

Submission | Reinsurance pool for cyclones and related flood damage

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*Actively
engaging
communities*

Introduction

Archers, The Strata Professionals [Archers] was established in 1982 and have become the strata industry's [the industry] leaders by keeping in touch with the evolving needs of stakeholders. Residents, owners, investors who have a financial investment in the property have a shared responsibility to maintain facilities. To ensure compliance the body corporate elects a group, called a committee, to act on their behalf. The committee is supported by the strata manager [a function that Archers provide] and on occasion, a building manager.



The founder and chairman of Archers, Mr Colin Archer, has been and continues to be an advocate for fairness, transparency and providing quality support to clients in the industry. He is a founding, life and longest serving member of the Body Corporate Management Institute of QLD [BCMIQ], which commenced in 1984, now known as Strata Community Association QLD [SCA Q]. He is also the founding president of the Community Titles Institute of Australia [CTIA], now known as Strata Community Australia [SCA]. He is a continuing supporter of both institutions and plays an active role in advocacy in the industry.

We are in a unique position in understanding both the specific challenges facing strata communities in Northern Australia and the broader strata sector as we operate 3 branches in Northern Queensland. Our branches in Cairns, Townsville and the Whitsundays provide services to over 7,000 lots under management and in Queensland we have over 31,000 lots under management. Our clients in this region have been significantly impacted by the exorbitant insurance premiums.

Archers have been advocating for a reinsurance pool since 2012. Mr Archer, as a committee member of SCA, made a submission to the house of representatives standing committee on social policy and legal affairs in January 2012 and again to the ACCC Northern Australian Insurance Inquiry in January 2018. In both these submissions the key recommendations to address the problem were:

1. Government intervention in private insurance markets through the introduction of a reinsurance pool to normalise market conditions; and
2. Change the Rating method to assess Commonwealth (GST) and State (stamp duties) taxes applied to insurance premiums, to ensure they do not unfairly penalise Northern Australians who pay 5-7 times the household premiums of other Australians.

Archers stance has been consistent since 2011 when we co-hosted the inaugural forum, held in Port Douglas November 2011, and was attended by over 400 units owners and other stakeholders. SCA and an insurance industry representative outlined the factors behind the current situation and heard at times distressing feedback about the impact on local communities.

Since that time the situation has only compounded. Examples included:

- Pensioners and other retirees on fixed incomes struggling to cope with massive insurance-driven rises in body corporate fees, already their largest single expense;
- Investors facing almost negative returns before interest, caught in a perfect storm of soaring outgoings, a soft rental market and collapsing property prices;
- Real estate salespeople who said they could not ethically sell apartments as a viable investment;
- Builders and other tradespeople dealing with the impact of complete collapse of any new strata-type construction activity; and
- Building executive committees concerned about the long-term effects of slashed maintenance budgets, usually to help offset rising insurance costs, on the quality of life of residents and asset values.

Archers have been a long-time supporter of educational seminars hosting bi-annual events in Cairns, Townsville and Airlie Beach. We have been fortunate to work alongside owner advocate Margaret Shaw and Warren Entsch (the local member for Cairns) as well as many other stakeholders over the past twelve years.

There is no choice for strata titled property owners with legislation clearly stating the need to insure common property at the replacement value. Without relief from both levels of Government, deployed in a measured, fair and consistent approach, the disparity between insurance coverage in different regions will continue to grow and, we speculate, will begin impacting other markets.

The consultation paper

We welcomed the announcement made by the Government on 21 May 2021 in relation to the design of the reinsurance pool [the pool]. The consultation paper seeks submissions from industry participants on how to structure the design of the pool to achieve the following four objectives:

1. Designing a scheme that improves availability and affordability of insurance in areas of the country that are at high risk of natural peril, such as cyclones;
2. Understanding the risk associated with establishment of the pool to be mitigated across the short, medium and long term. This involves a fair assessment of how the scheme will be used to achieve balanced outcomes. In the short term, the target of lowering premiums, in the medium term to improve property resilience and over the long term, encourage new construction in high risk areas compliant with cyclone and related flood damage construction codes;
3. How the transition of the industry in accessing the reinsurance pool will be managed; and
4. To minimise any adverse or unintended impacts from the establishment of the pool.

Executive Summary

We have been involved in front line advocacy of the Government intervening in the Insurance market through the introduction and fair implementation of a reinsurance pool to normalise market conditions since 2011 and we continue to be in favour of it.

We would again strongly encourage the consideration of state and federal Governments to address the double dipping of taxation applied to premiums.

Responses to the consultation paper are detailed below.

Consultation question responses

Reinsurance pool coverage questions

1. How should 'cyclone' and 'cyclone-related flooding' be defined for the purposes of defining the reinsurance pool's coverage?

Yes, and we support the use of established definitions by the relevant bodies, such as the Bureau of Meteorology. However, where:

- there are grey areas; or
- no definition exists; or
- restrictions due to increased specificity created by insurers in policy conditions and exclusions;

The Australian Reinsurance Pool Corporation [ARPC] should be given the authority to decide on the definition that is mutually beneficial to the insured and insurer. The Insurance Council of Australia [ICA] could consult with ARPC to supply recommendations. Providing clear guidelines is pivotal in assessing eligibility.

2. Should storm surge be covered by the pool and included in a definition of 'cyclone-related flooding'?

The definition of a storm surge¹ is "a rising of the sea as a result of wind and atmospheric pressure changes associated with a storm." The definition of a cyclone is "a system of winds rotating inwards to an area of low barometric pressure, with a clockwise (southern hemisphere) circulation; a depression." It would be logical to be covered by the pool.

3. Is it desirable for the use of standard definitions of 'cyclone' and 'cyclone-related flooding' to be required in policies covered by the pool?

Yes, however, cyclone-related flooding defining eligibility based on proximity to an event is not considered an acceptable method as we have witnessed with parametric cover, the remedy for those impacted is extremely limiting.

4. Are there any difficulties which may arise from including home building, home contents, or residential strata policies in the reinsurance pool and how should the scope of this coverage be clarified?

There are many variables in the assessment of exclusions in strata coverage for the building and common areas. For a standalone strata titled building, the way the building insurance interacts with individual owners and in what circumstances which policy covers a claim depends on:

- The type of format plan;
- Flood impacted areas and the location of the lot in the building i.e. ground floor will attract higher premiums;
- In Queensland the module that the scheme was registered under;
- Other nuances such as if the damage applied to two lots or one²;
- Where the damage occurred, common or private area; and
- Inclusions surrounding flooring replacements of lots which give rise to claims on the body corporate policy rather than the lot owner's policy, giving rise to higher excess and in turn higher levies.

5. Are insurers able to separately price or estimate the value of the property component of business insurance packages?

Not specifically relevant to strata.

6. Are insurers able to separately price or estimate the value of the residential and small business components of mixed-use strata title policies?

Implement the use of the common guidelines used in mixed used buildings around Australia. Strata insurance does not include business interruption cover, other than loss of rent.

¹ Definition from Oxford Languages (storm surge and cyclone)

² pursuant to the *Body Corporate and Community Management Act 1997*, s.182 (3) of the *standard module*

7. Are there any difficulties which may arise from including mixed-use strata title policies in the reinsurance pool and how should the scope of this coverage be clarified?

Further to the response to question 4, specifically for layered schemes, which have several different types of buildings, such as a residential tower, commercial tenancies and corporate office tower the assessment of insurance claims is incredibly complex and where a claim can be covered is not always clear with again, each scheme requiring a review of set up and coverage.

8. How should 'small business' be defined for the purposes of eligibility?

The reinsurance pool taskforce should receive a recommendation from the relevant Chamber of Commerce or relevant stakeholders representing business to determine this definition for eligibility.

9. Are there any difficulties which may arise from including small business property insurance policies in the reinsurance pool and how should the scope of this coverage be clarified?

Not specific relevant to strata.

Reinsurance product design and insurer participation

10. What is the current approach used by insurers to assess and measure cyclone, storm surge, and related flood damage risks, to what extent are individual policy level data available, and how are cyclone related risk premiums calculated in insurer pricing models?

Many factors are considered:

- Year of build which is an important consideration, particularly pre-cyclone code buildings, which are now excluded by most insurers, should be assessed for resilience;
- Floor area;
- Maintenance (both day-to-day upkeep and major works) undertaken in line with the sinking fund forecast recommendations to build resilience;
- The cyclone rating and the proximity to water to name a few;
- The slope and roof structure are also variables impacting coverage.

11. How should the reinsurance pool design a risk rating system for cyclone and related flood damage risks, and what are the trade-offs associated with using risk tiering and with the level of granularity used?

The risk rating system needs to take into consideration the year the property was built, apply it to building standards at the time of construction and assess the maintenance undertaken since the build. Where a property has complied with the sinking fund forecast recommendations, received over the life of the property, the risk applied should be lower than a building that has not complied with maintenance obligations.

12. How much risk exposure should primary insurers retain?

A percentage value on cyclone excess available from the pool would provide certainty around risks and allow insurers to price (in conjunction with the risk rating system) with more confidence. The ICA is likely to have a more comprehensive position on this.

13. Would implementing a reinsurance pool have any effect on the claims management process, and how could this be addressed in the reinsurance pool's design?

When a cyclone event occurs, claims increase. The question around who should be involved in the process considering that the insurance holder is the body corporate, which is a building, (run by committees) and relevant stakeholders are companies providing services and not individuals. If the design could recognise and allow stakeholders and committees to deal with claims, this will ensure effective action in response to a weather event.

Reinsurance funding should include specific allocations for onsite claim management.

14. What is the appropriate level of participation in the pool, and how should considerations of coverage and the amount of risk to be ceded be addressed?

The pool should be available to all eligible participants in Northern Australia.

15. How should industry transition be managed and what is the best format and timeframe for it to take place?

There is an immediate need however, we recognise that consultation is required.

Reinsurance pool governance and monitoring

16. What should be the key goals for a regular review of the reinsurance pool and what would be the optimal timeframe?

If the four objectives stated in the consultation paper are being achieved, these being:

- Designing a scheme that improves availability and affordability of insurance in areas of the country that are at high risk of natural peril, such as cyclones;
- Understanding the risk associated with establishment of the pool to be mitigated across the short, medium and long term. This involves a fair assessment of how the scheme will be used to achieve balanced outcomes. In the short term, the target of lowering premiums, in the medium term to improve property resilience and over the long term, encourage new construction in high risk areas compliant with cyclone and related flood damage construction codes;
- How the transition of the industry in accessing the reinsurance pool will be managed; and
- To minimise any adverse or unintended impacts from the establishment of the pool.

In terms of timeframe, every two years.

17. Should the reinsurance pool have a planned exit date?

No.

18. Which mechanisms will ensure the pass-through of reinsurance premium savings to insurance policyholders?
For example:

- 18.1 Explicit price monitoring of insurance premiums?

Yes. Disclosure of insurance brokers, strata management companies on commissions and effective monitoring to ensure committees are informed when deciding are required.

- 18.2 Additional requirements to disclose the cost of reinsurance to policyholders?

The recent legislative reform has not gone far enough in regard to disclosure requirements in general, but specifically for insurance renewals. By the ARPC overseeing insurance disclosures will ensure the commissions are not taken and the savings can be passed onto the insured.

- 18.3 Any additional mechanisms that may be appropriate?

No.

Links to risk reduction

19. To what extent do insurers price in discounts into insurance premiums for mitigation action undertaken by or affecting policyholders?

The Pilot Resilience Program provided reports for mitigation works for properties in Northern Queensland. Where these works were undertaken we did not see the relevant discounts being received by a majority of our clients.

How might mitigation be encouraged by the reinsurance pool's design? For example:

19.1 Should the pool provide discounts for properties that undertake mitigation?

Mitigation and maintenance works are essential for a building to retain its value. The resilience program should be extended as widely as possible to ensure its effective and non-involvement should result in reduced benefits or in flagrant cases, no cover.

19.2 Should the pool have an explicit mandate to encourage mitigation?

Yes.

20. How should the pool's design seek to discourage any increase in risky behaviour? For example:

20.1 Should there be a time-based cut-off to exempt new builds from the pool?

Absolutely not, without access to this pool, new developments will not be viable.

20.2 Should the pool only allow new builds that have been built to adequate standards and in suitable locations?

Yes, buildings need to be built to code with additional resilience options rewarded.

21. To encourage further action by states and territories on insurance affordability:

21.1 What settings could be included in the design of the pool?

21.2 Which policy options could be introduced alongside the pool?

State government policy options and settings should be designed to ensure they promote confidence in the ability for the desired outcomes to be achieved.

We have previously agreed with the recommendation to alter the method of levy stamp duty at a state level. However, in the event stamp duty remains unchanged, the ACCC report suggested state governments consider implementing direct revenue towards mitigation initiatives, such as rebates.

Without a genuine commitment to support residents impacted by excess insurance costs, there is unlikely to be further development in Northern Australia.

Interactions with the ARPC's existing functions

22. What are the potential interactions between the terrorism reinsurance pool and the new cyclone and related flood reinsurance pool?

The terrorism re-insurance pool levies commercial insurance policies which include commercial strata policies accordingly, there is some interaction.

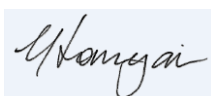
It is significant pool of funds. Our recommendations for the last 10 years, have proposed these could be used as a capital to underwrite this reinsurance fund.

Thank you for taking the time to review our submission. Should you have any queries or wish to discuss this further, please contact either of us.

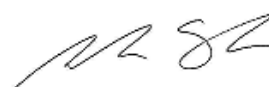
Yours faithfully



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