INSURANCE COUNCIL OF AUSTRALIA

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SUBMISSION TO THE COMMONWEALTH GOVERNMENT DISCUSSION PAPER "ADDRESSING THE HIGH COST OF HOME AND STRATA TITLE INSURANCE IN NORTH QUEENSLAND"

The Insurance Council of Australia (ICA) welcomes the opportunity to provide comment on matters relating to the costs of insurance in North Queensland. The ICA would also welcome an opportunity to engage with relevant government stakeholders on these matters, noting the complexity and potential for misinformed government interventions to have counter-productive impacts. The ICA stands ready to respond to any request for further engagement.

Executive Summary

- Insurance markets in Australia (and in North Queensland in particular) are competitive and efficient with contestable pricing. Insurance pricing in North Queensland reflects the underlying risk of loss, in addition to the prudential settings under which Australian licensed insurers are required to operate in order to protect consumers.
- North Queensland properties face natural hazards at a greater frequency and intensity than other regions, yet are constructed using the same principles as buildings in other states. Insurers will price according to the risk, based on the latest information in their possession. Insurers are developing more sophisticated data and methodologies to understand risks at a more granular level. However, claims experience, technical pricing and the prudential regulatory regime demand that insurers price for such risks and hold appropriate capital. Finding measures that address the underlying risk factors faced by North Queensland properties is the only solution to sustainable price relief.
- Insurance plays a critical role for society. It signals the existence and nature of specific risks to property owners, communities and governments, and helps incentivise risk reduction measures. As recently identified by the Productivity Commission review of Barriers to Adaptation, intervention in insurance markets to alter pricing signals will suppress incentives for the community and governments to address the underlying risk. Governments have a role to play, particularly in ensuring that appropriate incentives are in place for reducing and mitigating risk. When public policy intersects and mandates a quick social policy response in private markets,

there is potential for longer-term impacts and distortions that can lead to some insurers reducing or withdrawing their market presence, reduced competition and potentially market failure with risk pushed back to governments, and ultimately taxpayers.

- North Queensland consumers are responding to premium increases within the context of the impact upon their household and business budgets. However, the concept of insurance affordability must be discussed in the context of value, which is in turn driven by the risk profile, coverage of the policy itself and propensity to make a claim. Raising affordability concerns solely on the basis of an individual's capacity to pay a risk premium does not acknowledge the risk-based pricing nature of insurance, and misrepresents the nature of potential solutions.
- Issues under consideration in the Treasury Discussion paper are best resolved in a broader framework developed under the guidance of the **Financial System Inquiry** process currently under way. Moreover, the ICA notes that framework issues around how risk is allocated in the economy is also expected to be considered in the **Productivity Commissions Inquiry into Natural Disaster Funding**. Policy development on the level of competition and pricing issues for strata insurance in Queensland will be improved following evidence supplied from the Australian Government Actuary 2014 review into strata insurance pricing. The ICA submits that actions prior to these processes being finalised could result in perverse or counter-productive outcomes. Where risk should lie is becoming increasingly complex as economic losses caused by natural peril are continually rising exacerbated by the rapid accumulation and aggregation of risk due to increased urbanisation and build up of infrastructure. With this comes increasing pressure on the insurance industry. Insurance is socially valuable and an effective tool for transferring and mitigating risk. However, the expectation that insurance alone can bear this risk is not realistic. It is important that the complexities in this debate are understood and considered holistically rather than focusing the debate solely on the price paid by consumers.
- There is no known evidence to suggest that aggregation of building insurance products has been successfully implemented by insurance markets internationally. Unlike motor insurance, which in some markets can be responsive to aggregation due to its common and homogenous characteristics, building insurance is not easily aggregated. Building insurance relies upon the unique circumstances of each property's location, design, materials and age, as well as different sales channels. The ICA contends that:
    - Though aggregation might deliver some consumer impacts with simple products such as motor insurance, complex products such as home insurance would require information that would be unfeasible to obtain, maintain and manage through an aggregator service without expending any perceived savings through increased insurers compliance and transaction costs.
    - Some building insurance products are sold through insurance brokers, not direct to consumers, which makes direct comparisons problematic.
    - Forced aggregation of products in a market such as North Queensland will not provide the pricing outcomes sought by government and may only serve to

again highlight the underlying risk factors in the region and the absence of solutions.
    - Aggregation in the North Queensland market could stimulate insurers, who must carefully manage exposure in this high hazard region, to use the aggregator service to reduce market share rather than compete to gain more.
    - Any aggregator arrangements must be supported by full disclosure of the interested parties.
- Compliance costs for the aggregator options put forward by the discussion paper are likely be considerable and would further exacerbate premiums in North Queensland. Individual insurer submissions may provide additional data on specific compliance costs, taking into account the nature of their own operations.
- The ICA supports the concept of a scheme to provide access to strata building engineering inspections as developed with James Cook University (JCU). The ICA welcomes the budget allocation of funding to pursue such a scheme and emphasises that any such scheme should operate in accordance with five simple objectives designed to facilitate consumer choices:
    - A Body Corporate should be provided with a grant from government that can be used to fund or co-fund an engineering inspection and reporting process for their building.
    - The engineering inspection should be carried out by qualified personnel in a manner consistent with the processes identified by JCU.
    - The report produced should identify building issues that could lead to an increased risk of damage during extreme weather and should identify possible rectification options for the body corporate to consider.
    - The engineering report produced should be retained by the Body Corporate and be able to be used as a tool to negotiate with as many strata insurers as they wish to approach.
    - The report produced should be provided to JCU for research purposes, to assist with identifying long-term trends in construction and building issues for Australia's most cyclone-prone region.

- Noting that current policy settings already allow unauthorised foreign insurers (UFI) to access the Australian market, which has not occurred in any material way, unspecified changes further encouraging the entry of UFIs are not expected to fundamentally alter pricing in North Queensland. Any UFI would still face the underlying risk factors accompanying property insurance in North Queensland. Additionally, participation in such a market may also be constrained by the investments needed to secure systems in identifying risk to a satisfactory confidence level. The ICA believes all insurers operating in Australia should do so on a level playing field, subject to the same laws and regulations, Notwithstanding this, in the event that policy or prudential settings were to be adjusted to encourage a UFI to participate, the ICA considers participation should be ringfenced and limited to Far North Queensland and that the consequences of doing so need to be spelled out for consumers. These consequences include:

- The absence of access to the Financial Claims Scheme
    - The absence of any ad-hoc political driven post-event funding in the case of absence or disappearance
    - Lack of access to domestic consumer protection and prudential arrangements
    - Lack of protection from the General Insurance Code of Practice
    - Comprehensive consumer disclosure by government regarding the removal of these protections.
- ICA believes that the most effective measure to provide immediate relief to North Queenslanders has not been canvassed by the paper, but has been recommended by all relevant inquiries and reviews over the past decade. Immediate taxation relief on insurance products, particularly those that the state has made compulsory and then proceeds to charge a stamp duty against (strata), would provide immediate premium relief to all Queenslanders.

  The ICA proposes that consideration should be given to exempting mandatory insurances (such as is the case with strata) from the levying of stamp duties.

  The ICA notes that the Queensland Government expects to collect from general insurance policyholders, $871 million in this fiscal year and more than $4 billion dollars from 2013-14 to 2016-17. Not only is this level of revenue collection a disincentive for Queenslanders to be adequately insured, it is also a considerable cost burden on household budgets, directly increasing the cost of risk based insurance premiums.

Importance of getting the framework right – awaiting the finalisation of the FSI

The release of the Treasury discussion paper on North Queensland insurance markets is taking place at the same time as the Commonwealth is considering the future of Australia's financial system. The Insurance Council has lodged a comprehensive submission to the Financial System Inquiry (FSI) emphasising the fundamental importance of settling a lasting and durable framework for the financial system and within that system, the critical role that efficient insurance market settings play in managing risk in the broader economy.[1]

Fundamentally, the ICA contends in its submission that with the appropriate regulatory and policy settings, the opportunity exists to widen the capacity of the financial system to manage insurable risk, and with that, to relieve the remaining sectors of Australian society (namely individuals and government) of having to bear risk and loss. As the ICA outlined in its submission to the FSI:

> "*The current review of Australia's financial system has the unique opportunity to embed into Australia's future policy making the key role that insurance plays in the system and the wider economy. Importantly, the review has the opportunity to*

[1] See Insurance Council of Australia submission to the FSI available at www.fsi.gov.au

articulate a lasting and durable framework from which future policy makers will draw. Simply, the Financial System Inquiry has the potential to settle ad hoc policy debates in the sector and to establish the conditions under which insurance markets operate effectively and efficiently in the future and risk is allocated in the economy to those with the least cost capacity to bear such risk."

The ICA also notes that other stakeholders and regulatory agencies have submitted similar views to the FSI on the importance of pursuing a Wallis-like framework for the financial system and the challenges that arise in the absence of such a framework from ad hoc and uncoordinated policy development.

Further, some submissions have sought to raise policy issues and directions, directly relevant to the broader matters under question in the North Queensland discussion paper. For example, both the Treasury and the Australian Securities and Investment Commission (ASIC) submissions raise concerns with the application of financial disclosure arrangements, with Treasury arguing that there exists a broader challenge to establishing cost effective approaches to consumer sovereignty including "*the scope for promoting market solutions by redesigning disclosure requirements for the digital age to enable the growth of information intermediaries that can apply expertise in presenting information in an effective and digestible way*". [2] The Treasury also urges the FSI to explore the scope of enhancing the efficiency and competitive arrangements in insurance markets especially in those segments with limited participation.

In its submission to the FSI, ASIC also urged a rethink of disclosure and competition, including submitting a proposal to include an explicit competition goal in ASIC's charter. ASIC suggested that existing disclosure arrangements have reached their limitations as a policy framework and that there was potential to "*improve regulatory design with a better understanding of consumer behaviour and decision making".* [3]ASIC also articulated that so called "choice engines", when designed "responsibly" can also add to competitive tension between product and service providers providing consumers with potentially greater choice, better quality and competitive prices.

The ICA's preference is for the fundamental insurance framework to be settled through the process of the FSI and, following the release of the FSI final report and recommendations, that policy development in insurance markets adhere as best as possible to the framework developed. In this regard the North Queensland paper – though topical - could be said to be premature and, in order to ensure a more durable policy development process, should at least await the conclusion of the FSI process.

ICA contends that more immediate relief for policyholders is within governments' grasp through targeted taxation relief in high hazard areas or on insurance products, in particular those that are mandatory.

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[2] See The Department of the Treasury's submission to the FSI available at www.fsi.gov.au
[3] See Submission by the Australian Securities and Investment Commission to the FSI available at www.fsi.com.au

Understanding premiums in Queensland

The discussion paper asserts that "*average premiums for combined home and contents insurance in North Queensland are around 2.5 times those in Queensland's southern cities*" and "*that average premiums for combined home and contents insurance for a sum insured of about $300,000 for building and $80,000 for contents can range from around $3,000 to around $6,000 per year for properties with no or negligible flood risk*".

This assertion requires examination in order to establish a firmer foundation upon which to value Treasury's propositions to address affordability issues:

Average Premiums - North vs South

Table 1 provides a snapshot for the average premium and sum-insured for two postcodes in North Queensland and two postcodes in Southern Queensland[4]. A subsequent examination of the quantum and drivers behind those differences is relevant to the proposals canvassed in the discussion paper.

Northern Queensland Case Study Postcodes		Southern Queensland Case Study Postcodes	
Townsville	**Cairns**	**Ipswich**	**Toowoomba**
Postcode 4812	Postcode 4870	Postcode 4305	Postcode 4350
Average Premium Paid In Postcode **$2,162**	Average Premium Paid In Postcode **$2,191**	Average Premium Paid In Postcode **$1,314**	Average Premium Paid In Postcode **$1,090**
Average Sum-Insured in Postcode **$417K**	Average Sum-Insured in Postcode **$441K**	Average Sum-Insured in Postcode **$392K**	Average Sum-Insured in Postcode **$434K**
Average Premium for $380K Combined Home & Contents **$1,970**	Average Premium for $380K Combined Home & Contents **$1,887**	Average Premium for $380K Combined Home & Contents **$1,273**	Average Premium for $380K Combined Home & Contents **$954**

Table 1 – Example Average Premiums and Sum-Insured Comparison Northern Postcodes v Southern Postcodes

The ICA supports the position that there is a differential in average premiums between the southern and northern postcodes of up to 2.5 times. However, the average premiums quoted in the discussion paper for a sum-insured of $380,000 at a non-flood risk location appear inflated.

The ICA believes this inflation could inadvertently create the perception with many stakeholders that average premiums in Queensland are 100 to 300 per cent higher than reality, potentially distorting the context upon which policy decisions are being made.

[4]Based upon submission to the ICA of Total Sum-insured, Total GWP and Number of Policies in Force for Home/Home & Contents for 2,500 individual postcodes in Australia, from greater than 80% of the insurance market.

Why is there a difference in risk premiums?

The discussion paper identifies the higher proportion of claims payout for Queensland compared with other states. The drivers behind this are principally that Queensland, and in particular North Queensland, are exposed to more natural hazard events. Figure 1 below provides a stark illustration of cyclone exposure in Queensland, with northern regions experiencing far more frequent events.

Figure 1 – Path of cyclones over previous 100yrs

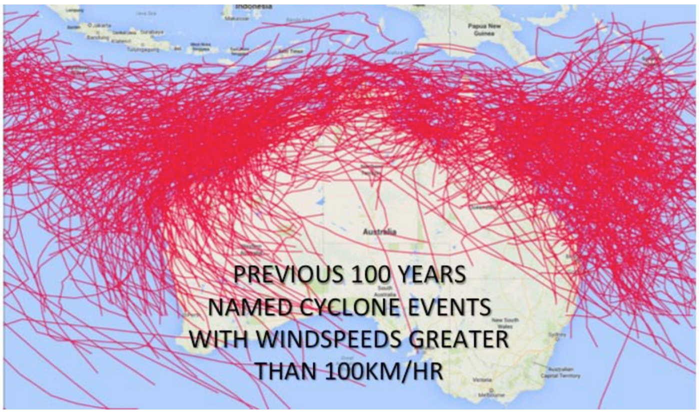
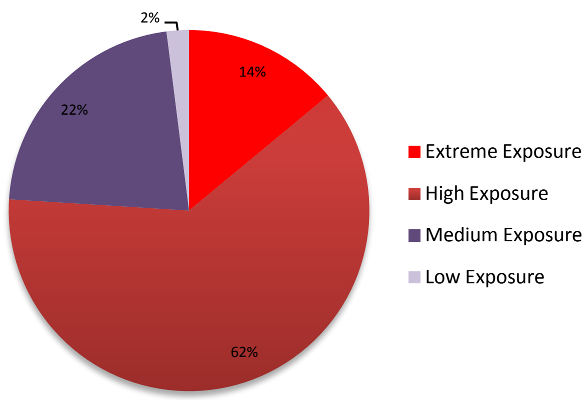
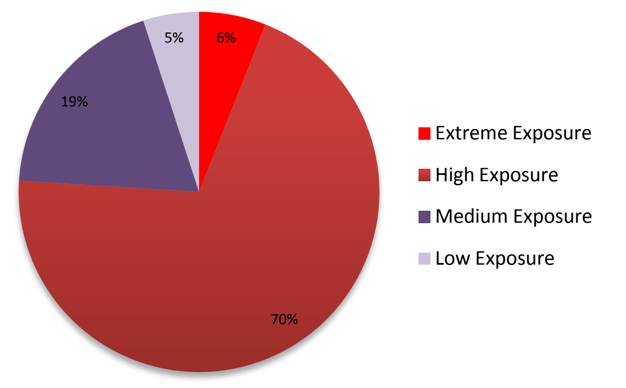
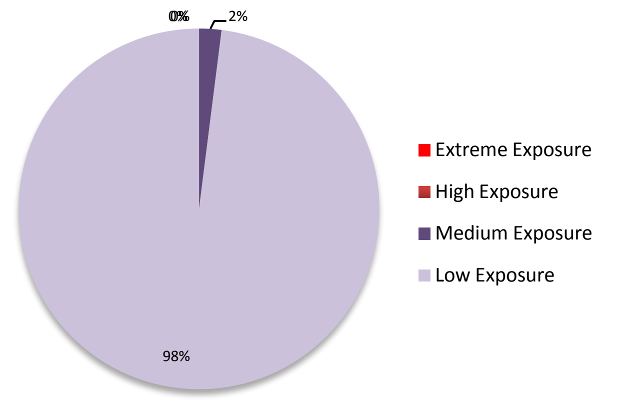
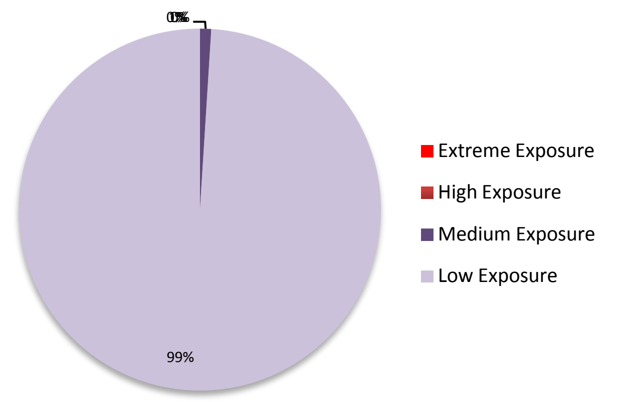


Table 2 takes this macro level data and illustrates its relevance to pricing at postcode level. Demonstrating that one of the key factors driving price differential between North Queensland and Southern Queensland is the material difference in exposure to cyclone winds. Similar examples focusing on flood, earthquake, storm and tidal surge exposure can be provided for these northern and southern postcode examples.

	Postcode	Individual Address Exposure to Extreme Wind (Cyclones > 100kmh)
North	4812 (Townsville)	

	4870 (Cairns)	
South	4305 (Ipswich)	
	4350 (Toowoomba)	

Insurance pricing in Far North Queensland, and in Queensland more broadly, is reflective of the underlying hazard profile, as well as the regulatory and capital conditions under which Australian licensed insurers are required to operate.

North Queensland properties face natural hazards at a greater frequency and intensity than other regions, yet are constructed using (with some minor enhancements to protect life) the same principles as buildings in other states. As identified in the discussion paper, and underlined by the Phase 1 JCU report into strata property, addressing the underlying risk

factors faced by North Queensland property is the only sustainable solution to reducing risk premiums.
The ICA has noted a common misperception among some political commentators. Some stakeholders have suggested that as the media rarely shows collapsed and totally destroyed buildings following a cyclone, that the insurance industry is overstating the position regarding the level of damage that these events deliver. This misperception can be addressed by breaking down the amount of claims and different categories of loss from Cyclone Yasi.

The value of insured damage arising from Cyclone Yasi was in excess of $1.3 billion and the number of claims was 74,000, with a breakdown of claims comprising:

- 28 per cent repair to homes/units
- 27 per cent damage to home and contents
- 19 per cent damage to commercial property
- 13 per cent damage or loss to domestic vehicles

Less than 1 per cent of total claims from Cyclone Yasi comprised total loss of domestic buildings.

Excluding total loss of domestic buildings, examples of Cyclonic Event damage to homes/units included:

- Water ingress to basement – damage to lift motor room, lift, garage doors and other electrical infrastructure
- Water entry via roof – replace and repaint ceilings, potential damage to electrical systems and replace carpet and soft fit to buildings
- Wind and debris damage – replace cement render and paint, repair fence and guttering damage
- Wind – roof mounted antennae damage resulting in damage to roof and subsequent water ingress damage

Are premiums unaffordable in North Queensland?

The concept of insurance affordability is an elusive notion that is challenging to measure in a meaningful way without also taking account of the value of the product.

Though an insurance premium for a cyclone-prone location will be higher than for a non-cyclone prone location, the consumer with a higher cyclone exposure has a higher probability of making a claim and therefore receives a greater value from having the cover.

The ICA does concur with the sentiment that over recent periods, community concerns around the affordability of insurance in North Queensland have increased. As the discussion paper outlines, a fundamental driver of premium increases in recent periods has been an adverse claims environment as evidenced by the gross loss ratios experienced for property classes.

Providing a definition of what constitutes an affordable insurance premium is, by nature, normative. By its very nature, an insurance premium is the consideration payable for a contract under which a risk-adverse party seeks the security of a known payment when faced with a loss from an uncertain event. In this regard, each premium payable includes an amount set aside by the insured party themselves for any unexpected future loss incurred.

To the extent that an insurance premium is considered unaffordable regrettably misunderstands insurance markets in so far as the price of the insurance contract (and risk transfer) is exogenous to commonly applied understandings of affordability, such as income and the cost of goods and services sold.

There are also a number of important background and behavioural factors in Australia that need consideration in this debate:

- Consumers in Australia often see insurance as a grudge purchase. As outlined in the ICA submission to the FSI, although rational individuals might be expected to weigh the costs and benefits of buying insurance compared with self-insuring and appreciate the benefit of paying a relatively small certain amount against the likelihood of a very large uncertain loss, insurance is often not perceived this way. Rather, individuals consider that paying premiums to insurance companies with no perceived return is unfair, and insurance cover becomes a grudge purchase (except of course at the time of claim).
- There is a growing expectation by consumers that governments will intervene and provide protectionist measures for individuals. Consumers using new communication platforms such as social media are relatively more powerful about demanding action and intervention by governments. This is often true for minority groups as well. Extensive media and social backlash from such campaigns then leads to public policy responses that tend to be reactive and focused on quick wins that may not adequately consider the longer-term potential for unintended consequences.

Competition in North Queensland Insurance Markets

The ICA notes that fewer insurers offer cover, both home and strata, in North Queensland than elsewhere in Australia. There are a number of factors driving this, the strongest of which relates to the underlying risk profile and the capital requirements that an insurer must comply with in order to operate in the market.

There has been no evidence provided to date that suggests the number of insurers operating in Northern Queensland has materially impacted upon contestability and therefore insurance. In 2012, the Australian Government Actuary (AGA) concluded prices in the region were not unreasonably high when assessed against the underlying risk. Though the return to sustainable strata pricing since the 2012 report will be reflected in sustainable profits, there has been no evidence to suggest that insurers are pricing excessively in light of the extant risks.

The extent to which higher risk profiles are driving factors for high insurance prices was again demonstrated following the failure of the One Big Switch churn campaign to attract an insurer for the North Queensland market – even the most aggressive competitors in the market find the loss profile in the region unpalatable. If the Coles/Wesfarmers venture had offered One Big Switch customers insurance options in North Queensland, it is probable that the insurance pricing offered would have been dominated by the risk profile in the region, as the insurer would still be required to operate prudentially. Prices would conceivably have been up to 2.5 times the prices offered in less hazardous regions, if offered at all (in this case, not offered).

Uncertainty regarding the natural perils risk in Northern Queensland is the same level of uncertainty that exists in all regions. Industry is undertaking measures to reduce uncertainty by working with state and local governments. However, refinement of the hazard profiles is unlikely to reduce the relativity of hazard impacts between North Queensland and the rest of the country.

The AGA also noted that with the return to a more sustainable level of insurance pricing in strata insurance, the market may respond with more insurers wishing to participate. ICA has noted increased interest in the strata market as a result of a return to acceptable loss ratios. However, many of those insurers who have flagged interest have also signalled concerns over government intervention in the market that would reverse the progress made by free market forces.

ICA contends that developing further conclusions about the state of the market in Northern Queensland is premature and should be considered only once the AGA's 2014 report is released and understood. Should the AGA report indicate that profitability is returning to the Queensland market, government intervention may not be necessary and attention could be focused on removing other pricing impediments that against the interest of the consumer, such as state taxes and levies.

Aggregator and Comparator Options

The discussion paper seeks views on whether the development of a comparison or aggregation service would reduce transaction costs in a region such as North Queensland or even more broadly.

Treasury has used the UK Motor Insurance Market as an example of where aggregation has had an impact on insurance pricing, to the apparent benefit of consumers.The supposition that such arrangements might be successfully translated to the home and/or strata markets in North Queensland is fundamentally flawed and would be unlikely to succeed.

The ICA submits that the risk profile in North Queensland means insurers must prudentially manage their exposure with great care, arguably more so than in other regions. As a result, insurers' appetite for such risk is limited. The operation of an aggregator or comparison service for the region may have unintended consequence, with insurers undertaking insurance pricing designed to reduce their exposure, rather to compete to gain market share.

With respect to a full-service live aggregator service, it is also worth considering that home and/or contents insurance in North Queensland (NQ) is exceptionally complex and includes diverse products across a number of different sectors, including private occupied properties, rental properties, commercial property (including agricultural business) and holiday rentals, and across diverse geographic areas.

Considering this high level of diversity, plus varying degrees of risk, individual insurers have estimated that about 150 different questions will need to be asked to determine an accurate quote. Navigating such a process will be highly time consuming and complex for consumers. Further, each insurer has its own distinct underwriting criteria and a direct comparison between insurers may not appropriately reflect this difference.

Treasury’s spectrum of options ranging from a comparison website providing information on products and snapshot pricing, through to a full-service live aggregator providing property specific price quotes and sales, each have merits and flaws if government intervention in the market is pre-ordained.

Individual insurers will have their own views on each proposed model and the potential compliance costs that might be incurred, and necessarily passed on to consumers.

Noting the previous government interventions in markets – such as Grocery Watch and Fuel Watch –have had little success, the ICA submits that if government-sponsored aggregation or product comparison is unavoidable, in this instance it be carried out with the following principles in mind:

- Participation by insurers should be voluntary
- The focus should be only on product features and not on price
- A genuine and rigorous cost benefit analysis that also considers the cost impact of ongoing compliance costs on consumers should be undertaken
- Any disclosure of pricing should include full disclosure of the government taxes and charges added to the risk premium
- Government should accept liability for advice given through the service to consumers.

As an alternative to an aggregator service, the government might consider applying resources to a specialist broker service that could take clients over certain thresholds of hazard exposure and work with the industry in an attempt to place the business competitively.

Several well-placed broker services could facilitate this for government. These are mechanisms that the industry and community are familiar with and would serve the further purpose of assisting government to understand circumstances where hazards are beyond the appetite of all insurers and hazards are beyond the capacity of communities to tolerate. This alternative leverages existing financial structures in the Australian market and has the advantage of being non-interventionist and achievable.

With particular regard to strata insurance, the concept of an aggregator or comparison service is fundamentally flawed. Strata insurance is an intermediated product by nature; it is not available to the average consumer via the internet or over the phone. Brokers and agents provide advice and a range of quotes to body corporates for them to consider, after examining a large range of factors unique to each building. The implementation of an aggregator function would simply not be able to provide a usable service to consumers, would displace brokers and also remove from body corporates the advantage of having an insurance expert provide advice on relevant products as well as leveraging policies across multiple body corporates and associated discounts.

The ICA submits that if the 2014 report of the AGA indicates that there is a return to profitability in the North Queensland strata market, than when measured in 2012, that government should not intervene to attempt to artificially increase competition further. Government should allow the market to operate unhindered, and should focus more appropriately on removing the direct charges that government adds to the cost of an insurance premium.

The role of Unauthorised Foreign Insurers (UFI's)

The broader role of UFIs in the Australian insurance market has been the subject of extensive policy making application over the past decade. Following the release of the HIH Royal Commission in April 2003, and in response to a recommendation of the Commission, the Commonwealth initiated a review of the appropriate regulatory settings for the both Direct Offshore Foreign Insurers (DOFIs) and Discretionary Mutual Funds (DMFs).

The so-called Potts review recommended tighter regulation of the prudential and marketing arrangements of DMFs and DOFIs. In late December 2005, the Commonwealth initiated a discussion paper process on how best to implement the recommendations in the Potts review. Subsequently, in 2007, the Commonwealth introduced the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act,* which governs the arrangements applicable to foreign insurers today.

However, the NQ Discussion paper is now seeking to disturb the regulatory settings governing foreign insurers notwithstanding the extensive consultations and decision that have characterised decision making on this matter in recent years. In this regard, the case for change must be premised on the basis that any changes to the regulatory settings for UFIs would outweigh their costs, including any future costs that may arise from the absence of prudential and consumer protection.

The current exemption under which UFIs may write insurance in Australia therefore reflects a bipartisan approach to balancing the need for protection for Australian business and consumers with the acknowledged need that some insurance will not be able to be placed in Australia[5]. It is currently open for a broker to use the third limb of the exemption in order to put business with a UFI by certifying that a risk cannot be reasonably placed with an Australian authorised insurer.

The fact that this is not happening now (giving rise to Treasury's proposal) would indicate either that UFIs are unwilling to provide home and strata-title insurance for North Queensland on better terms than Australian authorised insurers, or that the brokers are unconvinced that it would be in the consumer's best interests to place the insurance offshore. For example, a broker may have doubts that the claims process would be as certain or convenient.

It would be a significant distortion of the existing well-designed exemption to classify home and strata title insurance as an atypical risk, thereby enabling brokers to place the insurance with an UFI without having to certify that it could not be reasonably placed with an Australian authorised insurer. However, given that there is no evidence that certification is a barrier to insurance being placed with a UFI, it is unlikely that this relaxation would result in any more insurance coming into the North Queensland market.

The discussion paper could be read as suggesting that the exemption regime be disregarded and UFIs be allowed to sell insurance directly to Australian consumers without having to meet the stringent requirements of the Australian prudential regime. As explained below, this could lead to consumers being left significantly exposed to unmet or poorly managed claims.

Consequences for locally unauthorised insurers if UFI restrictions were relaxed

If home and strata title insurance in North Queensland were recognised as atypical risks, given the level of risk involved in providing such cover, it is not expected that there would be significant UFI interest. However, opening the market to competition from insurers that do not have to meet Australian prudential requirements could well deter potentially new players among Australian authorised insurers from considering whether they could profitably offer these covers.

If the suggestion is that UFIs be allowed to sell insurance in North Queensland without prudential compliance, the consequences for the Australian general insurance industry would be far more serious. The cost advantage to UFIs would be such that Australian authorised insurers could well be forced to leave the North Queensland market.

Risks associated with relaxing restrictions on UFIs

Relaxation of restrictions on UFIs, either by making home and strata title atypical risks or lowering prudential requirements for UFIs, would leave consumers potentially exposed to considerable uncertainty.

The Treasury NQ discussion paper outlines some of the tradeoffs associated with relaxing entry for UFIs to allow them to participate in the Australian market (and NQ in particular). For example, the discussion paper canvasses the concept of restricting access to the Financial Claims Scheme should not apply in respect of insurance purchased through a UFI. Though an appropriate trade-off, the ICA contends that this measure is necessary but not sufficient to extend/relax regulatory arrangements to allow UFIs access into the Australian insurance market. In this regard, the ICA recommends a principles-based approach should govern the regulatory settings for UFIs in the Australian insurance market and these principles would include:

- No access to the domestic Financial Claims Scheme by any purchaser of an insurance product purchased through a UFI.

- No access to domestic consumer protection arrangements such as the Financial Ombudsman Service and the General Insurance Industry Code of Practice. In the event of a dispute, insureds would seek remedy and restitution through the courts in the relevant jurisdiction.

Taxation of Insurance Products in Queensland

Regrettably, the NQ Discussion Paper does not discuss the impact of state-based taxation on the purchase of insurance products in Queensland. Moreover, following the increase in the applicable stamp duty rate from 7 per cent to 9 per cent in Queensland in 2013, the cost of insurance in FNQ increased accordingly.

The ICA has long submitted that specific taxes on insurance premiums, whether in the form of stamp duties or levies to fund fire and emergency services, should be abolished. This view is consistent with the recommendations of the Review of Australia's Future Tax System and many other inquiries. However, the ICA recognises the revenue implications of such a removal and has put before policy makers several alternative funding arrangements, including the option to address revenue shortfalls through improving existing state taxes such as payroll and land. [6] The latter "tax mix switch" model has been successfully deployed in the ACT.

Notwithstanding that the preferred approach to insurance premium taxation remains the complete abolition of all state taxes on insurance, there remains scope for taxation reform options in the transition to their full abolition. In the case of mandatory insurance for strata properties, there remains the viable option that, given the purchase of insurance is mandatory under State government law, then the purchase of such insurance be exempt from stamp duties.

An exemption for stamp duty on insurance for strata buildings would be consistent with the treatment of other compulsory insurances required by respective State government law. For example, the requirement to compulsory purchase third party motor personal injury insurance in Queensland results in this form of policy being exempted from stamp duties.

The ICA contends that the case for compulsory insurance purchase rests on the need to improve the operation of the insurance market in the particular class by avoiding counterparty risk. In the case of strata insurance, the absence of compulsory insurance may impose disproportionate burdens/costs on remaining unit holders in the event that a unit holder had insufficient capacity to meet any losses from an unforseen event. In that regard, it is appropriate that the lowest cost solution is to mandate the requirement for insurance.

However, equally appropriate would be ensure that compulsory insurances are not required to pay stamp duties and in the case of NQ, relief from stamp duty would provide a fillip to affordability constraints. Government concerns about how insurance affordability impacts

[6] See ICA submissions to the Henry Tax Review, the NSW IPART review in State Taxation, the Victorian parliamentary review in State Taxation, the Tasmanian governments review into State Taxation and the SA Parliamentary Review into State taxation. All available at www.insurancecouncil.com.au

upon its constituents, while continuing and in some instances increasing taxation of policyholders, thus exacerbating the cost, are incongruous and difficult to explain.

Conclusion

Governments should not act to address perceived problems through regulation unless a case for action has been clearly established. Moreover, any regulatory or legislative response should be proportional to the issue or ‘problem’ being addressed.

The ICA submits that the problem has been defined in this instance through media and speculation, lacking the context and precision required in order to justify market intervention. Putting this aside, the response selected (aggregation) has not been successful in any market and has been preferred over options to either remove a direct cost impediment on consumers (taxation) or to pursue in earnest solutions that will work to reducing the actual level of damage suffered by Australian communities and businesses.

If you require further information in relation to this submission, please contact Mr Karl Sullivan, Insurance Council’s General Manager Risk & Disaster Directorate at ksullivan@insurancecouncil.com.au.

Yours sincerely

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