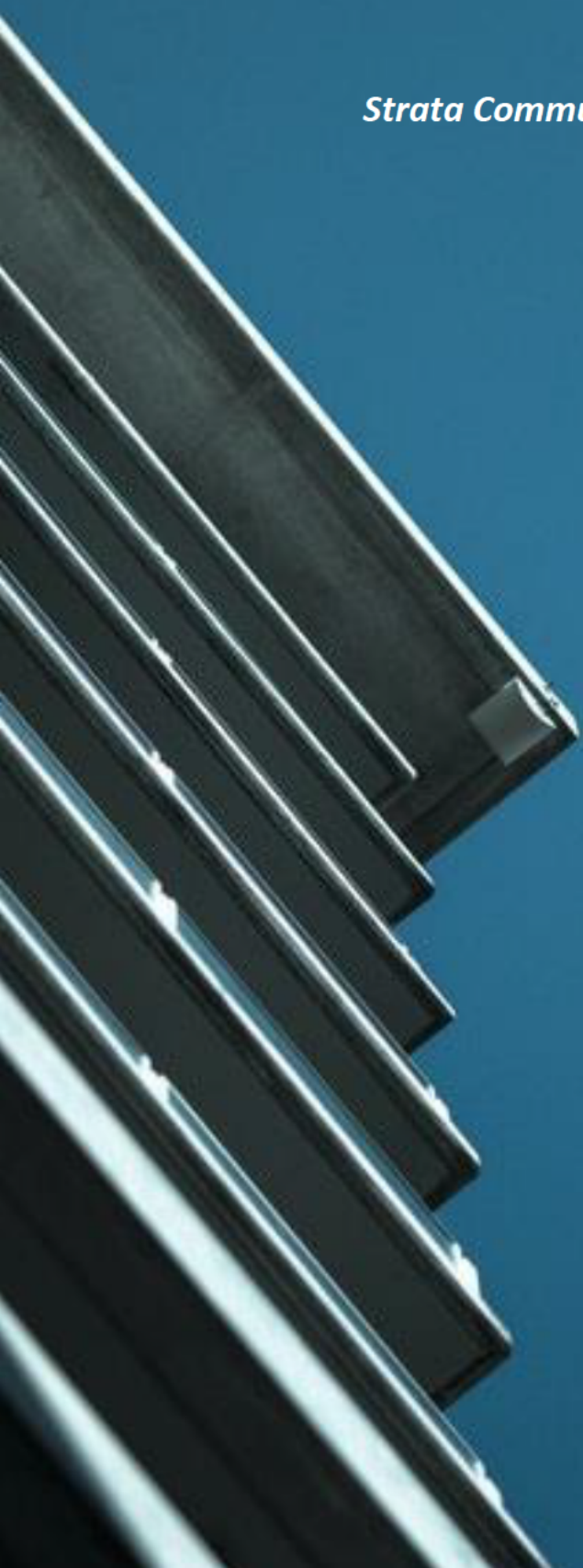


Reinsurance Pool for Cyclones and Related Flood Damage

Strata Community Association (SCA) Submission

18 June 2021



Introduction

Strata Community Association (SCA) is the peak industry body for Body Corporate and Community Title Management (also referred to as Strata Management, Strata Title or Owners Corporations Management) in Australia and New Zealand.

Our 5,000 individual and corporate members include strata/body corporate managers, support staff, owners' representatives and suppliers of products and services to the industry. SCA proudly fulfils the dual roles of a professional institute and consumer advocate.

Direct employment in specialist strata management companies is approaching 10,000 people. More significantly, they are pivotal in an estimated \$6.7 billion in annual economic activity.

Based on the 2020 Australasian Strata Insights Report, more than 2.2 million people live in flats and apartments, the vast majority being strata titled.¹ This figure does not include other forms of strata title such as townhouses and community titled developments. Nor does it include businesses operating in strata titled commercial buildings. The estimated value of property under strata title in 2020 exceeds \$1.3 trillion.²

As the growth of apartment and strata living has intensified over the last decade, the strata management strata services industry has grown in lock step to serve it. Strata managers navigate through a maze of Commonwealth, State and Territory legislation and regulation ranging from actual strata specific legislation, regulation, workplace, health and safety issues and building codes as well as measures applicable to the management of body corporate funds.

A strata manager is expected to be knowledgeable on a range of issues relating to the management of a strata scheme.

If you have any questions or feedback regarding this submission, please contact [REDACTED]
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¹ Hazel Easthope, Sian Thompson and Alistair Sisson, *Australasian Strata Insights 2020*, City Futures Research Centre, UNSW, Accessed at <https://cityfutures.be.unsw.edu.au/research/projects/2020-australasian-strata-insights/>

² Ibid, p6

SCA's Response

Background

SCA has been a strong and consistent advocate for policies, funding and programs, including for a reinsurance pool, that improve affordability and availability for residents living in strata communities, and residents generally, in Northern Australia.

For years we have heard consistently from our members, most particularly in Northern Australia, about the difficulties in obtaining and affording strata insurance and we welcome the action relating to the reinsurance pool.

Although this particular submission is concerned with direct responses to the formation of a reinsurance pool in July 2022, it is important to note that there are many other measures that we are advocating for to improve affordability and availability. These include:

- stamp duty and other governmental fee and levy relief by way of reduction, abolition or specific problematic regional consideration
- understanding the critical role of the strata manager in the strata insurance lifecycle
- the importance of the strata insurance supply chain
- the correct implementation of consumer-focused disclosures and actions that bring absolute client transparency
- other countermeasures to the issues of strata insurance availability and affordability.

Within our own industry we know that strata managers are critical to keeping the consumer informed, sourcing insurance policies, negotiating terms and conditions, processing claims, renewing policies and filing reports and updates based on defects and their rectification, building repairs and maintenance, amongst myriad other administrative functions.

What we would like to see from government, while the spotlight is on affordability and availability, is a system and reform based on evidence that recognises and promotes the value that strata managers bring in providing the consumer with detailed information and performance that guides them towards good consumer outcomes.

To aid the work of government and stakeholders within the strata industry to achieve good outcomes for consumers, SCA has formed a national taskforce with the goal of advising stakeholders in each state and territory. The SCA taskforce has commissioned a comprehensive report into strata insurance in Australia, due to be released in mid-2021 and entitled "A Data-Driven Holistic Understanding of All Aspects of Strata Insurance in Australia & New Zealand." This report is being independently authored by Dr. Nicole Johnston, who is a renowned strata industry expert and is with Deakin University in Melbourne, Victoria.

This will be the most comprehensive report on strata insurance assembled in Australia to date. This will guide the discussions and represent an important industry perspective in order that we can collectively achieve better consumer outcomes whilst underscoring the value of strata managers and the strata sector when securing strata insurance.

We wish to ensure that any reforms undertaken by State and Territory governments and regulators that flow from the report are well-informed, evidence-based and properly take into account the vital role of the strata manager and the specific situation on the ground. Local knowledge is paramount in the strata insurance process and strata managers are best placed to service this market.

Consultation Question Responses

These questions are referenced from the [consultation paper](#) which can be found at the [Treasury Reinsurance Pool for Cyclones and Flood Damage Homepage](#)

Questions 1 – 3

1. How should 'cyclone' and 'cyclone-related flooding' be defined for the purposes of defining the reinsurance pool's coverage?
2. Should storm surge be covered by the pool and included in a definition of 'cyclone-related flooding'?
3. Is it desirable for the use of standard definitions of 'cyclone' and 'cyclone-related flooding' to be required in policies covered by the pool?

SCA's Response to Questions 1-3

As the consultation paper indicates, there is a standard definition of 'flooding' in Australia but not for 'cyclone-related flooding'. The standard definition of flood in Australia is:

The covering of normally dry land by water that has escaped or been released from the normal confines of:

1. any lake, or any river, creek or other natural watercourse, whether or not altered or modified; or
2. any reservoir, canal, or dam.

SCA's response to Questions 1-3 can be best summarised by the following:

- SCA endorses using the Bureau of Meteorology's declaration (sometimes referred to as naming) of a cyclone as a 'trigger' for cyclone claims eligibility.
- Storm surge should be included in coverage of cyclone events, as it is directly related to the effects of the cyclone.
- Common definitions by the reinsurance pool in relation to storm surge and cyclone-related flooding should be sought to make claims applicability and processing more effective.
- The Insurance Council of Australia (ICA) have established definitions relating to flood, cyclone-related flooding, storm surge and other events and as the body representing insurers should be tasked with developing appropriate definitions to be used by the reinsurance pool and where feasible by the insurance industry filing policies in potentially affected areas. Definitions established should seek to ensure that consumers are protected when it is reasonable to conclude that the effects of the cyclone have been a major contributor to the damage incurred.

Questions 4 – 9

4. Are there any difficulties which may arise from including home building, home contents, or residential strata policies in the reinsurance pool and how should the scope of this coverage be clarified?
5. Are insurers able to separately price or estimate the value of the property component of business insurance packages?
6. Are insurers able to separately price or estimate the value of the residential and small business components of mixed-use strata title policies?
7. Are there any difficulties which may arise from including mixed-use strata title policies in the reinsurance pool and how should the scope of this coverage be clarified?
8. How should 'small business' be defined for the purposes of eligibility?
9. Are there any difficulties which may arise from including small business property insurance policies in the reinsurance pool and how should the scope of this coverage be clarified?

SCA's Response to Questions 4 - 9

SCA's response to Questions 4 – 9 can be best summarised by the following:

- The building and common contents are the most important element in any strata insurance coverage, and particularly so when trying to address this particular concern with overlap.
- Being on the ground floor will have an impact on premium, and as many businesses – retail, commercial and the like – may potentially be situated on the ground floor, this should be taken into consideration when seeking cover and securing adequate insurance cover on these types of buildings.
- Personal contents of owners and tenant as opposed to a strata building and common contents insurance are mutually exclusive risks as there are different responsibilities involved. Personal contents insurance is a discretionary purchase with full responsibility of the policyholder (i.e., and owner or tenant) to obtain their own coverage if they choose to insure. Building and common contents are compulsory insurances for the bodies corporate with shared responsibility and joint and several liabilities to one another for any shortfall in cover.
- Contents and property insurance should be treated separately to try to address these issues as conflating the two will make it much harder to identify risk and identify and manage claims processes when an event occurs.
- Insurers will always try to resolve the issues with the building firstly, and contents secondly, in order to try to address the main event issue ASAP to prevent further damage (flood etc.) and make the property safe prior to any other claims management.
- Home contents insurance is very specific to the contents of property itself. This means it is unlikely to be able to be incorporated. Small objects such as jewellery could have higher value and stock in mixed use schemes is an issue. Therefore, the view is that contents should be excluded. Personal contents for strata will need to be treated separately per owner and tenants but there may be demand for protection from the reinsurance pool from owners of apartments, townhouses and other strata schemes.

- Mixed-use strata is no different from residential strata; the strata policy provides cover for the building and common contents where no costs of the business are to be included in the cover.
- Insurance pricing is often calculated around different uses and floor areas. Pricing is calculated and established based on a combination of floor area and usage. These factors are important when assessing coverage within mixed-use complexes.
- Good strata insurance policies will adequately separate common areas from private areas, however any major weather event will see overlap between some impacts into other areas (building roof cracks and water damage subsequently suffered inside an apartment).
- SCA recommends that the reinsurance pool taskforce consults relevant Chambers of Commerce and relevant stakeholders bodies representing business, particularly in Northern Australia to arrive at a fair and equitable definition of 'small business' for reinsurance purposes.

Questions 10 - 17

Reinsurance product design and insurer participation

10. What is the current approach used by insurers to assess and measure cyclone, storm surge, and related flood damage risks, to what extent are individual policy level data available, and how are cyclone related risk premiums calculated in insurer pricing models?
11. How should the reinsurance pool design a risk rating system for cyclone and related flood damage risks, and what are the trade-offs associated with using risk tiering and with the level of granularity used?
12. How much risk exposure should primary insurers retain?
13. Would implementing a reinsurance pool have any effect on the claims management process, and how could this be addressed in the reinsurance pool's design?
14. What is the appropriate level of participation in the pool, and how should considerations of coverage and the amount of risk to be ceded be addressed?
15. How should industry transition be managed and what is the best format and timeframe for it to take place? Reinsurance pool governance and monitoring
16. What should be the key goals for a regular review of the reinsurance pool and what would be the optimal timeframe?
17. Should the reinsurance pool have a planned exit date?

SCA's Response to Questions 10 - 17

Insurers examine building construction, floor area and usage when assessing risk for the risks as outlined. Broadly speaking, insurers will not insure a strata building which hasn't had an examination of the roof cavity, most particularly. Cyclone risk is linked to standards of the subject building, and buildings built to a category 5 (cyclone) standard are much more readily insured than buildings where no report exists.

The risk rating system should be directly linked to building standards and ongoing maintenance of a scheme. Risk rating should be related to resilience. Some insurers will not provide cover for buildings that are not of 'massive' construction such as brick or concrete, particularly in North Western Australia (North WA), even if they are cyclone rated and, consequently, the reinsurance pool will need to address whether or not these examples are to be included or excluded. It's likely to be an "all in or all out" policy.

Primary insurers will be best served by having a capped dollar value or percentage value on any cyclone excess being paid by the reinsurance pool. This will mean that they are able to insure more safely in the knowledge that, should an event occur, a scheme will have the ability to pay. Due to the high risk of cyclone, and with excesses that can be exceedingly high, insurers may judge that there is a lower prospect of recovering the excess, making insurers more reluctant to offer a product. Therefore, the guarantee of a large portion of excess being paid may be the best way to ensure that strata insurers re-enter the market. Higher excesses are quite a recent feature in the market, having only been available for approximately six or seven recent years. Their impact is largely unknown at this stage, largely due to their recent introduction and a lack of useful data to gauge their impact. A

limited market has emerged selling 'Excess or Deductible Buy Down Policies', so that some owners are paying for two levels of cover. These policies may be more prevalent in North WA and are for cyclone-only cover.

With regard to decision making processes, the reinsurance pool program should allow for as much flexibility as possible for strata managers to be able to act quickly in order to process a claim. Rather than a strict adherence to the specifically allocated individual strata manager who regularly manages a specific strata scheme being absolutely required to act to process claims, there should be an allowance made for other properly qualified assistant managers or actual in-house insurance managers, as an example, to be able to quickly act to process claims. This is important in the case of a cyclone or flood, where resources need to be deployed quickly and efficiently to manage multiple claims across multiple schemes, and without this flexibility, claims processing will potentially be much slower.

The reinsurance corporation must be appropriately staffed to ensure efficient discussion and claims management between companies and the corporation. A simple and effective mechanism which addresses all of these concerns must include monitoring and agreement around cyclone excess. Claims management processes must be reflective of the fact that in Queensland, for example, strata management agreements are with companies, not individuals. Previous programmes have encountered issues around agency, and these issues should be considered. Participation in the reinsurance pool need not be mandatory, but would encourage re-entry into the marketplace by insurers, which will in turn increase availability and affordability.

- Mixed-use precincts should not be excluded from any future regime, as they are strata complexes in their own right, contain private households and residences and have taken out appropriate insurances as such.
- As the peak national strata body and with insurance one of the core areas of business we facilitate and interact with for clients, we are advocating for a reinsurance pool that is extremely simple in its design. A simple design will attract and retain insurers to the scheme, leading to the best consumer outcomes through competition.
- Claims management processes should be handled by the insurers, who have the greatest experience undertaking these processes. Claims are managed hand-in-hand with strata managers where they are engaged and result in the fastest and most accurate claims processing.
- The best level of participation in the pool would be 100 per cent of insurers in the market and in consultation with the insurance industry requirements that aim to achieve this goal should be explored and potentially put in place by making participation mandatory.
- In terms of industry transition, insurers should all start on the same date, and be given as much time and resources as possible to properly establish internal mechanisms and processes prior to a start date.
- Three years should be the absolute longest timeframe between reviews. This timeframe should not be any longer due to the possibility of a very large event occurring and subsequent lessons learned and changes to the market needing intervention or action. In addition to a mandatory review, there should be a review following an event to gauge what worked and did not work with a view to improvement before another event.

- No. The exit date (if there has to be one) should be tied to ensuring that there has been substantial improvement in cyclone mitigation in the North. Rather than a time frame, an improvement in community resilience (which can be reasonably achieved) should be the goal for any timed exit. There is consensus that there should be explicit government monitoring of availability and affordability which should be contingent on ongoing access to the pool. Disclosure is key and welcome in all areas. There must also be legislated monitoring and compliance with maintenance of schemes to ensure those that become cyclone resilient are maintained as such.

Question 18

18. Which mechanisms will ensure the pass-through of reinsurance premium savings to insurance policyholders? For example: 18.1 Explicit price monitoring of insurance premiums?

SCA's response to Questions 18 can be best summarised by the following:

- This is incredibly important to those living in strata communities. This must work effectively and have sufficient oversight.
- Important to be able to evaluate the effectiveness of the reinsurance pool in subsequent years of the program and reviews.
- Disclosure, transparency and price monitoring conducted with an adequate measure of government oversight (privately commissioned or government run) if done correctly have the potential to ensure pass-through (if the scheme is effective).
- Specific details of the mechanism should be developed by the ICA and insurance stakeholders in consultation with the reinsurance pool taskforce.
- The key goals of review of the reinsurance pool should be ensuring that availability and affordability continue to improve going forward.

Question 19 - 23

Links to risk reduction

19. To what extent do insurers price in discounts into insurance premiums for mitigation action undertaken by or affecting policyholders?

20. How might mitigation be encouraged by the reinsurance pool's design? For example: 20.1 Should the pool provide discounts for properties that undertake mitigation?

20.2 Should the pool have an explicit mandate to encourage mitigation?

21. How should the pool's design seek to discourage any increase in risky behaviour? For example:

21.1 Should there be a time-based cut-off to exempt new builds from the pool?

21.2 Should the pool only allow new builds that have been built to adequate standards and in suitable locations?

22. To encourage further action by states and territories on insurance affordability: 22.1 What settings could be included in the design of the pool?

22.2 Which policy options could be introduced alongside the pool?

SCA's Response to Questions 19 - 23

Mitigation is a serious matter and must be both encouraged by way of incentives and discouraged by way of penalties for non-disclosure or inaction on behalf of owners committees. These will need to be actively engaged and accountable should they wish to participate in the benefits of the reinsurance pool and the improved availability and affordability of strata insurance in problematic climactic regions in particular. Formulas in this regard will need to be established and SCA, along with strata insurance partners and insurance industry experts, can assist in this regard.

The Pilot Resilience Programme must include roof engineers examining roofs and promoting substantial investment in cyclone-proofing roofs when discovered to be sub-optimal. All new builds North of the Tropic of Capricorn, as a good example, must be mandated by law to be built to a category 5 standard and substantial renovations should also be obligated to upgrade the strength of their roofs.

Legislation should only allow construction to a category 5 standard in the future. There should be ongoing liaison between the Resilience Pilot Program and body corporate committees to ensure that maintenance of high standards is continued.

There should be substantial investment in roof resilience, enhancing construction standards and ensuring that committees do not ignore their maintenance obligations.

In addition:

- Mitigation efforts are directly tied to premiums and insurance coverage and the reinsurance pool's design must take into account the new \$40 million Strata Titles Resilience Pilot, as well as previous initiatives and work done by insurers and councils on mitigation.
- Older properties should not be refused access to the reinsurance pool.
- Within the mitigation program and its interaction with the reinsurance pool, mitigation efforts in relation to buildings should first and foremost focus on roofing, where a large

proportion of cyclone effects are experienced and the most severe impacts from damage are caused.

- The resilience program should be extended as widely as possible and be properly incentivised or penalised to ensure it is optimally effective



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