ACN 151 156 357

15 July 2011

Natural Disaster Insurance Review
c/- The Treasury
Langton Cres
PARKES ACT 2600

By email: NDIR@treasury.gov.au

Our submission is attached. We wish to make two key points:

1. Any program to support access and availability to disaster insurance should include the strata and community title sector on equitable terms relative to any assistance to households in detached properties, while recognising the different characteristics of this market, and

2. Such a program should not be risk-specific but should extend assistance to a range of scenarios where market failure creates access and affordability barriers to insurance against extreme weather events.

Please feel free to contact me directly for any further information, clarification or any other assistance you may require.

Yours sincerely

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Submission

Natural Disaster Insurance Review

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Strata Community Australia is the new peak body for the strata and community title services sector. Six state-based bodies – the Institute of Strata Title Management (NSW), Owners Corporations Victoria, Community Titles Institute of Queensland, Strata Titles Institute of Western Australia, Community Titles Institute of South Australia and Strata Titles Management Institute of ACT – have voted overwhelmingly to adopt shared branding from July 2011. They will become members of a new national body replaces the former National Community Titles Institute with a new governance structure and representational model and a new mandate to promote professional standards and advocate on behalf of its members and their customers – the people who live, invest and work in the various forms of strata and community titled property around Australia.

Central to SCA's purpose is promoting greater awareness of the specific needs of the sector. The Natural Disaster Insurance Review issues paper therefore is particularly welcome for its explicit recognition that the strata and community titled property insurance market is different from ordinary households and businesses. All too often our sector has been a blind spot in policy development in Australia and programs as a result have been poorly designed at best for servicing the needs of the quarter of all Australian households who do not live in standard detached housing.

This submission will concentrate on those aspects of the paper specifically relevant to our sector. However we believe it is important to provide some context to assist with understanding the unique characteristics of the strata and community title insurance market.

Perhaps more critically, this submission also highlights the importance of extending the flood solution to other areas of insurance where geographic concentrations of extreme property risk are producing similar market failures – specifically, the availability of coverage for buildings in cyclone-prone areas of Queensland and Western Australia.

Background

While the risks of strata and community titled property are similar to those of ordinary households and business premises, there are a number of fundamental points of difference.

Firstly, the insured entity is a body corporate (or owners corporation, strata company, community association etc) which holds the property on behalf of individual owners. The exact legal form varies with state and territory legislation but the principles are essentially the same. In particular, these are unlimited liability entities - which means individual owners have a joint and several, unlimited liability to the body corporate.

Consequently, all state and territory legislation requires bodies corporate to take out some form of insurance. The specific insurance requirements vary between states in the degree of prescription about the nature and scope of insurance required. But the underlying policy objective is the same across Australia: to protect individual owners who ultimately bear the unlimited risk but who do not have direct control individually over insurance decisions. Generally speaking, though, this objective fails when appropriate insurance cover is unavailable or uneconomic, as we have seen in the Brisbane floods and even more so in cyclone-prone areas of Queensland and Western Australia.

Each strata and community titled property is unique and unsuited to a commoditised or standard insurance product. Building age, design and structure are all important variables in terms of potential claims costs and thus premiums. In the case of Brisbane floods, for example, design and location of key communal services such as lifts, pumps etc were major contributors to claims costs which ran into millions of dollars, in some cases, in buildings where no actual residences were directly affected. In practice this means all business is written on an individual basis either by specialised insurers or through specialised intermediaries.

Finally, as a specialised market, strata and community title property insurance is more exposed than the broader property insurance market to insurance portfolio management through anti-selection marketing strategies. Put simply, all insurers seek to control exposure to concentrated risks such as flood and cyclone. These are different to other hazards such as fire and hail because they occur only within well-defined locations. The relatively small number of insurers in the strata and community title market means the withdrawal of one insurer from writing business in high risk zones due to poor claims experience, changes in business strategy or underwriting capacity can have domino effect. Other insurers will compete to avoid taking on additional exposure through pricing, then declining to quote for new business through to withdrawal from the market altogether. Soon no insurer wants to be the last one standing in that segment of the market. This dynamic goes a long way to explaining the lack of flood cover for strata and community title property and the same scenario is now playing out in cyclone-prone areas of Queensland and Western Australia.

Chapter 2: Home Insurance cover for flood

Neither proposed model is completely suitable for strata and community titled insurance. The opt out model is effectively what is in place now, at least to the extent that each policy is negotiated and priced individually and those responsible for arranging insurance are well aware of their coverage or lack of it.

The specialised nature of our market means that automatic flood cover would most likely lead to withdrawal of coverage in flood prone areas. This is evidenced by the limited availability of flood cover now and the fact that virtually all the estimated 400 buildings affected in the recent floods were uninsured. Currently these properties are at least able to access insurance for other risks.

Chapter 3: Identifying homes with high flood risk

As indicated in the introduction to our submission, neither approach sits well with the strata and community titled sector because of the diverse nature of the underlying risks. An engineering approach to flood would be a poor proxy for relative risk because of the variety of buildings and the propensity for high-cost at-risk assets to be sited below flood levels. Similarly, price alone is unlikely to be an accurate or meaningful measure particularly if it is not expressed as a proportion of sum insured which is the usual measure in the strata and community title market. A more equitable approach would see funding through a claims recovery model that was event-triggered and needs-based on a similar basis to current disaster arrangements

Chapter 6: Flood cover for strata title and other residential property

This submission recognises the difficulties in extending any flood insurance scheme to the strata and community titled sector. However failure to do so would perpetuate the existing inequity being experienced by the thousands of disaster-hit households who do not live in standard detached housing. Current natural disaster arrangements do not recognise body corporates etc as eligible entities for assistance purposes and as a result they have been left largely to fend for themselves. Almost without exception, buildings affected by the Brisbane floods were uninsured. Damages in some cases running into the millions of dollars wiped out maintenance funds and required substantial calls on individual owners which are likely in many cases to run into tens of thousands of dollars over a period of time. We are not aware of any instance where these buildings or the individual owners have been able to access government programs or public appeal funds to assist with rebuilding, while individual uninsured households have received substantial payments.

Similarly, there is no policy reason to differentiate between strata, company title and mixed use complexes. Retirement homes, aged care facilities, caravans and mobile homes are quite different legal structures and outside the scope of this submission.

At a principled level, government assistance is warranted simply in recognition of the role governments at all levels have played in encouraging development in risk-prone locations. National policy has encouraged development in the north since World War Two as both an economic and strategic imperative. Development on flood-prone land has simply reflected market forces and the attractiveness of many of these locations.

Original and subsequent purchasers of these properties would have reasonably assumed that obvious risks had been properly considered in the planning and development approvals. The role of building codes in reducing cyclone risks is well documented and proven. Similarly, flood plain policies since the 1980s in particular have substantially reduced flood risk, particularly in NSW. The fact that government continues to support uninsured flood victims through its disaster recovery programs, and the wider community through appeal funds, is suggestive of a broad consensus that managing these risks is a social as well as an individual responsibility.

At a practical level, extending any assistance arrangements to high-risk properties would have a number of positive benefits to all key stakeholders in the strata and community titled sector. For body corporates etc it would provide greater certainty and eliminate some potential legal exposure in terms of compliance with current compulsory insurance provisions. For individual owners, it would reduce a significant financial exposure and improve investment value by eliminating a major disincentive to potential owners. For insurers, it will reduce volatility and make these market segments more attractive.

Chapter 8: Natural disasters other than flood.

The starting assumption in this chapter that cyclone insurance is generally available does not apply to the strata and community title sector. The withdrawal of insurers from the market in recent months has resulted in a crisis of cost and availability that has become a significant community issue along the Queensland cost. It is also emerging a significant barrier to proposed major residential developments to support the resources boom in north-west Western Australia.

While commercial confidentiality has made it difficult to obtain hard empirical data, the following table provides examples of recent premium increases experienced by one SCA member company in:

Cairns	**Sum Insured ($m)**		**Premium**		**Cost/unit**	
Units	2010	2011	2010	2011	2010	2011
10	2.3	2.4	$ 4,267	$ 12,202	$ 427	$ 1,220
18	5.8	6.0	$ 12,256	$ 29,425	$ 681	$ 1,635
24	10.2	8.3	$ 16,694	$ 30,224	$ 696	$ 1,259
Airlie Beach						
11	9.6	10.0	$ 21,822	$ 45,102	$ 1,984	$ 4,100
28	8.6	9.0	$ 17,504	$ 49,813	$ 625	$ 1,779
94	31.2	31.2	$ 24,052	$ 80,683	$ 256	$ 858
44	20.0	26.4	$ 30,237	$ 99,984	$ 687	$ 2,272
16	7.7	7.7	$ 7,382	$ 34,055	$ 461	$ 2,128
Townsville						
71	31.1	37.3	$ 64,619	$ 91,831	$ 910	$ 1,293
17	5.6	5.6	$ 8,699	$ 27,552	$ 512	$ 1,621
73	50.0	63.8	$ 87,277	$ 242,121	$ 1,196	$ 3,317
123	52.0	54.6	$ 82,926	$ 161,039	$ 674	$ 1,309

The causes are complex but reflect the dynamics of a specialised market with limited capacity where recent weather claim costs have suggested significant under-pricing of those risks in the past. It is unlikely that these adverse market conditions will change in the foreseeable future.

SCA strongly supports the concept of Automatic Natural Disaster Insurance supported by appropriate pooling and subsidisation where risks exceed the market's capacity and there are public policy reasons to support the viability of existing and new developments. Eligibility for support should be based on a combination of geographic risk profile and event type and severity. Importantly, it should not be limited to one specific risk.

The potential role of government is evidenced by the fact that these issues do not arise in the Northern Territory where the government-owned Territory Insurance Office continues to provide cover for buildings at commercial but significantly more affordable rates than at comparable cyclone risk areas in the north-east and north-west.

Chapter 11 — Non-insurance of homes: should home insurance be compulsory?

Compulsory insurance is already a fact of life in the strata and community title sector. This has not prevented buildings and owners incurring substantial uninsured losses in the recent floods and it6 fails to deal with the loss of affordable cover in cyclone zones. Non-compliance is also, anecdotally, a significant issue across Australia for smaller self-managed buildings. Enforcement is at best spasmodic and reactive.

Compulsion can only be effective with an appropriate compliance mechanism and extensive regulatory oversight to maintain affordability and availability across all market segments. This would appear to be beyond the scope of the current review.

Further information:

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