

18 September, 2015

Mr Mike Callaghan AM
Chair
Northern Australia Insurance Premiums Taskforce
The Treasury
Langton Crescent
Parkes ACT 2600

RE: Northern Australia Insurance Premiums Taskforce Interim Report

Regis Mutual Management (Regis) is grateful for the opportunity to respond to the concerns and focus questions detailed in the Northern Australia Insurance Premiums Taskforce Interim Report.

Based on our extensive experience developing and managing mutual models, we believe there are a number of compelling advantages to introducing a mutual component to cyclone coverage in Northern Australia.

1. Education and mitigation.

The task force has identified that “the insurance industry has not effectively informed the public about how and why the industry has changed its practices”. The mutual’s profit-sharing model incentivises responsibility and mitigation by educating members on preventing situations that would lead to claims. Successful mitigation is communicated back to members as a price signal, in the form of reduced premiums.

2. Utilisation of government subsidy.

Mutuals’ primary responsibility is not to pay dividends to shareholders but to invest in education and mitigation, and to redistribute any surpluses by way of reduced premiums. As such, the Government can be more certain that the subsidy is passed on to the policyholders than under the reinsurance pool option.

3. Coverage gaps.

Using a hybrid model in partnership with partner insurers, the mutual would provide first loss coverage for named cyclones as part of a seamless experience to a consumer purchasing insurance.

4. Competition.

By providing first loss coverage for named cyclones, the mutual would provide insurers with the maximum protection from cyclone losses and thereby increase competition in the insurance market in Northern Australia.

Regis Mutual Management (Regis) is in a unique position to assist the Northern Australia Insurance Premiums Taskforce develop a mutual hybrid that we believe will achieve the optimal outcomes for the cyclone-affected consumers of Northern Australia.

Since 2007 Regis has assisted numerous organisations to establish and manage their mutuals. Our speciality is in the creation of discretionary mutuals that provide a financial service—the provision of affordable risk protection to members. Our clients are among the best and most successful discretionary mutuals in Australia and the United Kingdom.

Yours sincerely,



Gerald Ewing
Chief Operating Officer
Regis Mutual Management



Submission to the Northern Australia Premiums Taskforce

A response to the Interim Report

By Regis Mutual Management Pty Ltd

18 September 2015

Introduction

The purpose of this submission is to respond to the focus questions raised in the Task Force's interim report into the options available to the Commonwealth Government to reduce home, contents and strata insurance premiums in northern Australia.

A mutual insurer offering cyclone cover to individuals

Focus Question 1:

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?

The task force has identified that “the insurance industry has not effectively informed the public about how and why the industry has changed its practices”. As a result recent re-evaluation of the risk, and therefore of insurance prices, by insurers has caused widespread concern about affordability. In response to this, the mutual model is designed to make affordable insurance cover accessible to populations whose needs are insufficiently catered for by the existing insurance market, whether it be availability, cover or price.

A mutual insurer provides the following advantages in implementing a solution:

5. The mutual would be owned by the policyholders, providing them with responsibility and a say in the implementation of the solution.
6. A publicly owned mutual provides a platform for increasing policyholders' knowledge and understanding of the risk and cost of cyclone coverage.
7. The mutual is an ideal vehicle to oversee a mitigation programme for policyholders, providing both the incentive and imperative for improving community resilience to adverse weather events.
8. The mutual's profit-sharing model incentivises responsibility and mitigation by educating members on preventing situations that would lead to claims. Successful mitigation is communicated back to members as a price signal, in the form of reduced premiums.
9. The Government can be more certain that the subsidy is passed on to the policyholders than under the reinsurance pool option.

What government support would be required?

To meet the objective of lowering consumer premiums for home, contents and strata title insurance, a government subsidy will be required. The subsidy can be progressively reduced, smoothing the impact of the increase over time. In the meantime a concerted effort to improve the cyclone resilience of insured property can mitigate some of the risk and reward those who take steps to further protect their property.

The following would be required from the Government to support the mutual:

- A guarantee and/or annual aggregate reinsurance programme to protect the mutual from the risk of multiple claims events.

- A subsidy to be passed on to policyholders either directly or, as we propose, via discounted reinsurance.

Consumer Experience

Focus Question 2:

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?

The mutual would take a first loss limit out of an insurance policy. For insurers who partner with the mutual, first loss coverage for named cyclones would be provided by the mutual with the balance of the coverage and limit provided by the insurer. This would offer a seamless experience to a consumer purchasing insurance through a partner insurer.

To ensure a seamless and expedited claims experience we propose engaging the services of a leading insurance law specialist to draft a suitable clause for the mutual and insurers' policies. The intention of this clause would be for the mutual to provide a "carve out" of named cyclone cover up to a limit and for the insurer to continue to provide cover above the limit.

We recognise this as a priority activity once the model has been decided upon. We would draw on the experience of this in other parts of the world to ensure that the risk of dispute is eliminated or made manageable.

Example: A blended mutual

Regis Mutual Management has experience developing blended approaches to insurance such as the model it created for the Activities Industries Mutual (AIM).

AIM was established in the UK in response to a market failure when commercial insurers could not meet the liability cover needs of adventure activity and outdoor education providers. AIM is a "hybrid" mutual which means that its cover is in two parts. The first part of each risk is retained by the mutual and pooled amongst members under a discretionary model. Above the level of mutual retention, AIM has in place an insurance policy for all members up to the total limit of cover required. This structure enables the mutual to provide insurance certificates to members which comply with statutory regulations where required such as employers' liability.

Focus Question 3:

How should a cyclone mutual insurer price its policies?

The cyclone mutual must use risk-based pricing in order to comply with the Taskforce's principle that "incentive structures should be appropriate, in particular, the incentive for people to reduce the vulnerability of their property to cyclone".

The mutual would need to develop a pricing algorithm which reflected the risk price as closely as possible before a subsidy is applied. In our experience such an algorithm can be constructed with the assistance of an actuarial consulting firm within a 3-6 month period including its automation.

The pricing algorithm must include the provision for discounts for policyholders when specific risk improvement measures have been taken. The mutual would work together with the Cyclone Testing Station to identify a range of cost effective mitigation actions for which discounts can be made available.

Focus Question 4:

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?

According to the Taskforce’s principle “the options should as far as possible, be targeted to have the greatest impact on consumers experiencing insurance affordability issues resulting from cyclone risk without discriminating between states or parts of states”.

Our understanding of the findings of the AGA, as summarised in the Taskforce interim report, is that the people of Northern Queensland and, to a lesser extent, North Western Australia and Northern Territory, are experiencing insurance affordability issues.

Therefore, to meet the Taskforce principles and to maximise the effectiveness of the mutual, we suggest making the solution applicable to all policyholders in the areas identified as experiencing affordability issues.

The mutual solution becomes more effective as its scale increases. The aim of the mutual is to provide affordable cover to those in cyclone-prone areas, and as such it should be available to all consumers in those areas. Under the mutual model, a larger pool of policyholders creates additional benefits for members in the form of reduced premiums rather than profits to the organisation or external shareholders. There is no need to limit coverage to only those who mitigate, as this may be financially burdensome to those least able to afford insurance. Policyholders will be incentivised with lower premiums to take mitigation action.

Focus Question 5:

What would be required for private insurers to be an agent for a cyclone mutual insurer and sell its policies and manage claims against those policies?

We recommend that all APRA licensed and authorised insurers can apply to become agents for the mutual. To ensure the standards of the mutual are upheld, the agency agreement would need to proscribe service standards, particularly around claims management.

Making the agency arrangement open to all APRA licensed and authorised insurers should stimulate competition in the affected area and thereby support the Taskforce principle that “the options should as far as possible, support a competitive private market for insurance.”

Private insurers would need to be compensated for acting as agents and there are a range of remuneration examples that can be drawn upon in other catastrophe schemes operating in the US, Japan and New Zealand.

The mutual will reduce insurers’ cyclone exposure and should encourage more insurers into the market.

Governance and Regulation of a mutual

Focus Question 6:

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

The discretionary mutual structure, supported by a Government guarantee and aggregate reinsurance protection would be regulated by ASIC under existing financial services regulation.

The mutual member-owned model intrinsically provides for good governance because the mutual board has only one duty which is to serve member interests rather than the stock market.

Risk to Government

Focus Question 7:

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

We propose the mutual provide a first loss limit for named cyclones while their partner insurers provide a seamless continuation of cover up to the sum insured.

Mitigation will have the greatest effect upon claims falling within the first loss limit and providing cover in this layer through a mutual will ensure that incentives to influence behaviour will have maximum impact.

The advantages of this arrangement include:

- Providing insurers with the maximum protection from cyclone losses and thereby increase competition in the insurance market in Northern Australia.
- Enabling the largest level of discount to be passed on to policyholders.
- An alignment of interest between the partner insurer and the mutual.
- The insurance industry is given an established appetite and process for discounting deductibles.
- Measuring, managing and protecting the mutual layer's exposure would be simpler and therefore more cost effective.

Focus Question 8:

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

We suggest that support for the cyclone mutual insurer can be scaled back over a period of 5-10 years as the mutual builds sufficient surplus and arranges commercial reinsurance contracts. Both the loss experience and progress of mitigation measures could accelerate or slow down the reduction of government support.

The mutual model offers the advantages of public ownership without many of its disadvantages. A mutual model allows a service provider to focus on the benefits to its members instead of profits. At

the same time mutuals provide all the benefits of competition in the marketplace without the creation of new government departments and infrastructure.

Other options

Focus Question 15:

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

A blended approach

A mutual supported by reinsurance provided by the Australian Reinsurance Pool Corporation (ARPC) would solve this issue. This blended approach combines the direct pricing and public participation of a mutual with the reinsurance capacity and skills of the ARPC. The Government can manage subsidisation by providing discounted reinsurance from the ARPC for the primary mutual layer. This arrangement gives Government management of the subsidy and enables policyholders to confidently manage their risks through their ownership of the mutual fund.

A blended approach would also provide greater certainty that the subsidy reaches the policyholders.

Mitigation

Focus Question 16:

What can be done to encourage greater efforts to mitigate the risk of damage from cyclones? Are there impediments to insurance premiums being responsive to mitigation action by property owners?

There are many practical and cost effective measures that individuals can take to mitigate the risk of cyclone damage to their property and community. The creation of a focussed mutual owned by its policyholders for their own benefit is the ideal structure for providing those affected with an incentive to mitigate risk both individually and collectively.

Mutuals' primary responsibility is not to pay dividends to shareholders but to invest in education and mitigation, and to redistribute any surpluses by way of reduced premiums. This process places an emphasis on individual responsibility within a context of the common good. Externalities are managed via premium loadings directly related to the actions taken or not taken by an individual to prepare and mitigate against foreseeable scenarios.

The impediments to insurance premiums being responsive to mitigation action relate to the availability of an independent certification of the mitigation work and the administration of the discount process in insurers pricing models.

The ability to incentivise effective mitigation would be central to the purpose of a cyclone mutual. This can be further reinforced through the terms of reinsurance arrangements. In contrast to commercial insurers operating in many areas and offering multiple products, the mutual would be designed to resolve the certification issue and create pricing models that were responsive to mitigation as the core of its purpose.

About Regis Mutual Management

Regis was established in 2007 to provide a complete professional outsourced management solution to the members of protection mutuals, or those wanting to establish a mutual. The company operates in both Australia and the United Kingdom.

Regis' provides a range of mutual services from the creation and establishment of mutuals through to the complete outsourcing of the management.

Regis applies financial discipline and governance to the management of a mutual so it can operate efficiently and in the sole interests of its members.

The ethos of mutuality has never been more relevant than it is today and this is good news for anyone that wants to see greater diversity and true choice in the financial services sector.

Passionate about mutuals and mutuality, Regis's relationship with its portfolio of mutual customers gives the company a unique insight into the benefits and challenges of discretionary protection mutuals both in Australia and internationally.

W: www.rmml.com