing. This would only have an effect if new entrants to the Australian market were participating in NQ, but they are not. Also, due to complexities in covers, would suggest using the Prescribed Contract as per the Contracts Act as the basis for the comparison.
- The engineering assessments have been started by one insurer at its own cost already.
- In encouraging foreign underwriters to participate in the NQ market may weaken legislation in place for all underwriters. Also, of the top 10 insurers in the world at the moment, 3, AIG, Zurich and Allianz already underwrite business in Australia, but do not underwrite extensively in NQ.

Given that the significant price increases in north Queensland do not appear to have been driven by a lack of competition, this would suggest that the introduction of an aggregator website and opening up the market to foreign insurers would not substantially reduce prices in the region. However, more information and competition is generally good for consumers. There are other options that could lead to price reductions and better outcomes for consumers in north Queensland. Insurance brokers could be an effective intermediary for consumers to use to assess the insurance options that best meet their specific needs. In addition, as discussed above, effective mitigation measures can result in substantial reductions in insurance premiums. Cooperation between parties to identify and implement mitigation measures, such as the proposed strata-title property assessments, should be encouraged. Page 389

Your comments in relation to the introduction of an Aggregator and opening the market to foreign insurers are noted and agreed.

Whilst the Australian Treasury Actuary suggests that the current market rates are correct, the lack of competition must have some impact on pricing, particularly in the Body Corporate and Farm Insurance areas. You suggest that there are other options which could lead to price reductions and I believe that Government Intervention is a real option. Insurance brokers have their hands tied due to the lack of markets available to them.

In relation to mitigation, this is easier to implement in relation to flood effected areas than properties. However, when one considers mitigation for property risks in NQ, the issue becomes extensive. Mitigation in this case, relates to having properties built or upgraded to the highest and latest building codes. For all new buildings this should be compulsory, however for buildings built prior to 1985 and not built to code, this process may be extremely costly and in any case only minimise damage and not totally stop damage, should an extensive cyclone strike the NQ region.

Moral hazard

Moral hazard is a form of information asymmetry that occurs when a party takes more risks because some of the costs of those risks will be borne by another party. Parties that do not face the full cost of risks might not undertake effective risk management.

Governments provide a number of types of financial assistance to households and businesses in the event of a natural disaster. For example, households can receive payments including the Australian Government Disaster Recovery Payment and assistance under category A of the NDRRA. As well, small businesses and primary producers can receive loans and grants under categories B and C of the NDRRA. This financial assistance is designed to help with some of the shorter-term costs of a natural disaster, rather than providing compensation for losses to private assets (Attorney-General's Department 2012b). Page 390

Some inquiry participants claimed that the NDRRA and other sources of financial assistance (such as charity relief funds) influence households' and businesses' decisions to take out insurance. For example, Risk Frontiers (sub. 19) submitted that there is anecdotal evidence of moral hazard, and cited a study it undertook after the Queensland and Victorian floods in 2011 that found few people were interested in flood proofing their house. In addition, Suncorp Group (sub. 71) suggested that the Australian Government Disaster Recovery Payment and the Disaster Recovery Allowance have occasionally influenced sum insured and insurance excess decisions, and reduced the overall level of insurance cover. The Actuaries Institute (sub. 97) claimed that post-event compensation from governments encourages people to be less self-reliant.

Due to the affordability issue being experienced by many people in NQ, the approach following previous cyclones and Government hands outs is, as outlined above, to either :

- Cease insurance cover in full
- Reduce sums insured to make the premium affordable, but expose themselves to co-insurance issues in the event of a claim.

- Increase excesses and take the risk themselves.

All of these tactics will in the event of a major catastrophe potentially leave the resident in a state of financial hardship and loss, from which they may never be able to recover from, unless Governments intervene.

The Actuaries Institute (sub. 97) claimed that post event compensation from governments encourages people to be less self-reliant

This comment reinforces my earlier points that post event compensation is not the way to go and encourages people to transfer risk to themselves and in the event of a catastrophe occurring the expectation is that the Governments will come to their assistance. I believe this needs to be stopped and a proactive approach by Governments incepted to make residents take out their own insurance covers.

Some local governments raised concerns that there is an increasing expectation among households that local governments will undertake clean-up work after a natural disaster, which should be undertaken by asset owners.

Again, an expectation that Governments or local bodies will take over if an event occurs.

6.5 Insurance affordability and coverage

The issues discussed earlier in this supplementary paper have in many cases resulted in concerns about reduced affordability and coverage of insurance for households and businesses. This section discusses affordability and coverage issues, and if they have arisen due to market distortions.

Affordability

The affordability of insurance is an important factor in insurance and risk management decisions more broadly. Increasing the cost of insurance, all else equal, can decrease the level of cover. Parties might not take out insurance where they would have done so at a lower cost.

This comment is very true of the current market in NQ, where the unaffordability and availability of coverage is driving insureds to transfer risk to themselves and self-insure.

However, the cost of insurance being high is not a problem per se. Where high costs reflect the level of risk, this is an efficient outcome. Governments should avoid intervening in the market in this case, so as not to distort price signals. However, reduced affordability of insurance is a concern if it is due to market distortions, such as taxes, a lack of competition, or information asymmetry. Governments might also intervene in the market where there are equity concerns, such as people on low incomes facing large insurance costs.

The current pricing of property in NQ may in fact reflect the risk and exposure, however the increases experienced in the last few years have not been reflective of the current claims. As commented, Governments should intervene in a market, where a lack of competition, also acts as a driver for price increases. The Australian Government has in two cases in the last 12 years entered the insurance market where both a lack of market or affordability became an issue. They were as follows :

- 2003 – Terrorism Risk. The Federal Government set up the Australian Reinsurance Pool to accommodate this risk and manage a "terrorism pool."
- 2004 – Public Liability Insurance Crisis. A temporary co insurance pool called the Community Care Underwriting agency was established when a Public Liability Insurance crisis occurred.

The price of property insurance has increased significantly in recent years for some policyholders and particularly in some geographic areas (Treasury 2014a). Since 2009, household building insurance premiums have increased by six times the increase in the consumer price index, and household contents insurance premiums have increased by twice the increase in the consumer price index (figure 6.1). Premiums appear to have increased more in some jurisdictions than others. Gross premiums incurred (which include new policies as well as price increases) by Australian insurers have increased at a faster rate in Queensland than in other states and territories between 2005 and 2013 (APRA 2013a). Insurance price increases do not appear to be due to increases in housing construction costs.

There are areas [in far north Queensland] now where home owners cannot get home insurance and where it can be obtained, it is just too expensive. As a result a larger number of homes in the Far North are now uninsured. (Tablelands Regional Council (Qld), sub. 40, p. 5)

In some parts of Australia, especially North Queensland, there is major community concern about the cost of property insurance. ... These concerns indicate that the cost of insurance (ie the cost of funding the pool) has reached levels that are unacceptable to the community, and may well be unaffordable to many property owners. If they chose to not continue with their insurance, they expose themselves to significant personal loss, including the potential loss of their family home. (NIBA, sub. 64, p. 6)

This issue of affordability is compounded by the fact that often the areas with the highest premiums are those with the lowest earnings. (Actuaries Institute, sub. 97, p. 4)

A number of studies have looked at insurance affordability for low-income households. Collins (2011) and Sheehan and Renouf (2006) found that affordability was the greatest barrier to people on low incomes having adequate insurance cover.

Again, all these comments endorse that the cost of property insurance in NQ is a major obstacle for people to insure and that they are now exposing themselves to significant personal losses.

Intervention by governments, for example, through subsidies to reduce the premiums of high-risk customers, is not warranted. Subsidies dull the price signals sent to policyholders, reducing the marginal incentive to undertake mitigation measures that could decrease natural disaster risk.

If this comment is correct, why did the Federal Government intervene in the market as outlined above, where a lack of a market and an affordability of product previously occurred?? There is currently a real need for the State and Federal Governments to intervene in the Domestic Insurance markets in NQ to provide price cushioning for customers. This, coupled with mitigation and upgrading of domestic buildings to make them compliant to Cyclone building codes would assist in increasing the level of insurance in the market place.

Removing or reducing distortions in the market would be more effective. For example, removing specific taxes and levies on insurance premiums would reduce the price of insurance and improve affordability (section 6.4). Page 393

In August 2013, the Queensland State Government increased Stamp Duties on Insurance policies from 5% on Motor and 7.5% on Home to 9%. This also had an effect of compounding the total cost of insurance in the market place. I would urge the Queensland State Government to rethink this and provide relief on Property risks in NQ.

While mandatory insurance, such as a government backed insurance scheme like those used internationally, would potentially address non insurance and underinsurance, it would have significant costs. For example, given the high cost of insurance in some places and the variability of natural disaster risk across Australia, the introduction of mandatory insurance would likely require some level of cross subsidisation or provision of direct subsidies to high risk customers. As discussed earlier, these measures distort the price signals provided to policyholders, reducing the effectiveness of insurance as a risk management tool. In addition, there is evidence that international government backed insurance schemes often do not have adequate reserves and capital, and have resulted in crowding out of the private sector (supplementary paper 9). Page 397

I believe that a Queensland State and Federal Government intervention is required in the short to medium time to create affordability and availability of Home property insurance in North Queensland. The point raised in the above mentioned extract, is that it is costly and if a Cyclone should occur the fund may be under funded. However, I believe that a joint approach by the Queensland State and Federal Governments on a similar line to the New Zealand Earthquake Commission approach is what is needed at the moment. It is interesting to note, that the New Zealand Earthquake Commission has just renewed their reinsurance programme, with an increased capacity, after the treaties were exhausted recently with the Christchurch events. (Copy of public information attached.)

Also, the Federal Government has in place a vehicle, the Australian Reinsurance Pool, which could be expanded to handle a Named Cyclone Reinsurance Pool, reducing costs.

It is also interesting to note, that in the Pivot North report recently tabled in the Federal Parliament, Allianz, one of the world's largest insurers made the following comments :

- ***4.100 Allianz Australia highlighted the weather risk component of insurance costs in North Queensland, particularly relating to floods and/or cyclones, stating that 'average premiums between North Queensland and elsewhere involving multiples*** *of 2.5 times reasonably reflect differences in risk'. Allianz Australia noted, however, that 'this conclusion becomes harder to sustain in light of evidence that some homeowners face premiums of ten or fifteen times those of other Australians', and that 'at such extreme levels, premiums cease to act as an appropriate price signal'.107*

- *4.101 As a means of spreading the risk from weather events in North Queensland, Allianz suggested a reinsurance pool, explicitly subsidised through a levy, similar to that provided by the Australian Reinsurance Pool Corporation, which manages terrorism related risks. Allianz noted that:*

The provision of subsidised reinsurance for cyclones and floods would remove the high level of uncertainty associated with insurers' exposure to these events and the concentration risks that limit their appetite for business in areas such as Nth Queensland.

Also, in the Actuaries Institute presentation to the Productivity Commission dated the 20th June, 2014, they stated as follows :

We do, however, advocate consideration be given to the need for intervention to assist consumers who cannot afford insurance or avoid insurance with the expectation that the community will provide compensation for losses.

To be effective any reinsurance pool would need to be set up appropriately. Any pooling arrangement should only be set up on a temporary basis and should include clear mitigation targets in order to reduce the risk and premiums over time. It should only apply to existing properties and would not be applicable to new developments, so that the problem is not compounded by allowing the market to increase exposure and vulnerability. The pool should not blunt the insurance price signal to consumers, the government and the community as a whole.

Successful examples of temporary pools include: the Australian Reinsurance Pool Corporation set up by the Commonwealth Government to manage a 'terrorism pool' funded by an explicit levy on all non-residential commercial insurance policies. A similar successful temporary co-insurance pool called the Community Care Underwriting agency was established in 2004 when there was a public liability insurance crisis in 2004.

If this pool were to be established, the Institute proposes that:

� the extent of any subsidisation of premiums be contingent on local and state councils, and potentially homeowners and businesses (i.e. the stakeholders) undertaking (or at least contributing to) adequate risk mitigation. It is important that the premiums charged for high- risk properties provide an incentive to individuals and communities to implement risk mitigation efforts, and not encourage undesirable development;

▯ the pool could act as a mechanism for co-ordinating loss funding and appropriate development decisions;

▯ the Government set an objective to reduce the size of any post-disaster funding intervention over time as mitigation actions reduce the number of properties at high-risk of disaster; and

▯ that such a pool could cover flood and actions of the sea, with extension to other perils with consideration given to any mitigation actions available

4.2 Direct mitigation infrastructure spending – Government-funded

An alternative funding option is for direct investment in mitigation infrastructure projects. This could be funded by local councils and state and Commonwealth Governments via a new tax or specific levy collection e.g. fire service levy on council rates. Funding of mitigation projects has been limited to date. This is in part due to current government budget pressures. Non–partisan support is essential to ensure an infrastructure mitigation budget is funded.

Direct infrastructure investment will not address any affordability issues in the short-term. As mitigation efforts will take some time to develop, post disaster funding by government is likely to continue. Another option is for the government to subsidise premiums charged for high-risk Page 13 of 16 Institute of Actuaries of Australia

Both these two well respected parties support the need for intervention and the creation of a reinsurance pool. For once a major insurer had openly stated the real reason why many insurers do not wish to participate in the property market in North Queensland. Surely these organisations add great weight to the need for Governments to act now and not delay and wait and hope that another large event does not strike and the pull on the public's purse. Copies of both these comments are attached for your information.

<u>RECOMMENDATIONS</u>

Therefore to resolve the availability and affordability of Property Insurance in North Queensland, the State and Federal Governments should take the following actions:

- That the Queensland State Government reduces Stamp Duty on Domestic Insurances in North Queensland immediately to ease the total amount payable by NQ residents on Home and Body Corporate policies. This would also flow through to GST reducing and give an immediate saving to policy holders.

- That the Queensland State Government works with the Federal Government to set up a scheme similar to the New Zealand Earthquake Commission focusing purely on the risk of Named Cyclones. This interim initiative could be operated by either the Australian Reinsurance Pool or the Queensland State Government Work Cover body, to minimise initial setup costs and utilise their already in place reinsurance facilities to access markets.

- That via this scheme, all properties in North Queensland should have a minimum cover in place, purchased via their local Councils or in the event of persons renting a property via their real estate manager or Landlord.

SUMMARY

When another cyclone hits the North Queensland region and causes considerable damage, many residents will suffer huge financial losses due to them being either underinsured or uninsured.

We have seen the initiative of the Northern Territory Government in creating the Territory Insurance Office, when insurance for certain risks in the Northern Territory was hard or impossible to obtain. Also, when Terrorism and Liability risks were either unavailable or unaffordable, the Federal Government stepped in and created solutions.

In North Queensland now, we have a crisis in relation to affordability and availability of certain classes of insurance.

The Federal Treasurer, Mr Hockey, described the issue in his Budget speech as "acute."

The Queensland Premier, Mr Newman, was reported as commenting "insurance as the single biggest issue facing the region".

The LNP Member for the North Queensland seat of Kennedy, Mr Warren Entsch and head of the Federal Parliamentary committee on the development of Northern Australia was reported as commenting that the "NT was the only place in Northern Australia his committee visited where insurance was consistently available and affordable."

"Everywhere else it was absolute crisis and market failure and when you could actually get it you couldn't afford it" he said.

I would therefore urge the State and Federal Governments to work with the insurance industry immediately to implement a short and long term solution to the insurance crisis in North Queensland.

Yours faithfully,

Philip Stace

Attachments:

- Submission Cover Sheet
- North Queensland – Members of Parliament Insurance Action Plan Response
- Response to Mr Cormann

- Copy of Page 136 from Pivot North report with Allianz's comments
- Copy of page 13 from the Institute of Actuaries of Australia's response to the Productivity Commission.

NORTH QUEENSLAND - MEMBERS OF PARLIAMENT INSURANCE ACTION PLAN

Objective – To make cover for Cyclone damage affordable for domestic properties, be they home owners, occupiers or Landlords located north of the 26th Parallel in North Queensland.

Situation :

- In the last two years, insurance premiums for property insurance in North Queensland have risen markedly. It has been reported that 200% increase in home cover is not uncommon and for Body Corporates premium increases have been in the 1,000 % ranges.

- Insurance companies have advised that the increases are due to increased reinsurance costs as a result of recent Catastrophe history, notably Cyclone Larry 2006 and Cyclone Yasi 2011. (Please find attached an Insurance Council of Australia list of Historical Disaster Statistics. From these statistics, Cyclone Yasi and Larry cost the insurance industry approximately $2,000,000,000.)

- The $2,000,000,000 is the insured loss. Not quantifiable is the uninsured loss and funds paid out to assist persons by both the Queensland State and Federal Governments.

- Insurance companies have pulled out of insuring some sectors of the market such as Body Corporates where now only CGU and Vero operate. In the Farm Insurance market only CGU, QBE, Elders (owned by QBE) and WFI (who are in the process of being sold to IAG/CGU) operate. WFI had taken a position of not writing any new business in NQ.

- The lack of markets, has led to people either under insuring their property, not insuring at all or taking large excesses to reduce their costs.

- The issue re insurance price increases was further compounded in July 2013 by the Queensland Government increasing Stamp Duty on insurance policies to 9%.

- Companies have also included Flood cover in their policies, which has compounded the catastrophe premium increase and stamp duty increase.

- Insurance Companies have imposed a Named Cyclone excesses on their policies.

- With the Liberal National Federal Governments stated strategy of getting people to move North, something has to be done to reduce the cost and make insurance affordable and indeed available for all home owners and occupiers in NQ.

- The other concern is that people having seen the Federal and State Governments giving hand outs in the after math of previous Cyclones, there is a mindset that should a cyclone hit again, this activity will happen again and therefore there is no need for people to take out their own insurance cover.

- Refer Farm premium comparisons attached

- The 10 point plan does not appear to have a direct action plan in place and tends to focus on the body corporate issue and allowing insurers to set the agenda.

Summary :

- Insurance has therefore become unaffordable to a lot of people and pushed up the cost of living for many others.

Solutions:

The issue of Catastrophes is both a State and Federal concern. I believe both should look at the New Zealand Earthquake Commission model, where they identified the issue of a catastrophe exposure , earthquake, many years ago and set up the Earthquake Commission. (I attach copies of web sites on the New Zealand Earthquake Commission.)

State : In relation to NQ, I believe Queensland could set up its own Cyclone commission, which would insure all persons on a scale say as follows :

Named Cyclone Damage	Property Owner	Tenant
Building	$100,000	N/A
Contents	$50,000	$25,000

Premiums would be set and should a person wish to insure their property for more than the nominated figures, then they can go to their Home insurer and buy additional cover.

As with the Earthquake Commission in New Zealand, this would only cover Private Residencies and not Commercial properties. Situations for Body Corporates and Farm properties would I believe also fall under this category.

The objective would be to ensure all people living in the NQ region take out this cover and be covered for damage resulting from a Named Cyclone. For tenanted properties this could be done at the time the lease is signed, or alternately by the Landlord who would pass on the cost to the Tenant. This may be expanded to include all people living in Queensland which would increase the premium pool significantly and aggregate the costs significantly.

This would mean that insurers would have a sizeable excess on their cyclone exposure per risk. This may then entice insurers back into the market in NQ as their exposure would be greatly reduced. The State government would take out reinsurance cover to ensure their exposure is covered. This would be paid for by the pool created by the premiums paid. This can be illustrated by the Terrorism Insurance Pool, which I understand has accumulated a pool of approximately $13 billion. The other option, as outlined under Point 4 of the Insurance Action Plan, would be to expand the Australian

Reinsurance Pool to administer a Named Cyclone Insurance Pool. I should be noted that in the last two years, the Federal Government has taken dividends in excess of $600,000,000 from the Fund.

Federal Issue : From a Federal point of view, Australia is a country where catastrophes repeatedly happen, such as bush fires, floods, storms and hail storms. However only NQ has been hit with large insurance premium increases. A review of the Deloitte Access Economics paper entitled "Building our nation's resilience to natural disasters" makes little comment on the Cyclone exposure in NQ. (I attach a copy of this paper for your information.)

However, as with NQ, many people are either under insured or uninsured due to the high costs of insurance. The Federal Government could again look at a similar process as with the New Zealand Earthquake levy to have a cover for all persons to at least ensure coverage.

Recommendation :

Queensland State Government either:

- Sets up its own Named Cyclone Insurance Pool or :
- Negotiates with the Australian Reinsurance Pool Corporation to seek their agreement to organise and administer a Named Cyclone Insurance Pool for and on their behalf. The benefit of doing this would be that they already have a structure in place and may also be able to leverage off their current reinsurance programmes to obtain favourable terms.
- Under each option, the Queensland State Government may have to consider their position in relation to guaranteeing the fund up to an agreed amount.
- If the Queensland State Government sets up its own Named Cyclone Insurance Pool, it should look at utilising the structure of Workcover Queensland, including its current in place administrative and reinsurance facilities to minimise set up costs.
- If the Queensland State Government sets up its own Named Cyclone Insurance Pool, then it should seek a financial guarantee from the Federal Government until the Fund becomes self-funded.

Re : Addressing the High cost of home and strata title insurance in North Queensland

Attention : Hon Mathias Cormann

Dear Sir,

I am writing to you as a concerned citizen of Cairns and a person who has been involved in the Insurance industry for many years. I would thank you for the opportunity to comment on this issue.

I would firstly refer to the Foreword in your Discussion Paper and am disturbed that this calls for input on three options only. I would provide my feedback on these issues as follows :

Comparison Web site – I do not believe this will have any effect on reducing insurance premiums. Insurance policies are complex products with many variables as is being seen in the direct insurance market where price is the driver of the purchaser, sometimes to their detriment. The only way to minimise that issue, would be to have insurers quote per the Prescribed contracts as outlined in the 1984 Insurance Contracts Act. Would that reduced insurance premiums though ? I don't believe so.

Engineering Assessments of Strata Title properties – One insurance company is currently reviewing all its insured Strata properties in North Queensland. At no cost to the insured. After reviewing 10 properties, a 12 to 15 % premium reduction has been received on those properties. When the premiums went up by over 200 % it seems to have had little effect.

Expand North Queensland Markets to encourage foreign insurers – This quite honestly makes no sense at all. Australia has more than enough insurers, but many of them do not wish to expose their balance sheets to the risks in North Queensland. And why if you were a Foreign Insurer would you want to write business purely in North Queensland?

The three options as commented on above, do not address the key points of this issue, which are:

- The availability of Insurance coverage for people living and operating in North Queensland

- And subsequently the affordability of insurance coverage for people living and operating in North Queensland

The question we should ask is, "Why don't insurance companies want to write risks north of the 26th Parallel ?"

The answer is, " That their reinsurance costs and exposure to their balance sheets of writing business in North Queensland is too high, specifically in relation to Cyclone and Flood exposures." On page 4, Figure 4 of your Discussion paper, you show that approximately 40% of premiums relates to Cyclone cover and approximately 27.50% of premiums relate to Storm cover. It is interesting to note, that under 15% of premiums related to working losses as opposed to over 25% of premiums in Brisbane. This seems to illustrate that insurance business is good in North Queensland when a Cyclone or Storm does not hit.

So how then do we address the two key points noted above of availability and affordability of insurance in North Queensland ?

The State and Federal Governments have to take the Named Cyclone issue away from the insurers and set up a pool to insure that part of the risk, similar to the New Zealand Earthquake Commission.

Under that process, the risk of Earthquake is taken out of the Domestic Earthquake policy and is insured with the Earthquake Commission, up to a sum insured of $100,000 for buildings and $20,000 for contents. This is for a premium of NZ $180 plus GST. If an insured wishes to insure their property for more than the EQC Limit, then they go back to the general insurance market. The benefit to the insurance company is that they have a $100,000 excess before they are exposed to a claim, if at all, hugely limiting their risk.

By mirroring this, it would draw more insurers back into the market in North Queensland, as their catastrophe risk would be greatly reduced if not eliminated and as per Figure 4 in the Discussion paper, the premium allocated to the underlying loses in North Queensland are very low.

This would have the effect of solving the availability and affordability on Home and Strata Insurance in North Queensland and I would also draw to your attention, that in North Queensland, there are only two insurers insuring Farm properties, that is CGU and QBE. WFI have recently been sold to IAG, who own CGU and indeed WFI have not been writing new business in North Queensland for approximately two years.

I would also point out, that when the insurance market effectively removed Terrorism cover from their coverage's, the Australian Federal Government of the time created the Australian Reinsurance Pool to cover that risk. As at the end of 2013, the Fund has Nett Assets of $432, 642,000 and paid Dividends to the Federal Government of $218,990,000.

This body has the capacity to arrange through its current reinsurers a facility for a Named Cyclone Coverage, which could then be administered by the Queensland State Government and guaranteed by the Federal Government.

In normal circumstance, industry should be left to resolve its own issues. However we now have a situation in North Queensland, where we basically have a market failure.

In summary, my solution is for Government, both State and Federal to step in and address the issue, otherwise, if or when another Cyclone hits North Queensland, those people who are either uninsured or underinsured, will be financially ruined and will seek financial support from the Governments, which they may or may not be able to provide.

I trust this assists you in coming up with a solution to this problem and would ask if I could be included in the continued discussion to resolve the matter.

Kindest regards,

Philip Stace

4.99 Suncorp highlighted the benefits of risk mitigation, citing the example of Charleville and Roma, where flood mitigation measures had significantly reduced flood risk, allowing insurers to reduce premiums.[105] Insurance Australia Group also noted the work being undertaken to improve the resilience of strata title properties in North Queensland by CGU, funding building risk assessments for individual properties with recommendations for improvements to reduce the risk rating.[106]

4.100 Allianz Australia highlighted the weather risk component of insurance costs in North Queensland, particularly relating to floods and/or cyclones, stating that 'average premiums between North Queensland and elsewhere involving multiples of 2.5 times reasonably reflect differences in risk'. Allianz Australia noted, however, that 'this conclusion becomes harder to sustain in light of evidence that some homeowners face premiums of ten or fifteen times those of other Australians', and that 'at such extreme levels, premiums cease to act as an appropriate price signal'.[107]

4.101 As a means of spreading the risk from weather events in North Queensland, Allianz suggested a reinsurance pool, explicitly subsidised through a levy, similar to that provided by the Australian Reinsurance Pool Corporation, which manages terrorism related risks. Allianz noted that:

> The provision of subsidised reinsurance for cyclones and floods would remove the high level of uncertainty associated with insurers' exposure to these events and the concentration risks that limit their appetite for business in areas such as Nth Queensland.[108]

4.102 The Australian Government has acknowledged the issue of extreme weather events in the North, both in terms of the toll such events can take on infrastructure and the impact on insurance costs. The Productivity Commission has been tasked to undertake an inquiry into national disaster funding arrangements. The Government has also released a discussion paper addressing the high cost of home and strata title insurance in North Queensland.[109] The discussion paper highlights the role of risk factors in increasing insurance costs, particularly the risk of extreme weather events such as cyclones, and the need for mitigation of

105 Suncorp, *Submission 151*, p. 4; Mr Stephen Jeffery, Executive Manager for Home Insurance, Suncorp, *Committee Hansard*, Brisbane, 30 May 2014, p. 55.

106 Insurance Australia Group, *Submission 235*, p. 24.

107 Allianz Australia, *Submission 293*, pp. 5-6.

108 Allianz Australia, *Submission 293*, pp. 13-14.

109 Australian Government, *Green Paper on Developing Northern Australia*, Canberra, 2014, p. 30.

market and minimising the distorting effects of the government participating in a market currently provided by the private sector.

The Australian insurance market generally meets societies' needs well. Premiums are determined largely as a function of risk, enabling insurance costs to be an effective tool to encourage risk management. Any government intervention in the insurance market must be careful not to inadvertently promote risk-taking behaviour by dampening the relationship between risk taking and loss funding. For example, the National Flood Insurance program in the US resulted in significant losses due to the incentivisation of developments in ecologically vulnerable areas. We do not advocate replacing or impairing the insurance industry where it is currently meeting the requirements of society. We do, however, advocate consideration be given to the need for intervention to assist consumers who cannot afford insurance or avoid insurance with the expectation that the community will provide compensation for losses.

To be effective any reinsurance pool would need to be set up appropriately. Any pooling arrangement should only be set up on a temporary basis and should include clear mitigation targets in order to reduce the risk and premiums over time. It should only apply to existing properties and would not be applicable to new developments, so that the problem is not compounded by allowing the market to increase exposure and vulnerability. The pool should not blunt the insurance price signal to consumers, the government and the community as a whole. Successful examples of temporary pools include: the Australian Reinsurance Pool Corporation set up by the Commonwealth Government to manage a 'terrorism pool' funded by an explicit levy on all non-residential commercial insurance policies. A similar successful temporary co-insurance pool called the Community Care Underwriting agency was established in 2004 when there was a public liability insurance crisis in 2004.

If this pool were to be established, the Institute proposes that:

- the extent of any subsidisation of premiums be contingent on local and state councils, and potentially homeowners and businesses (i.e. the stakeholders) undertaking (or at least contributing to) adequate risk mitigation. It is important that the premiums charged for high-risk properties provide an incentive to individuals and communities to implement risk mitigation efforts, and not encourage undesirable development;
- the pool could act as a mechanism for co-ordinating loss funding and appropriate development decisions;
- the Government set an objective to reduce the size of any post-disaster funding intervention over time as mitigation actions reduce the number of properties at high-risk of disaster; and
- that such a pool could cover flood and actions of the sea, with extension to other perils with consideration given to any mitigation actions available

4.2 Direct mitigation infrastructure spending – Government-funded

An alternative funding option is for direct investment in mitigation infrastructure projects. This could be funded by local councils and state and Commonwealth Governments via a new tax or specific levy collection e.g. fire service levy on council rates. Funding of mitigation projects has been limited to date. This is in part due to current government budget pressures. Non–partisan support is essential to ensure an infrastructure mitigation budget is funded.

Direct infrastructure investment will not address any affordability issues in the short-term. As mitigation efforts will take some time to develop, post disaster funding by government is likely to continue. Another option is for the government to subsidise premiums charged for high-risk

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street, Sydney NSW Australia 2000
t +61 (0) 2 9233 3466 f +61 (0) 2 9233 3446
e actuaries@actuaries.asn.au w www.actuaries.asn.au