

The logo consists of a white square border containing the text 'TOWNSVILLE' in a bold, sans-serif font above 'CHAMBER' in a lighter, spaced-out sans-serif font.

TOWNSVILLE
CHAMBER

TOWNSVILLE CHAMBER *of* COMMERCE

Federal Budget Submission

2021 - 2022

INTRODUCTION

For 138 years the Townsville Chamber of Commerce has been the independent voice for the Townsville business community. As an apolitical, membership-based organisation, the Townsville Chamber is focused on advancing our members' interests and looking to grow future opportunities in the North. We work collaboratively with all levels of Government, other representative bodies, and public and private sector organisations.

The Townsville Chamber of Commerce welcomes the opportunity to present the Commonwealth Government with the following submission for the 2021-2022 budget.

INDUSTRY SUPPORT

As the market failure of insurance is a problem faced by a wider geographical area than just Townsville, the Townsville Chamber of Commerce has spoken to a number of Chambers and Industry Groups to support the recommendations made in this submission. We are pleased to advise the following organisations are not only supportive of the recommendations but have also added content and feedback in relation to the issues faced by trying to get affordable insurance in their regions.



Insurance: The Market Failure of an Essential Service in Northern Australia

OVERVIEW

The ACCC has recently finalised its much-awaited Northern Australia Insurance Inquiry (NAII). The report broadly highlights the issues known only too well to the residents and business owners in Northern Australia. Unfortunately, the report fails to expressly state the market failure of the essential service that is insurance, which will not only impede, but will ensure Federal Government objectives of developing Northern Australia remains unachievable without intervention.

INSURANCE IS AN ESSENTIAL SERVICE

A business or individual cannot operate in a free market in Northern Australia without insurance. It is a requirement:

- by a financier when borrowing money
- for an individual or business that provides goods or services at the legislated Australian Standards
- when renting a premise
- as part of standard procurement, supply, and grant funding contracts with Local, State and Federal Governments
- to operate a business legally in Australia in most industries
- to lawfully own or occupy for specific types of buildings and public spaces
- to import or export for trade and commerce
- to comply with both State and Federal legislation

Insurance is not a choice. Any Australian that contributes to making this great country a better place must have insurance. The Australian Government's stated agenda to develop Northern Australia cannot be successful if insurance is not readily available and affordable in a competitive marketplace. Insurance is not a product that is available in the open marketplace for consumer choice, it is a legislative requirement and financial prerequisite. Insurance is an essential service to conduct business, to buy a home, or contribute in a meaningful way to the economy.

THE PRINCIPLE OF INSURANCE

It is crucial to understand the basic principle of insurance. Insurance is when many people pay a little amount of money to create a bigger pool of money so that anyone unfortunate enough to suffer a loss is reimbursed financially for that loss from the pool.

The principle of insurance is profitable in Australia. According to the ACCC's NAII over the 12 years to 2018-19, insurers made an estimated profit of \$8.2 billion from home, contents, and strata insurance in the rest of Australia at a gross profit margin of 12%. (See page 108 of the NAII)

Not insuring particular geographical areas or specific events means more profit, at less cost, which is good for the insurance industry but supportive of a practice that is contrary to the fundamental basic principle of insurance to spread the cost of the risk of any single event across many people. When the delivery of an essential service is motivated by profit rather than the basic principle underlying the need for the service, government intervention is required. This is the basis for our call for government intervention.

Government intervention into the insurance industry does have precedence in Australia. In 2003 an insurance pool was created because terrorism cover was removed following the

September 11 attacks in America, leading to market failure.

The ACCC's NAII does not address the definition of a market failure but suggests that even if there is not yet a market failure across the whole of the country, government intervention is still justified.

*"This has included considering the extent to which affordability and availability issues stem from market failures, other impediments to robust competition or underlying cost drivers. **Without market failure, government intervention to reduce premiums may still be justified on social equity grounds or in support of broader policy objectives**". (Page 145 of the NAII)*

The term "market failure" was defined by Allianz in their submission to the inquiry in 2019.

"While an unavailability of needed insurance would meet the technical economic definition of market failure, Allianz suggests that an effective market failure arguably exists if such insurance is out of reach to those who need it because they cannot afford to purchase it." (page 6)

The NAII has identified that there was significant non-insurance taking place which is a clear market failure of an essential service. The NAII data that is already outdated and will only exacerbate the market failure in Northern Australia.

THE NEED FOR GOVERNMENT INTERVENTION

Several industry professionals, including insurance brokers whose business it is to identify insurance products within the market, have been unable to source suitable products for customers in Townsville and Northern Australia. Insurance brokers within the industry, who are also members of the Townsville Chamber of Commerce, are unwilling to participate or provide evidence for fear of retribution by the insurers. It also needs to be

highlighted that the market sees significant issues in renewing premiums due in 2021. The ACCC's NAII highlights that Northern Australia is not a profitable place to offer insurance and the publication of this inquiry's findings will only exacerbate the existing problems without Government intervention.

A SOLUTION FOR A COMPLEX PROBLEM

The insurance industry is complex. That does not mean there is no solution, it means a real solution may not be a simple one. The Townsville Chamber of Commerce believes that due to the complexities within the industry and to avoid further limitations being placed on Northern Australia's development, an environment must be created where there is not only a baseline for the essential service that insurance provides, but insurance at that baseline is affordable and healthy competition remains within the marketplace. More than one of the following recommendations needs to be implemented to ensure a competitive and responsible industry remains available in the open market. Provided there is a combination of more than one of these recommendations the Townsville Chamber of Commerce believes the issue can be resolved and the development of Northern Australia can be a realistic and achievable outcome for the Australian Government:

RECOMMENDATION ONE

Expanding the Australian Reinsurance Pool Corporation remit to include Northern Australia and the natural events of cyclone and floods

Precedent and justification for the Reinsurance Pool

The justification for the Terrorism Insurance Act 2003 and the development of the terrorism reinsurance pool was:

*“The terrorism events in the United States on September 11, 2001, caused massive losses to commercial property and corresponding insurance payouts. **Following these events, global reinsurers refused to underwrite for loss or damage to commercial property caused by terrorist activity.** In turn, when existing primary insurance policies expired, and property owners sought to renew them, **primary insurers explicitly excluded terrorism cover in those renewal policies.** As a result, **commercial property owners, including in Australia, were forced to assume the risk of loss or damage to their properties if there were a terrorist event.**”* (www.arpc.gov.au)

The Australian Government decided to intervene in the Australian insurance market to protect the Australian economy from the potential flow-on effects of the global withdrawal of terrorism reinsurance. In particular, the Government was concerned that forcing property owners to assume their own risk for terrorism would reduce financing and investment in the Australian property sector, including a substantial reduction in commercial building activity.

Subsequently, a scheme was established under the Terrorism Insurance Act 2003 (the Act) to replace terrorism insurance **coverage for commercial property and associated business interruption losses and public liability claims.** Under the Act, the scheme is administered by the Australian Reinsurance Pool Corporation (ARPC). The scheme commenced on July 1, 2003.

While the insurance industry will argue that the answer to the market failure with insurance in Northern Australia for the cover of cyclone and flood is mitigation either through building resilience into buildings, levies for flood events or other infrastructure improvements, there is no mitigation used by the insurance industry or ARPC when it comes to the risk of terrorism. No one would argue that mitigating against a terrorist act would be easier than mitigating

against an unpredictable natural event like a cyclone or flood.

The reasoning and justification for the reinsurance pool are clearly being replicated in Northern Australia with the risk of cyclone and flooding rather than terrorism. Since the inception of the ARPC, there has been a levy on all premiums in Australia to cover this risk. Policy holders in Northern Australia have been paying between 2% and 5.3% on their premium since 2003. While this is collecting a little from many to cover the risk of a few where there is a market failure, it is indeed following the definition of insurance.

According to the ARPC 2019-2020 Annual Report, the terrorism insurance scheme currently has \$13.7 Billion available for claims that arise from a terrorist attack.

The Allianz Australia Insurance Limited submission to the ACCC dated September 13, 2019, clearly articulates and supports the idea of a reinsurance pool. Allianz's model predicts a saving of over 50% on premiums for a standard home in North Queensland if there is a reinsurance pool. Allianz also indicated that they would re-enter the market with an insurance pool in place. This is seen as the most significant advantage to sustain lower premiums and thereby stimulate and re-introduce competition into the marketplace which will be the critical component in providing a platform to develop Northern Australia.

The terrorism insurance scheme reinsurance pool must be expanded to include the geographical area of Northern Australia and the natural events of cyclones and floods. This is a critical first step in ensuring competition and sustainability of insurance markets in northern Australia.

RECOMMENDATION TWO

The obligation for an insurer to provide insurance for all of Australia

As part of obtaining an insurance licence in Australia you must provide products to cover every part of Australia. This system works in parallel to a reinsurance pool. The pool provides confidence for insurance companies to re-enter the market and competition is critical to ensuring any government intervention reaches its full potential.

Regionalising the profitability of insurance completely contradicts the definition of insurance. When the risk is spread over the whole of Australia, the profitability of the insurance industry is indeed healthy. An estimated profit of \$8.2 billion from home, contents, and strata insurance in the rest of Australia, on a gross earned premium of \$69 billion, at a gross margin of 12% over the 12 years to 2018-19 is a healthy industry (See page 108 of the NAI). Singling out Northern Australia as one region that was not profitable, with a recorded loss of \$856 million or profit loss of 13%, does not mean insurance in Australia is not profitable, it just means you can indeed make more profit, and have less costs, if you are allowed to operate in just the profitable areas and not insure specific parts of Australia. As profit margins are pressured and shareholders require returns, multiple insurance companies are choosing to exit these areas and the NAI now provides documented justification for CEO's of corporate insurers to recommend their company exit the market in Northern Australia if they have not already. If we continue to allow insurance companies not to spread the risk, insurance will become harder to get in Australia.

The ACCC's NAI has highlighted a problem that people in Northern Australian and the insurance companies already knew existed. This report will escalate the problem of affordable and obtainable insurance in Northern Australia. In the long term, this will not be contained to

Northern Australia if insurers are allowed to only insure in "safe" or "low risk" areas.

By understanding the basic principle of insurance, it is clear that Australia is not being provided with the essential service that is required and Northern Australia is not insured to the standard that Australians require. Removing cover from particular areas, either through geographical boundaries, postcodes, street names, or not providing cover for named events like cyclones, floods, or terrorist attacks, is not spreading the risk. Rather, insurance companies are eliminating their exposure via exiting the marketplace. The risk is not being spread across the entire country. The hard reality at the moment is Northern Australia is contributing to a re-insurance pool to address a market failure for terrorism which will most likely occur in major capital cities, but major capital cities are not contributing to cyclone and flood risks in Northern Australia.

To drive a competitive and robust market, the risk of insuring in Australia must be shared across the whole of Australia.

RECOMMENDATION THREE

National Insurer – Baseline of insurance for all Australians

There is a market failure of an essential service in Northern Australia and if there is not a willingness from the private sector to provide affordable insurance to the entire country then there is no other option but for the Government to provide a baseline cover for the essential services required by legislation.

As a minimum, the standard cover should include building and contents and public liability for properties. In the same way the Government delivers other essential services to Australians like health care, the private market can continue to operate and provide optional products and levels of choice coverage in

healthy competition freely above the essential service baseline offered by the National Insurer.

As highlighted in the ACCC's NAII, offering the baseline service would be profitable for the national insurer and achieve the objectives of developing Northern Australian.

RECOMMENDATION FOUR

Abolish Additional Fees – Stamp Duty and GST

The Queensland State Government has a role to play and there should be an abolishment of stamp duty on home, contents, and strata insurance products.

This should be expanded to all premiums in Northern Australia, including cover for business policies.

The Queensland Government should abolish stamp duties on home, contents, and strata insurance products. State and Territory revenue needs could be more equitably met through other means or distribution of some of the profits from the National Insurer as per recommendation three above.

It has been widely acknowledged that stamp duties on insurance products are an inefficient form of taxation. This recommendation is in line with recommendations from previous inquiries into insurance and taxation issues.

Governments have previously received and continue to enjoy a windfall gain from the increase of insurance premiums in Northern Australia.

As an essential service (similar to fresh fruit, healthcare and bank account keeping fees) the insurance products provided by the National Insurer should be GST free, whether nationwide or only in Northern Australia where there has been a market failure.

As both GST and stamp duty are calculated on premiums, the direct impact on affordability of premiums for Northern Australia will be significant and the comparative loss of revenue

for the respective governments would be negligible due to the population of Northern Australia and the extent of non-insurance and impending further decline of re-insurance.

It should be noted that removing State and Federal taxes without ensuring healthy competition in the marketplace will see these benefits disappear.

CONCLUSION

In the upcoming budget it is imperative that provisions be made in relation to building a competitive, robust, and sustainable insurance market in Australia.

A combination of the above recommendations is critical to ensure fair and affordable insurance premiums in Northern Australia.

With the migration of individuals and businesses to northern parts of Australia as a result of COVID-19 lockdowns and restrictions in the south, it is timely that the Commonwealth Government seriously consider the aforementioned recommendations to support the prosperity and development of the nation.