2 June 2014

Manager
Insurance and Superannuation Unit
Financial System and Services Division
The Treasury
Langton Crescent
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Dear Sir/Madam

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

This submission sets out the Actuaries Institute's response to Treasury's discussion paper on *Addressing the high cost of home and strata title insurance in North Queensland* ('discussion paper') released for consultation on 9 May 2014.

As the sole professional body for actuaries in Australia, the Actuaries Institute represents the interests of its members to government, the business community and the general public. We are committed to providing independent and expert advice on public policy issues where there is uncertainty of future financial outcomes.

As a professional body, the Institute holds the 'public interest' or 'common good' as a key principle in developing policy. Our contributions to public policy are guided by the following principles:

- Individuals should be given fair treatment;
- The need to take a long term policy view, with appropriate transitional arrangements;
- Ensuring that consequences of risk taking behaviour are borne by the risk taker;
- Public sector involvement where the market does not meet societal needs; and
- Clear and reliable information available for decision making.

The Actuaries Institute would like to comment on two sections of the discussion paper: 'The high cost of insurance in North Queensland' and 'Addressing the high costs of Insurance in North Queensland'.

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The high cost of insurance in North Queensland

In recent years residential strata title insurance in North Queensland has seen premium increases of several hundred percent. It has been widely accepted that this is due to a combination of historical underpricing, increasing cost of reinsurance and recent losses caused by natural disasters with the associated accumulation of risk in North Queensland. With recent improvements in the validity and granularity of information and ever improving IT capabilities, many insurers have recently moved to assessing risk at the individual household level. Whilst this enables a more accurate assessment of the risk it inevitably leads to an increase in premiums for higher risk properties. Whilst this is arguably fairer, and certainly fairer for those low risk properties, it may create issues of affordability for high risk properties that were historically cross-subsidised. Typically this removal of cross-subsidisation results in relatively small reductions in a large number of policies and significant increases in a small number of policies.

An actuarial fair premium is based on the 'best estimate' of the expected annual claim cost plus expenses of the insurer plus a fair profit margin to compensate for the capital put at risk. Given the nature of insurance, it is not possible to determine the actual future claims cost, however it would appear that the premiums currently charged now more closely reflect the underlying risk. Given more detailed natural disaster information now exists and that these prices have persisted for more than three years it is reasonable to conclude that the higher prices in North Queensland reflect higher risk than other parts of the country and that they are likely to remain.

Addressing the high cost of insurance in North Queensland

The small size of the North Queensland strata title insurance market combined with the perceived risk/reward trade off may result in the competitive forces being weaker than in larger market segments. This results in the lack of a deep and competitive market. The development of an insurance website/aggregator will enable people to more readily compare premiums and policy features, which is a positive result. However, it will not address the fact that higher prices in North Queensland reflect higher risk than other parts of the country.

We believe careful consideration and caution would need to be applied before foreign/ unregulated insurers are allowed into the market. If these insurers are allowed into the markets, it could potentially set a precedent that would undermine the whole purpose of the Insurance Act 1973 (aimed at consumer protection and appropriate prudential management of Insurers protecting Australian policyholders). Significant capital and risk management requirements are required for domestic insurers to ensure that insurers have sufficient capital to meet their liabilities (i.e. that they are still around to keep their promise), even after a big event such as a cyclone. If insurers with lower capital and/or risk management standards are permitted to enter the market, this could not only result in an unfair playing field with domestic insurers but could also result in an insurer unable to keep their promise of paying claims after a significant event.

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We recommend that consideration be given to whether there are more efficient ways of passing the natural disaster risk to those willing to take them such as reinsurance/capital markets. For example, it may be possible to separate the natural disaster risk from the other components of house and strata title insurance, establish a group buying facility and determine whether a more competitive price can be obtained by accessing specialist international markets who may be better placed to diversify the north Queensland disaster risk. There may be a number of ways to facilitate the establishment of such a facility.

Focus question 24: What, if any, is the role for government/s in promoting resilience in North Queensland?

Insurance provides appropriate risk signalling and advice in relation to what risk management may be available and an assessment of its impact. Insurance transfers risk but does not reduce it. It is only through mitigation that risks will be reduced and thereby premiums effectively reduced.

A key area where government can play a more active role is in the enhancement of building standards to focus more on mitigating the risk of property damage from cyclones. Current building standards, in particular codes around cyclone proofing, are primarily focused on achieving structural integrity of buildings for the purpose of maintaining the personal safety of residents. There is no focus on minimising the cost of damage to properties beyond the main building structure e.g. contents or ancillary structures/materials such as BBQ areas (shade sails, umbrellas, outdoor seating areas etc.), satellite dishes and antennas, solar panels and the like. It is damage emanating from these elements that usually drives high insurance losses rather than damage to the main building structure.

A significant proportion of insured losses from cyclones emanate from water ingress into buildings as a result of external items causing impact damage to windows, doors and roof tiles/sheets. If building standards more strongly addressed the structural integrity of these external fixtures, then there would be significant scope for reductions in the level of insured losses from cyclones, which would ultimately result in reduced premiums.

More consideration could also be give to the types of building materials that are approved in building standards for cyclone prone areas. For example, more insured losses are being seen from the increased use of hebel blocks (a polystyrene type material) in the construction of the outer walls of buildings. Whilst hebel has some very attractive insulation and fire retarding properties, the soft material is very prone to damage from windstorm, particularly as a result of impact from external materials. Hebel is easily dented, resulting in significant insurance losses for replacement and rectification.

One of the important lessons learnt from the Canterbury Earthquakes in New Zealand is that rebuilding is a complex exercise and that speed counts. Unless infrastructure is fixed quickly in any city, nothing else gets fixed. Therefore although building standards and retrofitting activities can take some time to implement, it is beneficial to ensure that appropriate standards are developed before the unfortunate event of a cyclone so that a quick response can be determined.

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We recommend that cost benefit analyses of different retrofitting options be conducted so that opportunities for reduced premium options can be investigated. Building codes, retrofitting and planning laws can go a long way to improving disaster resilience in the long term. Even so, it must be recognised that far north Queensland is a high cyclonic area and there are therefore limits to the risk reduction that can be achieved.

The Institute would be pleased to discuss any of these recommendations in more detail. Please do not hesitate to contact our Chief Executive Officer, David Bell, on (02) 9239 6106 or email david.bell@actuaries.asn.au if you wish to discuss the matters raised in this submission.

Yours sincerely

Daniel Smith
President

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