



**Submission on the Interim Report of
the Northern Australia Insurance
Taskforce**

September 2015

1. About QBE

For over 127 years, QBE has been an integral part of the Australian business landscape providing peace of mind to Australians during normal business and times of crises. Our business has been a significant feature of Australia's commercial landscape since its early beginnings in Queensland. QBE is proud of its heritage and the support that it has provided to our customers and policy holders during this time.

Listed on the ASX and headquartered in Sydney, stable organic growth and strategic acquisitions have seen QBE grow to become one of the world's top 20 insurers with a presence in all of the key global insurance markets. QBE today is one of the few domestic Australian-based financial institutions to be operating on a truly global landscape with operations in 38 countries around the globe.

As a member of the QBE Insurance Group, QBE Australia operates in Australia primarily through an intermediated business model that provides all major lines of insurance cover for personal and commercial risk throughout Australia.

2. Northern Australia Insurance Premiums Taskforce

The Government has established the Northern Australia Insurance Premiums Taskforce (*Taskforce*) to explore the feasibility of options to reduce premiums in response to concerns raised about affordability of home, contents and strata insurance premiums in regions in northern Australia due to cyclone risk. There are two key options being considered which are a mutual cyclone insurer and a cyclone reinsurance pool. The Taskforce may also review additional options raised during consultations.

The Taskforce has released an interim report (*Interim Report*) for feedback and intends to provide its final report and recommendations to the Government in November 2015. These issues are complex and will become more so against the future change background and QBE appreciates the balanced approach taken by the Taskforce in delivering its Interim Report.

QBE has worked closely with and supports the Insurance Council of Australia's (*ICA*) submission (*ICA Submission*) to the Taskforce on the Interim Report. During the consultation period, QBE has provided additional information to the Taskforce to assist with its deliberations and specific information in relation to the two proposed options (a government supported reinsurance pool or mutual) and we do not propose to provide additional specific comments on these options.

As such, our comments in this submission are primarily focused on broader policy considerations.

3. Natural disasters and insurance

The higher cost of insurance is obviously a concern for those living in areas that are assessed as "high risk" from an insurance perspective. QBE acknowledges the concerns expressed by consumers to the Taskforce that they did not understand or were unconvinced by the reasons given for the rapid increase in insurance prices. QBE also accepts that communication by insurers to consumers can be improved to assist consumers better understand natural peril risk, how insurance works and how consumers can take action to mitigate their risk.

However, the higher cost of property insurance in northern Australia, as recognised by the Taskforce in the Interim Report, appropriately reflects the underlying risk factors of the region and provides an important and clear price signal of risk of which individuals, communities and all levels of Government need to be cognisant.

The Australian Government Actuary (*AGA*) studies of insurance pricing in northern Queensland over the seven year period 2005/06 to 2012/13 found insurers had paid out \$1.40 in claims costs for each \$1.00 of premium collected on home and contents insurance in north Queensland¹. As noted in the

¹ Interim Report, page10.

Interim Report, this business has not been profitable for insurers and insurance prices have been adjusted in recent years to more appropriately recognise the high natural peril risk in this area.

The progress in Australia over the last decade with industry/Government initiatives like sharing of flood risk data, flood mitigation projects and studies into strata building risks from cyclonic weather in far north Queensland has increased our understanding and helped reduce uncertainty for insurers when considering and pricing these risks. As technology develops and data becomes more available and accessible, insurers are gaining more information and developing better skills utilising modern risk assessment and risk management techniques to better understand, assess and continuously manage the nature of insurable risks.

As information becomes more readily available, insurers become more able to reflect the level of that individual risk and price accordingly. This benefits the majority of insureds in areas of low or medium to high risk. However, there are areas where legacy issues exist and the risk is relatively high, for example, the exposure to cyclone of some existing developments and strata in communities in far north Queensland, which is then reflected in higher insurance premiums.

This has exacerbated the debate around non-insurance, under-insurance and the issue of accessibility and affordability of insurance for natural peril risk, which is currently under the spotlight at an Australian political level.

It is important to recognise that insurance pricing plays a critical role for society by signalling to individuals, communities and government important information about the existence and nature of specific risks. In pricing risks, insurance companies give a signal to the market as to how they see that risk. In an efficient market, this is desirable, with price providing an appropriate signal about the increased level of risk and encouraging risk mitigation. Optimally, this would lead to action being taken to stop allowing development in inappropriate areas or by ensuring that new dwellings and construction in "high risk" areas meet building standards that would significantly reduce the potential damage should a significant natural peril event occur.

There is a danger when differentiated premiums are viewed by society and politics as unjust and discriminatory and public policy measures are introduced to address the perceived inequity. As noted by the ICA in its submission to the Interim Report:

Consumers being adverse to paying a price or fee on the basis that they believe it to be expensive, does not equate to market failure. If this were the case there are any number of products, services and commodities with unwelcome price tags in the Australian market where market failure could arguably be instantly declared...²

If pricing signals are lost or distorted by government intervention, market information is lost and risk is likely to increase.

4. Defining the extent of the affordability issue

The new digital reality facilitates consumers demands for action and intervention in a way that has not been previously possible. Given this new norm, there needs to be clarity over the extent and quantum of a perceived issue, prior to any public policy response that could have significant flow through implications in broader markets.

When individuals believe that governments will step in and provide a safety net there is significant risk of "charity" hazard as communities and individuals are dis-incentivised from mitigating or insuring their risk and abdicate personal responsibility.

The issue of affordability of insurance in northern Australia has been made more complex due to the lack of evidence about the nature and the extent of the problem. The Interim Report canvasses many of the complex policy issues and consequences that may flow from the options for government intervention that are under consideration. Given the significant possibility of longer term impacts and distortions that could lead to exits, reduced competition and potential market failure, it is critical that

² Interim Report, page3.

there is a clear understanding of the nature and extent of the issue before any policy decision is made.

As a result, the industry has undertaken an extensive data collection and analysis project to identify the extent of the affordability issue and to clarify some common misconceptions regarding insurance pricing in northern Australia. QBE refers the Taskforce to this detailed analysis and the key findings outlined in the ICA submission which crystallises the issue at hand. Importantly, this analysis demonstrates:

- There is **no market failure**.
- Premiums are higher for a very **small measurable identifiable group** of policy holders with property that is located in close proximity to the coast and, based on year of construction data, is not compliant with the cyclone wind code.
- Residents are not underinsuring to lower premiums nor voluntarily adjusting their premiums down by increasing excesses.
- North Queenslanders understand the risk and there is evidence that the preference is to take steps to address the root cause problems and take steps to “cyclone proof” their properties.

5. Is there a case for Government intervention?

Over recent decades there have been many disputes about government policies but the broad direction has been away from government intervention and subsidies towards greater liberalisation and reliance on markets. In this matter, however, the Government is preparing to reverse this direction and break new ground with a significant industry intervention.

Government intervention that can distort or destabilise a functioning market runs the risk of thinning or undermining the availability of private insurance and potentially producing unintended consequences for insurers and consumers. If private insurance cover becomes scarce, it is simply a question of time before the Government will be required to fund losses, which will have significant implications for the fiscal spend.

The prospect of the Government intervening in the insurance market has received little attention to date, but for it to start effectively using the Commonwealth balance sheet to lower the cost of home insurance premiums in one geographic area, for one particular peril, would be an historic step in economic policy.

Introducing such a scheme will set significant precedents for a range of other disaster types and a range of other domains. It is inevitable that the Government will be asked to rectify plausible anomalies and extend support for additional perils and geographic areas (for example, people in bushfire-prone areas in Victoria as well as people in flood-prone areas of New South Wales). Additionally, once a scheme is in place there will be enormous pressure on the Government to expand coverage to those people that just miss out, and to relax the criteria when events fail to meet the strict definitions. The existence of such a support scheme may also inspire further demands for expansion by the Government into other domains, such as agriculture, fishing and mining.

It is also unclear how the proposed reinsurance pool or mutual options are to be funded. It is anomalous to suggest that a levy should be imposed on insurance premiums to fund a scheme that is aimed at improving the affordability cost of insurance. Alternatively, raising taxes across Australia to finance the suggested reinsurance pool or mutual option will be a drag on growth, with a classic misallocation of resources from more efficient to less efficient uses. Ultimately, as a contingent liability for the Commonwealth Government, it will be all taxpayers who are funding the insurance premiums of a small and preferential minority.

Given the unique work undertaken by the ICA to define the extent and nature of the issue and the significant implications of the proposed options for Government intervention in the market, **QBE believes the case for broad based market intervention by Government has not been made**. Rather, the market is working effectively to price and balance risks in the high risk market of northern Australia.

Government clearly has a role to play however, particularly in ensuring that appropriate incentives are in place for reducing and mitigating risk and ensuring that new development and construction in “high

risk” areas meet building standards that would significantly reduce the potential damage if a major weather event occurs.

6. A better solution – the “Third Way”

The Government is entirely reasonable to be listening to the concerns of people in north Queensland, however there are more effective ways of helping vulnerable consumers than the two options under consideration by the Taskforce. From a policy perspective, government’s role should be focused on providing a social safety net for vulnerable consumers, particularly when there is no evidence of market failure, rather than displacing the private insurance market.

If Government intervention is considered necessary, QBE believes it should be targeted specifically for those low income consumers who are exposed in high risk property, rather than providing preferential treatment for consumers who are less impacted or who make a lifestyle choice and can afford to pay for that choice.

It is also important to focus on prevention and what can be done to address cyclone vulnerability for older properties identified as “high risk”. Finding workable solutions to mitigate risk and build more resilient communities must be an important longer term and sustainable solution to engender growth.

QBE considers that the “Third Way” proposal for cyclone mitigation assistance, as outlined in the ICA submission and supporting proposal by Urbis, offers a better longer term solution to addressing affordability concerns for low income consumers. This option also provides a workable solution to address the root cause issue of building vulnerability in older properties located in high risk cyclone areas.

QBE supports the Third Way solution which provides targeted support to the most vulnerable consumers. It provides a mechanism to reduce the risk over time and will enable steps to be taken to prevent damage occurring and therefore improve safety for communities. The cost to Government of the Third Way is estimated to be significantly less than the options currently being considered. It also has a limited timeframe, enabling Government to exit the arrangement in due course. Such an exit would not possible with the Government cyclone mutual and reinsurance pool options.

Importantly, the Third Way option is economically sensible. It will stimulate productivity and support jobs growth in northern Australia during the rectification period. It focuses on prevention by mitigating the risk for those highest risk properties. By building cyclone resilience, the likelihood and extent of damage by cyclones for those most vulnerable people and properties will be reduced. This will not only translate to less direct losses and damage, it will also assist in reducing the often unseen and devastating social impacts that such damage and disruption causes to peoples’ lives and families.

7. Insurance taxes

As has been recognised in numerous reviews, insurance taxes are one of the most inefficient taxes levied in Australia and should be abolished.

The best method of reducing premiums is of course for taxes on insurance to be reduced or even removed. Economists have long recognised insurance taxes to be one of the most inefficient forms of revenue-raising, and if the Government’s current tax review were to recommend the removal of stamp duties on insurance that would resonate with both consumers and economic policy experts. These inequitable and inefficient taxes and levies impact significantly on the affordability of insurance. As noted in the Interim Report, these taxes add either 19% or 20% to the cost of insurance premiums in northern Australia³.

8. Increasing consumer transparency

QBE believes that increased transparency and disclosure to purchasers of property in high natural peril risk areas should also be considered in this debate. There is a significant risk of moral hazard when individuals are not held accountable for their actions and believe that governments will step in

³ Interim Report, page 39

and provide a safety net. Without personal accountability individuals are dis-incentivised from mitigating or insuring their own risk.

Although there are clear legacy issues to consider, looking forward, local government disclosure of natural peril risk to consumers - at time of purchase or occupation – will enable better informed choices to be made by individuals enabling them to assume more personal accountability and responsibility.

QBE also accepts communication by insurers to consumers can be improved to assist consumers better understand natural peril risk, how insurance works and how consumers can take action to mitigate their risk.

9. Conclusion

As recognised in the Interim Report, this is a very complex issue that requires considerable unpacking and debate by stakeholders to ensure that all constituent parts of the puzzle are well understood prior to the implementation of any policy measures by Government.

Natural disasters are an ever present risk for communities in Australia. The contributions of the insurance industry in the recovery of communities from recent catastrophes are significant not only in terms of the billions of dollars of claims paid, but also in terms of the evolving risk mitigation and emergency management initiatives that build resilience into our communities. The support that private sector general insurance provides for people, businesses and communities is a critical factor in assisting in the expeditious economic recovery and rebuilding when natural disasters occur.

While northern Australia has long been exposed to natural hazards, the frequency of extreme weather events and their level of destructiveness appear to have risen significantly since 2006. These events caused significant damage with total insurable losses in excess of \$8 billion. Against that background some increase in insurance premiums in Queensland since the recent disasters is unsurprising.

Further, local council, state and territory governments continue to allow development in areas that are considered high risk with limited risk mitigation strategies required of developers. This increased concentration of people, infrastructure and economic activity in areas exposed to significant natural peril risk is a key driver of increasing loss particularly when the urbanisation occurs without appropriate mitigation to reduce vulnerability.

It is important government, industry and communities to focus on sustainable long term policies rather than quick fixes that could well exacerbate the tension between affordability and sustainable risk insurance. QBE believes that better communication and collaboration between all levels of government and the industry would help to tackle these complex issues, particularly in relation to land development, risk awareness and mitigation initiatives for exposure to catastrophic natural events for certain areas and risks in Australia.