P C Stace,

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14th September 2015

Response to Northern Australia Insurance Premiums Taskforce – Interim Report 2015

Dear Sir,

I refer to the Interim Report which has been released and would provide my responses and feedback. In order to fully respond, I will provide feedback in line with the Focus Questions as outlined on page 4 of the report as follows :

Option 1 – A mutual insurer offering cyclone cover to individuals

Q1 – What are the advantages and disadvantages of a cyclone mutual insurer, supported by the Government, with the objective of lowering consumer premiums for home, contents and strata title insurance for people experiencing affordability problems due to cyclone risk? What form of Government support would likely be required?

A1 – Advantages

- A properly funded and supported local mutual insurer could provide an affordable alternative to the main stream insurers.
- Provide local jobs and experience.
- Could bring competition into the market
- Potentially reduce the cost of insurance.
- Profit can be rolled back into the mutual to reduce the need for Government support and reduce insurance costs.
- Funds stay in the local area.

A1 – Disadvantages

- Single risk policy in a high hazard exposure area and would not be seen as a good opportunity for reinsurers to expose their capacity
- High set up costs
- Limited market opportunity if only marketing to residents of Northern Exposure
- Should the Mutual fail and there are claims outstanding, members may be asked to meet claims.

Q2 – How can a cyclone policy be sufficiently defined to fit neatly with a consumer's "non - cyclone" policy purchased from a private insurer so there are no gaps in coverage?

A2 – The exposure of cyclone is generally covered under the risk of Storm. In the local market currently, some insurers are placing a Named Cyclone Excess on their policies, such as :

"Where damage or loss is caused by a Named Cyclone the excess applicable will be the greater of your standard deductible or $2,500.

All other terms and conditions in relation to Excess's and their application will remain unaltered."

I would therefore suggest, that when the Bureau of Meteorology names a Tropical low as a Cyclone, that the cover as provided by the Mutual would respond. There would be some grey areas to clarify but I believe in general this would be workable.

Q3 – How should a cyclone mutual insurer price its policies?

A3 – Any insurance products has 4 components to its pricing – Reinsurance, Expenses, Cost of Claims in company retention and Profit. The cost and requirements of its reinsurance treaties would have to be calculated by actuaries and then brokered by reinsurance brokers. In the embryonic stages of the company, the make-up of the treaties would be critical in both protecting the company, but not over spending on treaties which are not fully utilised. A surplus line style treaty may suit the mutual in its embryonic stages.

Q4 – Should insurance from a mutual be open to all or should eligibility be limited, such as to consumers on lower incomes or consumers who take mitigation action?

A4 – I believe in the spirit of a mutual, all persons who reside in the designated geographic area of Northern Australia, should have the write to insure with the mutual company and have access to the facility. Persons who are of higher incomes would in theory own and insure properties of higher value and persons of lower incomes would own and insure properties of lower values. However in line with the question, it could be suggestion, that when joining the mutual, a fee could be charged based on the insureds income or say sum insured as a means of making it more affordable to lower income persons.

Q5 – What would be required for private insurers to be an agent for a cyclone mutual insurer – a discretionary fund or an APRA regulated entity?

A5 – I do not believe private insurers should be allowed to utilise a mutual fund insurer as a reinsurer. I feel that should a mutual insurer be set up, it should utilise its own capacity. For a private insurer to access additional or excess capacity, it would be down the path of the reinsurance pool.

Q6 – What would be a suitable organisational and governance structure for a mutual insurer – a discretionary fund or an APRA regulated entity?

A6 – I feel setting up in the initial stages as a Discretionary Fund would be the way to go, if the insurer was only to offer limited lines such as Home and Strata. Also, I understand the insurer if set up in this way, maybe exempt from State Stamp Duties?

Q7 – What are the advantages and disadvantages of putting a cap on the payout from the cyclone policy offered by a mutual?

A7 – I do not believe a cap on the payout from a cyclone policy offered by a mutual should be allowed. If set up correctly, with adequate reinsurance protections in place, the full payouts should be met. I do not believe a mutual or any other insurer should be allowed to operate in that manner. A clear disadvantage of a mutual would be that should the mutual fail to have sufficient funds to pay all claims, then the members in theory would be called upon to assist with meeting the mutual's obligations.

Q8 – When and how could the Government reduce support for a cyclone mutual insurer?

A8 – In reference to Question 7 above, the Federal Government may be called upon to guarantee the mutual, should it fail to meet its obligations if an event occurred for which it had insufficient protection. This would be similar to its participation in the Terrorism Pool, (Australian Reinsurance Pool). Any Government guarantee, should therefore be withdrawn when the mutual is in a position not to need such guarantee.

Option 2 : A reinsurance pool for Cyclone risk

Q9 – (A) What are the advantages and disadvantages of a cyclone reinsurance pool, supported by the Government, with the objective of lowering consumer premiums for home, contents and strata title insurance for people experiencing affordability problems due to cyclone risk?

(B) What form of Government support would likely be required?

I have split this question as I think the question has two parts.

A9 – (A) Advantages –

- The reason why a lot of insurers are currently not participating in the NQ market is that their Catastrophe and reinsurance Treaties are currently either up to capacity or it is too costly for them to buy more reinsurance capacity to grow their book. If the Government was to expand the Australian Reinsurance Pool, to include such cover, similar to the Terrorism reinsurance Pool, then this would make available to insurers a cost effective avenue to buy additional reinsurance.
- Another option would be to have the cyclone reinsurance pool, provide the insurer with a buy down option on their treaties, so the insurer does not over expose their own balance sheet.
- When the market is able to provide affordable insurance in NQ and the market has adequate insurers in it to provide competition, then the Government Reinsurance Pool, could be wound down.
- The Federal Government would provide a guarantee to the pool similar to what it has done for the Terrorism Pool

A9 – (A) Disadvantages –

- That it may become the long term solution, similar to the Terrorism pool.
- Insurers may not pass on the reinsurance cost savings that they achieve from such a pool to their clients in North Queensland.

Q10 – How should a cyclone reinsurance pool be designed to best fit with insurance companies existing arrangements? For example, how could cyclone and cyclone damage be defined so as to provide certainty about what is covered by the reinsurance pool?

A10 – As with Q9, I believe there are two questions here, the first being the definition of Cyclone damage and the second being the structure of the pool. I would comment on each as follows :

Definition of Cyclone – Under most insurance policies, Cyclone damage is covered under the Peril of Storm. CGU have implemented a Named Cyclone Excess, whereby if a tropical low is named by the Bureau of Meteorology, then an additional excess applies. I would therefore suggest, that the risk of Storm should still stay with the insurers, however, any claims resulting from a Named Cyclone would fall under the Reinsurance Pool as follows:

'Where damage or loss is caused by a Named Cyclone such damage is covered by the Reinsurance Pool'

Structure of the Pool – I believe the Cyclone Reinsurance Pool would be set up in a similar fashion to the Terrorism Pool. That is, the insurer would offset the risk of Cyclone to the pool, thus reducing their exposure and costs relating to cyclone.

Alternatively, A Cyclone Reinsurance Pool could be set up in a similar fashion to the New Zealand Earthquake Commission, in that the Pool insures the first say $100,000 of cyclone risk and if an insured wants to take a higher limit, then they can go back to the insurance market to buy that cover. The benefit to the insurer would be a greatly reduced exposure to claims from cyclone risk and to the insured, a cost saving as the insurer should pass on their savings.

Q11 – How should the price insurers pay for reinsurance from a reinsurance pool be calculated?

A – As with Q3 above, pricing is generally based on Reinsurance, Expenses and Cost of Claims in company retention and Profit. The cost and requirements of its reinsurance treaties would have to be calculated by actuaries and then brokered by reinsurance brokers.

The Pool may wish to adopt a one price fits all approach or refine their pricing to say a Post code driven alternative, based on previous claims experiences if that data is available.

Q12 – What are the advantages and disadvantages of limiting payouts under a reinsurance pool arrangement?

Q12 (A) – Advantages

- I believe a payout should only be limited in a similar approach as per the New Zealand Earthquake Commission.
- By doing this, it would reduce the Pools exposure
- Allow the current insurer market to continue to participate in that market
- Reduce cost to the insured
- Provide affordable cover to the insured
- Provide choice and options to the insureds
- Would allow more insurers to participate in the market.

Q12 (A) – Disadvantages

- Could leave insureds under insured for the risk of Cyclone if they only elected to take the reduced cover.

Q13 – (Q) When and how could the Government reduce support to the market through a cyclone reinsurance pool ?

(A) - As with the Terrorism Pool, I would see the Governments support being in providing a guarantee to the Pool only. Once the fund became self-sufficient, then the Government would reduce or limit its exposure. This would be of benefit to the Government, as the Government is the insurer of last resort, the Government would reduce its exposure to non-insured persons as the ability to purchase more affordable insurance would reduce their exposure.

Q14 – (Q) How could a cyclone reinsurance pool scheme be structured to provide an incentive to policy holders to mitigate the risk of cyclone damage?

(A) Please refer to answers under Q16

Other Options

Q15 – (Q) Are there any other approaches that could lower premiums in areas where affordability is a concern due to cyclone risk?

(A) – I would comment as follows :

- Make Cyclone Risk insurance compulsory for all renters. This could be done via the REIQ standard Tenancy Contract to ensure that if a cyclone hits, all residences would be covered and not reliant on Government bodies, either State or Federal to assist them. This would have a large impact on the number of uninsured residences in North Queensland.

- The adoption of a scheme similar to the New Zealand Earthquake Commission be set up by the Queensland State Government and Guaranteed by the Federal Government. A similar scheme could be set up by the West Australian Government.

- To have all houses upgraded to comply with the latest building codes. All buildings built post 1983 should be compliment. The cost to upgrade those houses which do not comply could be large and consideration may have to be given by Governments to supplement these costs.

- The Government considers the implementation of a Natural Disaster Levy for all, perhaps as an add on to Council rates, to create a pool to been drawn down similar to the nominal defendant principal for compulsory third party.

Mitigation

Q16 – What can be done to encourage greater efforts to mitigate the risk of damage from cyclones ?

Q16 – (A) Insurers could give larger premium discounts for insureds adopting individual property mitigation actions. Such actions could be :

- If the property has not been upgraded to latest Cyclone Building codes, then the installation of Cyclone or Hurricane straps could be an alternative.
- Storm Panels – These are corrugated steel or aluminium shutters bolted over windows and doors to protect form flying debris and water ingress. If fitted to tracks, these can be easily and quickly mobilised
- Roll down Hurricane or Cyclone Shutters – As with Storm Panels, these can be easily deployed before a cyclone arrives. Again, these are very effective against glass breakage and water ingress.
- Hurricane or Cyclone Glass – This glass is usually thick glass, which does not break, again minimising damage to inside of property
- Accordion, Bahama and Colonial Shutters – As with Shutters as outlined above, these limit damage to windows and also water damage through broken glass

Are there impediments to insurance premiums being responsive to mitigation action by property owners?

- No I do not believe there should be any impediments. Insurers should have enough data to know what type of damage has been caused by what type of event.

Q17 – What are the advantages and disadvantages of establishing an in dependent assessment process to determine the vulnerability of a house to cyclone damage and to verify what mitigation work has been undertaken? How could such a process be established?

Q17 – (A) Advantages

- To ensure that the building is built or has been built to the latest building codes required by the local council.
- I am not sure how the mechanics of this would work. That is how an independent assessor can determine the vulnerability of a property to cyclone damage. All an independent assessor can do, is to assess whether a property has been built to the latest codes and whether it has any further damage mitigation devices fitted as outlined above.

Q17 – (A) Disadvantages

- Information would have to be updated if or when further mitigation devices are fitted to the property. This maybe a costly exercise and provide no real benefit if the insurers do not pass on any real reductions.

Q18 – What are the advantages and disadvantages of (a) establishing a rating system for building vulnerability to cyclone damage that could be publicly disclosed at the time of sale, and (b) establishing a centralised database or building information that could be accessed by insurers ?

Q18 – A – I see no need for a rating system to be set up and publicly disclosed at the time of sale of the premises. Most premises at the time of sale have a building inspection completed by the purchaser. This could be created as a standard document and be made to include details of the properties compliance to latest building code and other cyclone mitigation limiting damage devices. The report could also include recommendations for the purchaser to consider to further improve the properties safety.

Q19 – What are the advantages and disadvantages of using increased excesses or policy exclusions to reduce the number of small claims following a cyclone ?

Q19 – (A) Many people at present are increasing excesses to reduce their premiums in an attempt purely to keep their premiums down. This practise is merely transferring more risk onto the insured and in the event of a cyclone or in fact any claim, is placing more of a burden on the insureds finances which they would be looking to recover in a time of disaster.

The only people who would be seeing an advantage from this activity would again be the insurers who would be reducing their payouts and transferring risk back to the insured.

Some insurers in an attempt to reduce their exposure, notably CGU have in fact imposed a cumulative Named Cyclone Excess, which would impose and additional excess on top of the insureds current base excess to reduce their exposure further. This is in my opinion is a disgusting act and they should have severe pressure put on them to cease this action immediately by the insurance industry.

In short I see no advantage to the insured to have their excesses increased, but plenty of benefit to the insurer.

SUMMARY

Over the last three years, insurance premiums in North Queensland have skyrockets by 100's of percentage points. Also, many insurers have either pulled out of writing business in North Queensland or put their premiums up to such a point, that they will not write any busy, which is the same effect as pulling out but by a different tactic.

Some market executives have stated that there is no market failure, there is plenty of competition. It is stated in the Interim Report that there are 12 insurers offering Home insurance in North Queensland. These are listed under point 7 on page 13 of the report. It is interesting to note from that list, that 3 are from the Suncorp family, 4 are bank affiliated insurers, when you contact them they are loathe to quote you unless you are a bank customer, Allianz have priced themselves out of the market, but will quote through their affinity group customers and QBE, RACQ and Youi do participate in the market, but with very differing underwriting guidelines and premiums. It is also interesting to note, that CGU and Vero are not mentioned as underwriting in North Queensland.

In my opinion, I would advise as follows:

- I do not believe that a Mutual Insurer would be the correct way to go. I do not feel that the size of the available market would make this a going concern.

- I do feel that a Cyclone reinsurance pool set up and guaranteed by the Federal Government would be a viable option and also allow the Federal Government in the future a way to reduce and eventually pull out of the insurance industry in due time.

- I do feel that a good viable alternative option to the two above would be for the Federal Government to set up a scheme similar in operation to the New Zealand Earthquake Commission. This would see both the insurance market and the Federal Government working hand in hand to resolve the issue. This type of scheme could also be extended in time to accommodate other risks such as bushfires.

Trusting this assists and looking forward to your final report,

Kindest regards,

Philip Stace