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# **RACQ Insurance Submission:**

***Addressing the high cost  
of home and strata title  
insurance in North  
Queensland.***

**Australian Government  
Discussion Paper  
9 May 2014**

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## **1. FORWARD**

RACQ Insurance (RACQI) is pleased to provide this submission in response to the Australian Government discussion paper "*Addressing the high cost of home and strata title insurance in North Queensland*", 9 May 2014.

The RACQI submission will outline proposed solutions to deliver workable short-term and long-term measures to address home building, home contents and strata title insurance affordability and accessibility issues in North Queensland, and across the broader general insurance market.

## **2. INTRODUCTION**

RACQ Insurance (RACQI) was established in 1971 and is wholly owned by The Royal Automobile Club of Queensland (RACQ) which was established in 1905 and is owned by more than 1.2 million Queensland members as a mutual organisation. It has a strong Queensland focus to its business, providing insurance cover to over 1.7 million policyholders throughout Queensland and northern New South Wales.

RACQI has an intimate understanding of the pressures and challenges facing homeowners and the industry as a whole when it comes to affordability and the pricing of risk in Queensland, especially North Queensland. RACQI, unlike some market competitors, has not imposed any generic new business embargos on either home or contents policy sales.

The last five years have been some of the most volatile in the local insurance industry's history and this volatility, both with major weather events and significant international financial instability has created genuine home insurance affordability and accessibility issues for consumers in high risk areas like North Queensland.

RACQI believes it important that the area described in the Discussion Paper as North Queensland, be clearly identified and defined by recognisable geographic boundaries. This is essential to determine precisely where the extent of any proposed resultant initiatives and/or policy amendments are to take effect, or be considered to take effect.

RACQI rejects recent assertions from a number of sources that there is market failure in North Queensland. To suggest so is incorrect as North Queensland householders are able to obtain insurance cover for both home building and contents, and strata title insurance from existing insurance providers. However, RACQI does acknowledge the price of such insurances is an issue for those in North Queensland communities.

While RACQI has a strong desire to be part of the solution when it comes to providing affordable insurance for Queenslanders into the future, we do harbour significant concerns regarding the intervention of Government in an operating market.

## **3. INSURANCE PREMIUM COST DRIVERS**

RACQI believes the full range of factors taken into consideration in calculating home building and home contents insurance premiums need to be fully understood and that market conditions, underlying risk factors, and underwriting considerations ultimately drive premium prices.

### **3.1 INDIVIDUAL RISK PRICING**

The sophistication and granularity of risk assessment and insurance premium rating has increased markedly in recent years as insurers seek to gain a better understanding of the drivers and profiles of risk. There has been persistent dialogue suggesting that insurance companies price household risk at postcode level in North Queensland.

While this may still be the case for some insurers, sophisticated market participants such as RACQI price household insurance at the individual property level. RACQI operates a highly sophisticated pricing engine which allows risk to be priced at an individual level, with all individual factors of risk being considered in the calculation of an individual premium.

This approach not only allows for the accurate assessment of risk, it also ensures that the consumer is paying a premium that is accurate and commensurate with the risk posed by their individual property circumstances. The outcome of this enhanced accuracy is that the pricing spread between different risks has grown.

### **3.2 CYCLONE RISK**

Approximately 15% of properties across Queensland have a significant cyclone risk. In the context of the north Queensland market, the proportion of properties exposed to significant cyclone risk is obviously higher and it is this peril, combined in some cases with elevated flood risk that is the primary driver of premiums in this region. The increasing spread of premiums is resulting in higher premiums for those consumers living in properties that have lower resilience to cyclones and flood.

### **3.3 FLOOD RISK**

Flood is another predominate natural peril in Queensland with around 10% of homes being at risk of riverine flooding. Naturally not every consumer will be exposed to the risk of flooding, and again there has been recent inaccurate commentary suggesting that insurers which cover riverine flood load all policyholders premiums regardless of relative risk.

RACQI has invested heavily in recent years to ensure that the pricing for riverine flood is at individual property level, and is as accurate as available data and technical models allow.

The key issue for consumers who reside in properties that have a risk of flooding is that around 3% out of the 10% flood exposed properties hold 85% of the modelled risk cost associated with this peril. As a result, a large proportion of the premium burden associated with flood is being held only by a few consumers. This creates an insurance affordability barrier.

Unfortunately an accessibility issue has also emerged for consumers in high flood risk areas where some insurers which do not provide coverage for perils such as flood are using their risk assessment models to decline the acceptance of any household insurance risk based on that consumers flood peril risk profile.

### **3.4 TAXES ON INSURANCE PRODUCTS**

Outside of the actions by insurers, taxes on insurance, including stamp duties and GST are adding a significant cost burden to consumers (up to nearly 20%). Despite recommendations arising from previous taxation reviews that insurance duties should be removed from the taxation landscape, they remain firmly in place in the Queensland market. The increase in stamp duty to 9% as at 1 August 2013, added approximately \$40 to the cost of a home and contents policy in north Queensland with the overall taxation burden on premiums in this area at an average of \$450 per policy.

## **4. STRATA TITLE INSURANCE**

RACQI does not write large amounts of strata title insurance however, we do acknowledge that premiums have risen significantly in this particular market in recent years. The Australian Government Actuary (AGA) report into the pricing of strata title insurance in North Queensland showed that reinsurance rates for strata properties had risen by 70% in the period 2007 to 2012. More broadly, property catastrophe reinsurance rates had also risen by a similar magnitude over the same period of time.

The AGA report also concluded that the movement in strata title insurance premium rates in North Queensland had been due to insurers addressing the underpricing of this class of business that had previously occurred over a prolonged period of time.

## **5. RACQI RECOMMENDATIONS TO IMPROVE INSURANCE AFFORDABILITY**

While some of the drivers of home and strata insurance premiums for consumers are linked to longer term issues, there are some immediate steps that RACQI believes could be taken to provide relief to consumers.

These include:

### **5.1 NATIONAL DISASTER INSURANCE REVIEW RECOMMENDATION**

The National Disaster Insurance Review (NDIR) recommended creating a risk pool for consumers in high risk flood zones. While the NDIR did not recommend a similar initiative for high risk cyclone areas, such a pool should now be re-examined.

The operation of the risk pool in particular zones could be progressively unwound as mitigation and community resilience measures come online. Access to the risk-pool could be means tested.

The NDIR proposal should also be re-examined in light of the relevant recommendations within the recent National Commission of Audit report (May 2014). The Commission of Audit report provided that; *Bodies recommended for abolition: The Australian Reinsurance Pool Corporation (ARPC). With continued recovery in terrorism insurance markets, there is scope for the gradual Commonwealth exit over the coming years.*

The ARPC manages the Terrorism Reinsurance Scheme, which currently has in excess of \$13 billion in claims reserves, and is scheduled to release \$700M in dividends from its claims reserves over the next five years to the Australian Government.

In light of the Commission of Audit report recommendation, RACQI believes the government should give consideration to a possible re-configuration of the original intended purpose of the Terrorism Reinsurance Scheme to assist with the current situation of the affordability of insurance and with regard to NDIR high-risk pool proposal.

## **5.2 MORATORIUM ON STAMP DUTY (North Queensland)**

The House of Reps Standing Committee on Social Policy and Legal Affairs (Post Disaster Review Committee)<sup>(1)</sup> recommended that a moratorium be placed on stamp duty charged on strata title insurance policies for the 2012/2013 financial year, which was not adopted. This should again be considered and possibly adopted for household and strata insurance either in certain zones (North Queensland) or across the market.

## **5.3 CATASTROPHE EXCESS**

Consumer education and market consideration of catastrophe excesses on home insurance policies. These excesses are a means to reduce up-front premiums. These are emerging in the strata insurance market but, not in the direct household insurance space. RACQI believes appropriate consideration be provided to the introduction of catastrophe excesses.

## **5.4 TAX DEDUCTIBILITY OF PREMIUMS (North Queensland)**

Making North Queensland region home building and contents insurance premiums tax deductible would immediately assist with affordability, and would undoubtedly reduce no insurance and underinsurance levels. RACQI believes the government should consider a proposal to make North Queensland home and contents insurance premiums tax deductible. Consideration of the category of tax payer who would be eligible for this would need to be undertaken.

## **6. INSURER'S CATASTROPHE RESERVES**

An analysis of the ability for insurers to hold 'catastrophe reserves' based on an approved actuarial formula should be considered. This reserve would be an allowable tax deduction in the year(s) it is raised. This would allow insurers to carry forward appropriate portions of any unused catastrophe or other allowances into following years. The objective here would be to create a reserve that would be funded in periods of benign weather conditions and used during more adverse conditions thereby reducing pressure on pricing increases that usually arise following event losses.

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<sup>1</sup> House of Representatives Standing Committee on Social Policy & Legal Affairs Report 2012

Prudential rules and limits would need to be developed and applied to such an approach. However, given that insurers do not price solely on a burning cost basis, but also on the prospective risk of events occurring, this initiative could contribute to relieving pressure on premiums.

## **7. RACQ PROPOSED LONG-TERM AFFORDABILITY MEASURES**

### **7.1 RISK MITIGATION INITIATIVES**

RACQ believes that investing in long-term community resilience programs such as flood mitigation is a solid investment in the viable future of North Queensland (and other) communities, and is an investment that will provide significant economic and social benefits.

The Queensland Government has been actively moving forward with encouraging and supporting local flood mitigation initiatives with the completion of stage one flood levee works at Roma and St George. These State Government supported initiatives have resulted in reduced premiums in those areas of these communities previously at risk of flood.

### **7.2 INCREASED FUNDING OF MITIGATION PROJECTS**

Greater funding and faster execution of risk mitigation initiatives will reduce the cost of events to Government and the community over time, and ultimately the cost of insurance. The Commonwealth paid \$5.3b in disaster relief funds in 2010/2012 to Queenslanders (2). Over time some of this funding could be directed towards longer term community resilience initiatives and solutions as well as some of the other solutions above.

### **7.3 REVIEW OF CURRENT BUILDING STANDARDS AND APPROVALS**

A major review of building standards and a co-ordinated national building approval scheme is required. A consistent and robust set of enforced building standards will reduce risk levels and therefore insurance premiums over time.

The potential benefits of this approach were evident following Cyclone Larry in 2008 where in the experience of RACQI, homes built prior to 1982 accounted for one third of the number of properties damaged, but contributed to over two thirds of the overall loss in monetary terms.

### **7.4 RETROSPECTIVE FITTING OF CYCLONE STANDARDS**

RACQI believes government financial incentives or subsidies should be provided to North Queensland householders who are prepared to retrospectively fit current cyclone building standards to their property.

Where the cyclone risk to individual property is reduced, building and contents insurance premiums could be then rated to reflect the decreased risk.

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<sup>2</sup> Source – *The Senate Environment and Communications References Committee report on Recent trends in and preparedness for extreme weather events, August 2013, Table 3.2, P67*

## **7.5 JCU STRATA BUILDING ENGINEERING INSPECTIONS**

RACQI supports the key recommendation of the James Cook University (JCU) report into the resilience of strata properties <sup>(3)</sup>, that engineering based inspections be carried out on strata title properties every 7 – 10 years in order to identify issues of deterioration that could decrease building resilience in cyclones.

## **7.6 CUSTOMER ADVICE**

The 2001 Financial Services Reform Act (FSRA) reforms effectively constrained the ability of large scale direct general insurers to advise customers on what policies, benefits and features would best suit them.

RACQI believes insurers should have the ability to tailor individual insurance solutions to individual customer needs.

However, the cost of and the necessary compliance regimes to enable customer service staff to be able to provide specific advice to a consumer on matters such as sum insured levels, product options and excess options etc is prohibitive. As a result, larger insurers have generally used the model that precludes the offering of nearly any form of advice.

With the establishment of the Financial System Inquiry, a key opportunity exists for the Government to examine the current financial licensing regime as it relates to General Insurer's ability to provide its customers advice.

## **8. DEVELOPMENT OF AN INSURANCE AGGREGATOR WEBSITE**

RACQI holds serious concerns regarding the proposal to establish an insurance aggregator website.

While there are car insurance website/aggregators operating both in Australia and overseas, these predominately focus on the motor insurance market due to the simpler nature of these products. Home insurance on the other hand, generally does not lend itself to being a successfully aggregated product due to the varying scopes of cover and benefits that various insurers provide, and the underlying desire of consumers to deal directly with insurers when insuring what for most is their single largest asset.

RACQI believes it is not feasible to accurately compare building and contents insurance products via a simple aggregator website. The ability for consumers to reasonably compare the level of cover on offer between insurers (and not just price) has been previously recognised by the Federal Government with the introduction of the requirement for insurers to provide Key Facts Sheets (KFS) for home insurance policies from November 2014.

The notion of establishing a price comparison website that would focus on price could result in a consumer not being fully informed, and potentially making a flawed decision when purchasing a financial services product.

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<sup>3</sup> *Cyclone Testing Station JCU Pilot Study: Examination of strata title risks from cyclonic weather by utilizing policy claims data June 2013*

RACQI also believes there is an incorrect and misleading underlying assumption that establishing an aggregator site for the North Queensland market will ultimately drive the cost of premiums down.

As previously stated, market conditions, risk assessment and underwriting considerations ultimately drive premium prices. This has been evident in the UK motor insurance market which is often touted as being a highly competitive market for motor insurance. While this is true and the existence of aggregators, particularly in the last 20 years has helped to drive this competition, it is ultimately the underlying performance of insurers' portfolios which drive premiums rates – not the mere existence of aggregators.

This is evidenced by the movement in motor vehicle premium rates in the UK. Data sourced from the AA British Insurance Premium Index <sup>(4)</sup> shows the quarterly movement in personal lines insurance premiums across both motor and home insurance since 1994. Despite the relative lack of an aggregated home insurance market in the UK, home contents premiums have remained flat since 1994, while home building premium rates have only risen since the GFC. It should be noted that the existence of a high risk flood pool scheme has been in existence in the UK for a number years and this will have contributed significantly to the lack of volatility in home insurance premiums.

Conversely, poor claims experience and underwriting results have resulted in material increases in motor insurance rates in the UK in recent years, despite the fact that this class of business remains heavily aggregated. Similarly an improvement in the underlying experience of motor insurance in the UK has now seen premium rates reduce.

Past reviews of aggregator sites in the UK conducted by the Financial Conduct Authority (FCA) and its predecessor have consistently highlighted concerns over the accuracy of both product and price advice carried on these web sites, which ultimately disadvantages the consumer. Locally, RACQI itself has experienced issues with our insurance products and prices not being accurately represented on such websites in the past.

There are also a number of authorised insurers currently not operating in the North Queensland market either actively or at all. Should an insurance website be established, RACQI would like gain clarity as to whether it would be mandatory for all current authorised insurers to participate in the website, and effectively operate in the North Queensland market. The key question is, on what criteria would insurers be chosen for inclusion on the site?

Any insurance website/aggregator would require a level of sophistication to provide accurate, current and comparable pricing on individual risk at a granular level, including excesses.

RACQI argues that this could only be achieved by enabling direct and real time access to insurers' databases and pricing engines. The cost of such an exercise could only be delivered at an inhibitive cost.

RACQI would argue that the alternative approach of the website providing indicative or sample prices is not in the best interest of consumer and goes to the heart of the concerns raised by regulators in other markets around the accuracy and transparency of information provided on aggregator sites.

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<sup>4</sup> Source – AA British Insurance Premium Index – 2014 quarter 1, page 11, graph AA British Insurance Premium Index – market average trends



The only means by which an insurer such RACQI could achieve this outcome would be to invest funds in ‘dumbing down’ our risk assessment and pricing capability and revert back to rating home insurance at a postcode level. This is clearly a regressive step and again the consumer would not benefit. Additionally, such an approach would undermine confidence in the insurance industry and ultimately the effectiveness of the aggregator site and Government policy delivery.

## **9. EXPANDING NORTH QUEENSLAND HOME AND STRATA TITLE INSURANCE MARKETS**

RACQI has concerns regarding allowing Unauthorised Foreign Insurers (UFI), to operate in the North Queensland market.

There would be an expectation that any UFI would have to be subject to Australian laws, regulatory requirements, the General Insurance Code of Practice, capital and prudential requirements, and that such companies would be subject to the Australian court jurisdiction.

Additionally, we do question the ability of some UFI’s to effectively meet their obligations and/policyholders needs in the time of a catastrophe event given their likely lack of local capability and capacity. Furthermore, the lack of a requirement to participate in the Financial Services Claims Scheme ultimately will not benefit the consumer and place the Government in a position where the assumption from consumers is that the Government would underwrite any losses from a failed UFI.

## **10. RACQI PUBLIC EDUCATION CAMPAIGNS**

RACQI believes ongoing public education is a critical component of community weather event preparedness, and in relation to general insurance matters.

RACQI pursues an active public education program to alert policyholders and the community to the dangers posed by natural perils, and to help inform and educate householders about the importance of maintaining adequate levels of household insurance.

The RACQI public education program is delivered through the publication of annual index reports, including:

- RACQI Cyclone Preparedness Index
- RACQI Household Cover Index (Queensland no and underinsurance report)
- RACQI Storm Preparedness Index
- RACQI Bushfire Preparedness Index.

## 11. CONCLUSION

RACQI has strong links with the Queensland community and we are committed to working with Government and the Community to ensure that Queenslanders continue to have access to home insurance cover that is adequate and sustainable from the perspective of policyholders, regulators and insurers.

RACQI asserts that insurers must ensure they remain financially robust and viable entities that are able to meet their obligations in their policyholder's time of need. It is a testament to the strength of the general insurance prudential regulatory framework in Australia that, through the series of natural disasters in recent years, the solvency of any general insurer did not come into question.

Appropriate development of long term infrastructure plays a key role in mitigating against natural hazards and RACQI sees this as a key issue moving into the future, particularly as it relates to past and future residential development in flood prone areas and building resilience in the event of cyclones.

RACQI stresses that workable short-term initiatives need to be put in place to effectively assist those consumers that reside in vulnerable properties.

RACQI believes now is the appropriate time to consider and fully examine potential means of providing immediate relief to those in the community who are most at risk but, are unable to afford insurance.

It has often been said that those who most need insurance are those who are most likely to be without insurance.

With this in mind, RACQI has proposed the government re-examine the National Disaster Review recommendation creating a risk pool for consumers in high risk flood zones and potentially extend the pool to high risk cyclone zones. The implementation of this initiative would provide immediate relief for 'battlers' and deliver safer communities by providing an incentive to progress community mitigation and resilience efforts as soon as possible. To actively encourage householders to take up insurance cover in high risk areas and to ultimately reduce the post major event relief cost burden on government, financial incentives must be considered and provided to consumers who take out insurance cover in these areas. Accordingly, RACQI has proposed the tax deductibility of household premiums to lessen the impact of premium costs on household budgets and to incentivise household insurance cover in high risk areas.

RACQI also believes insurers must have the ability to adequately and fully consider customer needs and requirements by being able to provide appropriate advice to customers, especially customers in high risk areas.

RACQI does not support the introduction of a website/aggregator as we are of the firm belief that should this proposal proceed it will be to the ultimate detriment of the consumer as the aggregator model, both within Australia and overseas, has proven deficiencies in both accuracy and transparency.

RACQI looks forward to working further with government on these issues and welcomes any further opportunities to contribute to this important discussion.

Yours sincerely



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