

Submission in response to the Interim Report of the Northern Australia Insurance Premiums Taskforce

17 September 2015

The National Insurance Brokers Association of Australia (NIBA) appreciates the opportunity to make a brief submission in response to the Interim Report of the Northern Australia Insurance Premiums Taskforce.

The Insurance Market in Far North Queensland

Information provided to NIBA by Members in North Queensland indicate that there have been a number of developments in the insurance market in Far North Queensland in the past 6 months.

There is a greater level of participation by insurers and insurance underwriting agencies, and some areas of the market are becoming very competitive, with strong price competition.

It would appear that favourable pricing is very dependent on the individual insurer and the various distribution channels used by each insurer. This applies in relation to both domestic and strata insurance.

NIBA is concerned that with the strong emphasis on price, there is very little discussion or understanding in the community regarding terms and coverage. Consumers assume that all insurance policies are the same or are very similar. NIBA and our members are very concerned that many policyholders may become disappointed if their policies do not respond in the manner they expect, if they need to make a claim.

NIBA continues to be concerned that many owners corporations are allowing their strata manager to arrange insurance through an insurer that they have a relationship with, without any analysis or understanding of the terms and adequacy of cover, and the possibility of better cover being available in the market place at a potentially better price. We remain concerned that relationships between strata managers and insurance companies (or their distribution agents) and the extent of any commission payments are not being fully disclosed to strata unit owners.

NIBA Members continue to have great difficulty placing cover for older properties, with very few insurers prepared to quote for these policies and with quotes designed to discourage the business.

Overall, there appear to have been significant developments in the market in the past 6 months, and NIBA recommends the Taskforce visit North Queensland once again prior to finalization of the report to Government.

Mutual Insurer

A mutual insurer could take two forms, as mentioned in the Interim Report – a discretionary fund or an APRA regulated entity.

NIBA believes that on the information currently available, the disadvantages of a mutual insurance arrangement would outweigh any possible advantages.

In relation to a discretionary fund:

- This is a mechanism for the pooling and sharing of risk, but it is not insurance. There is no insurance contract, there is no formal process of risk transfer, there is no binding promise to respond to the loss in accordance with the terms and conditions of the “policy” (noting that the sharing arrangement does not constitute an insurance policy in any case).
- Because there is no insurance contract – and in fact no insurance as such – all the consumer protection mechanisms contained in the Insurance Contracts Act, the Corporations Act and via the Financial Ombudsman Service do not apply.
- It is also important to note that a discretionary fund arrangement is not subject to stamp duty which applies to insurance contracts, thereby depriving the State Government of revenue.
- NIBA believes that a discretionary fund process can and often is appropriate for a defined group of people or businesses with strong common interests and an willingness to jointly manage and finance their mutual risks in this manner, outside the normal insurance market. In the case of North Queensland cyclone risks, this is something that is faced by the entire community, so the benefits of operating in a mutual process are likely to be lost.
- In any event, if a mutual is implemented, it would have to collect contributions sufficient to cover the level of losses likely to be sustained following any future cyclone. It is not clear, on the discussion to date, how the community would benefit from a model of this nature.

In relation to a mutual insurance company regulated by APRA:

- A mutual insurance company providing cover for cyclone risk in North Queensland (or Northern Australia) would effectively concentrate risk to such an extent that APRA would require substantial risk capital well in excess of that required to be held by current insurers, who are able to spread the risk of North Queensland weather losses across their entire book of business.
- One way around the need for substantial capital would be for the insurance company to be owned by the State or Federal Government. Recent experience in Australia has seen States and Territories sell their government owned insurance corporations, for a range of valid commercial reasons.
- The Taskforce has referenced the experience of Florida, where State Government owned insurance corporations providing cyclone risk insurance thoroughly distorted the property insurance market.
- NIBA firmly believes that a mutual insurance company – either State owned or with substantial State financial guarantees – would similarly distort the property insurance market in northern Australia. This is contrary to the Taskforce’s desire to, as far as possible, support a competitive private market for insurance.

Cyclone Risk Reinsurance Pool

NIBA believes that of the two main options identified in the Interim Report, a carefully designed cyclone risk reinsurance pool would be likely to be of most benefit to consumers experiencing affordability challenges in northern Australia.

It is critically important to note that the design of the cyclone reinsurance pool will need to be done very carefully, in order to avoid unintended consequences and to avoid unexpected impacts on the underlying property insurance market.

The terrorism pool operated by ARPC provides a guide to how a cyclone reinsurance pool could operate. Features could include –

- The pool would provide cover for a carefully defined cyclone risk. The definitions would have to be developed in close consultation with insurers, reinsurers, ARPC and relevant government agencies.
- In order to provide premium relief, the pool would require use of the Commonwealth's balance sheet for a period of time, in order to allow ARPC to charge less than commercial premiums to those insurance companies who wished to make use of the cyclone pool.
- It can be expected that if the cyclone pool provides defined cover at less than commercial rates, the price savings would be passed on to policyholders as a result of the competitive nature of the insurance market.
- The cyclone pool would be able to purchase some degree of protection for itself (retrocession reinsurance), but there would most likely remain a residual risk to the Commonwealth balance sheet.
- The cyclone pool would operate for a set period of time, to be determined by the Government, after which the pool would gradually increase its premiums to commercial rates. This is the process by which the Commonwealth would "exit" its support for this type of risk.
- The fixed period of time during which the Commonwealth supports the cyclone pool, and a strong commitment to exit the pool, should send a strong message to the community that steps will need to be taken to improve cyclone resilience in northern Australian properties. The return of commercial rates of insurance would provide a direct incentive for this to occur.
- The main concern regarding a cyclone pool of this nature, operating for a fixed period of time, is that many in the community may determine that they either do not have the funds to retrofit cyclone resilience into their properties, or take the decision to self insure the risk of cyclone. People on low incomes may need additional support to undertake cyclone retrofit activities.
- The pricing of the cyclone reinsurance pool should be determined by the ARPC and the Government in a manner that would lead directly to a reduction in premiums for property insurance in northern Australia. The actual pricing process would have to be determined by experts in this type of arrangement.

Mitigation

In Australia, governments determine what is built, where it is built, how it is built, and what buildings are used for.

Cyclones and extreme weather events will be an ongoing feature of Australian communities.

Insurance is the process of pooling and sharing the cost of defined losses. The cost of losses are shared across the pool of policyholders.

If insurance is to remain affordable for most members of the community, it is crucial that the overall level of losses, and ultimately the claims cost per policy, is managed effectively, and is kept as low as possible. This will only occur if there is concerted effort, by all levels of Australian governments, to assess and manage the cost of weather and other natural disaster events.

Because of the need to involve all levels of government, NIBA firmly believes this is an area that should have ongoing oversight by COAG itself.

Conclusion

NIBA remains ready and willing to continue to assist the Taskforce as it completes its deliberations on these important matters.

Please do not hesitate to contact us if you require further information in relation to any of these matters.

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