



9 January 2018

Submission to the Australian Competition and Consumer Commission
Northern Australia Insurance Inquiry

The National Insurance Brokers Association of Australia (NIBA) is pleased to provide the following submission to the ACCC Northern Australia Insurance Inquiry

About NIBA

NIBA is the industry association for insurance brokers across Australia. The association has around 350 member firms, employing over 4,000 insurance brokers in all States and Territories, in the cities, towns and regions of Australia.

NIBA's member firms include large multi-national companies, large Australian owned insurance broking firms, and a large number of medium and small insurance broking firms and their authorised representatives.

Most insurance broking firms are members of a network of broking firms, which provide commercial support for their insurance broking operations. The key network groups are:

- Steadfast – www.steadfast.com.au
- Austbrokers – www.austbrokers.com.au
- IBNA - www.ibna.com.au.

About Insurance Brokers

Insurance brokers work with their clients to assist them –

- understand and manage their risks, including the risk of loss of or damage to property or loss arising from liabilities associated with the operation of their business;
- put in place appropriate and agreed arrangements for the financing of those risks, including traditional risk transfer (insurance policies) and/or other risk financing mechanisms; and

- pursue claims under their policies when an insured event occurs, in which case the insurance broker becomes the advocate for the client during the assessment and resolution of the claim.

In times following major weather events and catastrophes, insurance brokers play a critically important role assisting their clients with the handling and settlement of their insurance claims. This effort on behalf of their clients invariably takes place locally, when insurance brokers are also seeking to repair and reinstate their own business premises and, on occasion, their own homes and property.

Experience has regularly shown serious confusion in communities following major weather events, and insurance brokers assist not only their own clients but anyone who asks for help with their insurance issues. The experience, knowledge and reach of insurance brokers, and their working relationships with insurers, becomes critical at these times of extreme stress in the affected communities.

It is important to note that insurance brokers act primarily for and on behalf of their client, and they owe statutory, common law, contractual and fiduciary duties to their clients for the nature and quality of the work they perform on their behalf.

When acting for and on behalf of the client, insurance brokers do not SELL insurance policies – they PURCHASE insurance policies on behalf of their clients from the markets available to them.

In addition to the valuable products and services they supply to their clients, insurance brokers also provide value to insurers and insurance underwriters by analysing and presenting information in relation to their clients' businesses and risks in a manner that allows the underwriting process to occur quickly and efficiently.

Insurance brokers hold or operate under an Australian Financial Services Licence issued by ASIC. Members of NIBA also subscribe to the Insurance Brokers Code of Practice¹, which is externally monitored and overseen by the independent and arm's length Insurance Brokers Code Compliance Committee².

The intermediated insurance market

Finally, the process of insurance brokers taking their clients' risks to insurers and underwriters is the process by which the intermediated insurance market

¹ See: <https://www.niba.com.au/codeofpractice/index.cfm>

² See: <http://www.fos.org.au/about-us/codes-of-practice/insurance-brokers-code/>

operates in Australia. The intermediated insurance market has been operating in this manner for over 200 years, and has proved very adept over time at offering a competitive market process for the supply and purchase of insurance and other risk financing products and services.

The intermediated insurance market works well when there are a number of suppliers keen to offer cover for a particular client. The market works less successfully when the supply of cover is limited to one or two players, or when the terms and conditions (and/or price) of the product become prohibitive for the clients. Northern Australia has experienced both of these conditions in recent years.

To that extent, the intermediated insurance market for clients across northern Australia should not be regarded as a typical insurance market or being reflective of the market for commercial and strata insurance in other parts of Australia.

The distribution of insurance products

General insurance products are distributed to the Australian community via two main mechanisms:

- Direct, where the insurance policy is purchased directly from the insurance company or their appointed agent. The appointed agent could be another commercial business such as a bank, supermarket, motor dealer, travel agent. Direct sales also occur by means of telephone call centres and via the internet.

The direct distribution model invariably does not provide advice to consumers and policyholders. They are provided with product information, and need to determine for themselves whether the insurance cover is sufficient and appropriate for their individual circumstances.

Insurance companies can and often do appoint underwriting agencies to underwrite and accept insurance risks on behalf of the insurer. The presence of underwriting agencies is a common feature of the strata insurance market in Australia.

- Intermediated, where an insurance intermediary – usually an insurance broker – acts for and on behalf of the client in the purchase of insurance products. Where this occurs, the insurance broker owes duties of care to the client, and is under a statutory obligation to act in the best interests of the client. On occasion, the insurance broker may be acting as a distribution agent for the insurer, in which case the client will be fully informed of the situation.

Only insurance brokers are authorised and licensed by ASIC to give advice on general insurance products and services.

Submission

Costs, premiums and profits for insurance in northern Australia

As noted above, insurance brokers purchase insurance on behalf of their clients. In these circumstances, they are subject to and often limited by the range and nature of products and services, and by the pricing, offered by suppliers of insurance cover wishing to do business in the regions across northern Australia.

The core issue for insurance in northern Australia is northern Queensland. That area has one major exposure not seen in most other parts of Australia: major tropical weather events, including cyclones.

The Northern Australia Insurance Premiums Taskforce examined carefully the issues, concerns and challenges for insurance coverage in northern Australia, and north Queensland in particular. Those issues and challenges are real, and do not have to be repeated here.

The exposure of northern Australia to cyclones and other major weather events is well known in the insurance industry, nationally and internationally. Indeed, the exposure to major weather events is well understood by reinsurers, who support the provision of insurance cover in the region.

The work of the Northern Australia Insurance Premiums Taskforce, and the reports published by the Australian Government Actuary, indicate that during most of the 2000's, pricing of insurance in northern Australia did not reflect the true cost of risks being insured by the insurance industry. The insurance industry then took steps to correct pricing anomalies, resulting in significant price increases for most policyholders in the region for property damage insurance. These price increases applied to domestic, strata and commercial insurance.

NIBA does not have access to data which would indicate the profitability (if any) of insurance currently written for risks located in northern Australia. Informal discussions with insurance industry executives indicate that there are few if any profits being made by insurers in northern Australia.

We note that earlier this year, Cyclone Debbie gave rise to estimated insured losses in excess of \$1.6 billion, with claims payments exceeding \$1.1 billion having been paid to date. The region continues to suffer major losses, and

continues to be supported to a substantial extent by the general insurance industry.

Overall, NIBA believes the work of the Australian Government Actuary was a thorough and sound review of the nature, extent and dimension of insured losses in northern Australia, compared to other parts of Australia, and set out a clear analysis of the cost and pricing of risk in that region. Our reading of the reports was that significant price increases were justified by the nature and size of losses that occurred in the region, the inadequacy of historical pricing, and the lack of significant attempts at mitigating the risk of property damage and building resilience in the communities in relation to damage by cyclones and other major weather events.

The competitiveness of markets for insurance in northern Australia

The commentary in the Issues Paper relating to market participants, countervailing power, the nature of competition and barriers to entry, exit and expansion are relevant and appropriate for virtually all areas of Australia except the areas covered by this Inquiry. The experience of NIBA and our members is that the nature of the property insurance market in northern Australia is very different to the market for this product in all other areas of the country.

Normal market conditions, and the benefits of competition (in terms of product, services and price) apply when there are a number of suppliers into a market, giving purchasers real choice for the cover they need. This is not the situation in northern Australia, and in northern Queensland in particular.

When an insurance policy is issued, the financial risk of loss associated with the cover provided by the insurance policy is transferred from the policyholder to the insurer. Prudent insurer management and APRA prudential regulatory guidelines require the insurer to hold sufficient reserves to readily and easily meet their financial obligations under the policies they issue. These reserves are made up of policyholder funds, and the insurer's own capital.

The insurer's capability to meet financial obligations is also likely to be assisted by reinsurance programs.

Insurers, quite rightly, have the right to determine where they will allocate capital (shareholders funds), so they will determine the policies they wish to offer, the terms and conditions they wish to attach to those policies, and the price they wish to charge for the risk that is transferred to them. In determining these factors, insurers (quite rightly) will form views on the extent to which policies will have negative financial consequences for the company, or whether there is a prospect of profit from the operation of the business.

Where it is difficult to determine whether the provision of insurance product is likely to be profitable or not, insurers typically protect their financial exposure and the risk of loss of capital by limiting their involvement in or even declining to operate in that market. In NIBA's view, this is exactly the issue that has raised concern in relation to property insurance in northern Australia.

As the Issues Paper notes, competition operates well when there are a number of suppliers offering product, and purchasers have the ability to pick and chose their preferred product and their preferred supplier.

Insurance brokers who are assisting clients with insurance cover for their property in northern Australia do not have access to a range of potential suppliers of insurance cover for that region. Clearly, insurers operating in the Australian market have decided to protect their financial exposure, and protect their shareholders funds, by restricting the amount of business they write in northern Australia.

It is common for members to report to NIBA that for specific risks (especially in the area of strata insurance), there are a maximum of two, and sometimes only one, source of supply of insurance. For some risks, brokers find it difficult to find any insurer who is prepared to offer cover, at any price.

With very limited supply into the market for property insurance in northern Australia, there is effectively no countervailing power available to consumers or those acting on their behalf, such as insurance brokers.

In these circumstances, the presence of commissions has little or no impact on the state of the market. Where supply is very limited, it is simply not possible for insurance brokers to direct business to companies with the most generous commission structure. They do not have those options available to them. In any event, insurance brokers act first and foremost to protect the interests of their clients – they are after all required by statute to act in their clients' best interests, and finding appropriate policy coverage at appropriate terms is the main challenge for insurance brokers.

In relation to barriers to entry, NIBA believes there are no technical barriers to entry for the provision of most property insurance in northern Australia. The real issue driving decisions to limit supply are the financial risks associated with nature of weather and cyclone activity which can and do regularly lead to very expensive and catastrophic losses in the region.

There is one possible exception to this position: insurance cover for strata properties is mandated by State legislation, and insurers must be prepared to issue cover and write policies on terms that meet the specific requirements of those laws. NIBA will make further inquiries to determine whether the specific insurance requirements of Queensland strata laws operate as a potential

impediment – effectively a barrier to entry – to more insurers entering that market.

Insurers could simply charge the correct technical price for the risk that is transferred to them. Experience has shown, however, that pricing of risk can reach a point where the community is not prepared, and in many cases is not able, to pay the size of premiums required to cover those risks of loss.

For this reason, the insurance industry, including NIBA, have been strongly arguing for coordinated activity involving all levels government designed to promote the mitigation of potential losses, and the building of resilience in communities across northern Australia.

The Northern Australia Insurance Premiums Taskforce, in its final report to the Federal Government, found that mitigation activities to reduce the risk of damage from cyclones are the only way to reduce premiums on a sustainable basis. On 18 December 2017, the Minister for Revenue and Financial Services announced the Government accepted this finding, and would not intervene directly in the insurance market.

On the issue of market entry, expansion and exit, a strong concern expressed by NIBA members has been examples in the past of an insurer coming into the region as a new market entrant, offering cover at prices below “normal” market rates, but only to suffer typical levels of claims costs and expenses, at which point they review their position and exit the market.

This indicates that there are few real barriers to entry and exit.

But where this type of activity occurs, the market for insurance cover is disrupted for the period the new entrant is present in the region, and consumers are seriously misled in relation to the true cost of risk associated with insurance cover for their property. Consumers see an insurer offering below market prices, and expect others to offer similar prices to match the market entrant. Consumers do not see the real reasons for the insurer’s decision to leave the market – the size of the losses that were sustained by that insurer in a reasonably short period of time.

Insurance brokers welcome new players, and are constantly looking for new suppliers of cover, but they also look for rational pricing and a commitment to meet the insurance needs of their communities in the medium to longer term. Short term disruption resulting from insurers entering and then leaving the market does not help consumers, and does not help the operation of a viable insurance market.

Consumers' experience with insurance

The Insurance Council of Australia has published an excellent report on the way in which consumers make decisions in relation to the purchasing of insurance³.

In northern Australia, the first issue confronted by consumers and insurance brokers is: what, if any, companies are prepared to consider insuring my property? Terms and conditions of cover, and the cost of cover, become irrelevant when there are only one or two suppliers of cover or a particular property.

NIBA has argued on many occasions, the true process for purchasing insurance should be along the following lines:

1. What is the nature of the risk to be insured? What are the particular features of the risk that might need special provision in an insurance policy. Most importantly, what are the type of losses that need to be covered by the policy, and what is the value of those losses if they occur? What is the correct sum insured for the proposed policy?
2. What cover is available for this type of cover? What are the policies that best match the nature of the risk that needs to be covered? Are there any specific terms and conditions in policies, and any particular exclusions, that would suggest one policy be used in favour of another?
3. What is the cost of the policies that best match the cover that is needed?
4. What is the reputation of the preferred insurer in terms of their attitude to claims and claim payments? Have they responded reasonably in the past, have they readily honoured their commitments under the policies they have issued?

For domestic insurance, many Australians undertake this process themselves, with greater or lesser success in matching the cover they purchase against the cover they need. Our observation is that most consumers chose cover based on price, with little or no regard to the terms of cover. We believe most consumers do not understand the fact that most insurance policies are different, including insurance policies offered by the same insurance group.

³ Too long, Didn't Read – Enhancing General Insurance Disclosure, available at: <http://www.insurancecouncil.com.au/issue-submissions/reports/too-long-didnt-read-enhancing-general-insurance-disclosure>

NIBA provided a detailed submission to the Parliamentary Inquiry into General Insurance. We refer the ACCC to that submission, and in particular to our comments regarding:

- The fact that Key Fact Sheets can be confusing and indeed misleading in the hands of most consumers;
- Insurance comparison web sites do not give sufficient attention to the terms and conditions of cover, and primarily refer to price, thereby potentially offering poor (and misleading) outcomes for consumers and the community;
- The need to review the standard cover provisions of the Insurance Contracts Act and the Insurance Contracts Regulations.

For strata insurance, NIBA has regularly expressed concerns in relation to the lack of understanding of insurance issues by strata unit owners and their governing committees. NIBA is also concerned about the fact that body corporate managers, who may have little or no training in or understanding of insurance issues, are arranging insurance for their body corporate clients, and are taking commissions for doing so.

NIBA has made a number of recommendations to State governments indicating that at least annually, the governing or management committee of the body corporate must receive a comprehensive report on the insurance program that is in place for the owners corporation, with recommendations and commentary regarding the ongoing appropriateness of the terms and conditions of cover, the sums insured, and the overall nature of the cover that is in place.

Only insurance brokers have the training and experience to provide this information and advice to owners corporations. Only insurance brokers are licenced by ASIC to provide these types of financial services and advice.

NIBA believes these issues are critically important for all owners corporations across Australia. The issues and challenges are particularly important for owners corporations in northern Australia, where there is very limited supply of cover for strata insurance. In addition, many strata properties are multi-million dollar resort style properties, which could be either largely owner occupied or largely available for holiday rental. The situation is further challenged by the fact that a significant number of properties are located very close to, or directly adjacent to, the ocean.

On the issue of switching insurers, this matter is considered by insurance brokers each and every day. Almost always, there is no alternative cover available.

Risk mitigation

NIBA has been consistently and regularly arguing for coordinated action by all levels of government for the promotion of activity which will mitigate the risk of loss as a result of major weather events, and which will build greater community resilience against the type of weather events regularly experienced in Australia.

We made submissions on this topic to the Productivity Commission inquiry into the funding of natural disasters, and made similar comments in our submission and our evidence to the Senate inquiry on climate change and related matters.

Our position is quite simple. Given the nature of weather activity that occurs across Australia, and particularly in northern Queensland, insurance will only remain readily available and affordable for the majority of property owners if action is taken to carefully manage the built environment to mitigate the types of losses that have been experienced in the past, and to build community resilience in this area.

We commend the work of the insurance industry, often working in conjunction with James Cook University, to develop more effective building standards for cyclones and other severe weather events in northern Australia.

We again note the Minister's statement on 18 December 2017 that "mitigation activities to reduce the risk of damage from cyclones are the only way to reduce premiums on a sustainable basis". NIBA fully supports the Government's position on this issue.

Regulation

NIBA is firmly of the view that the issues and challenges of insurance in northern Australia have nothing to do with –

- Information disclosure and transparency, although this can always be improved;
- Unfair terms in insurance contracts;
- Data availability and use.

The core issues are the lack of supply of cover, and the cost of insurance cover that is available.

Submissions and research papers mentioned in the Issues Paper fully set out the negative impact of taxes and charges on insurance premiums.

We are concerned that when insurers started charging significantly higher premiums to cover the cost of their losses in northern Queensland, the State Government increased the rate of stamp duty on insurance policies, thereby generating windfall revenue.

NIBA believes the Queensland Government should reform stamp duties on insurance premiums to ensure that owners of domestic and strata properties in northern Queensland pay similar amounts of stamp duty as owners of similar properties in the south east of the State. That would generate an immediate saving for property owners in the north.

Our ultimate preference is for the abolition of stamp duty on insurance premiums altogether. We accept this would have revenue implications for the State budget.

Conclusion

The issues and challenges for insurance in northern Australia were well documented in the work and report of the Northern Australia Insurance Premiums Taskforce. The Federal Government has now announced it has accepted the recommendations of that Taskforce.

The market for property insurance is also dynamic, and can and does change over time as insurers operating in the market constantly review their appetite for risk and their pricing of risks in that market. NIBA recommends the ACCC undertake a number of workshop discussions with insurance brokers operating in northern Australia during the course of this inquiry, in order to gain a first hand understanding of current market conditions.

The core issue facing property owners and insurance brokers is the lack of supply of insurance cover for properties in that region.

The supply issue is driven by the nature and scale of losses that have been sustained on a regular basis over the past 15 years, including losses arising from Cyclone Debbie earlier in 2017.

NIBA remains ready and willing to work with governments and communities to ensure the insurance process, and the insurance market, can deliver the required type of cover to property owners at reasonable cost. Achieving that outcome will not be easy.