INSURANCE COUNCIL OF AUSTRALIA

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Australian Competition and Consumer Commission
Northern Australia Insurance Inquiry
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ICA RESPONSE TO ACCC ISSUES PAPER – NORTHERN AUSTRALIA INSURANCE INQUIRY

The Insurance Council of Australia (ICA) is pleased to provide this response to the Australian Competition and Consumer Commission (ACCC) issues paper[1] regarding costs, premiums, profits, competition, consumer experiences, risk mitigation and regulation issues as they relate to the insurance market in northern Australia.

1. INTRODUCTION

1.1. The central role of insurance in a modern economy is the transfer of insurable risk. Through the acceptance of risks and the payment of legitimate claims, general insurance products improve economic welfare in Australia by reducing the cost of self-insurance and freeing resources for more productive uses.

1.2. The voluntary[2] and wide uptake by the community of general insurance products is an essential component of the Australian economy.

1.3. In practical terms, insurance products assist to ensure that individuals and businesses can pursue economic activities secure in the knowledge that risks have been transferred to their insurer.

1.4. The impacts of risk faced by the Australian community are considerable. During the past five years alone, the general insurance industry has paid more than $150 billion in claims[3] back into the Australian community – on average $135 million each working day. Claims arising from extreme weather and other natural perils account for about $9 billion in losses a year.

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[1] https://www.accc.gov.au/about-us/inquiries/northern-australia-insurance-inquiry/issues-paper

[2] With regard to property insurance, purchasing cover is almost entirely voluntary. Consumers can choose to go 'bare' accepting the risk themselves. Strata insurance (or an equivalent mechanism) is required to be held by registered strata insurance schemes in most States and Territories.

[3] APRA data

1.5. The need for a sustainable insurance sector, supported by government and community actions to reduce risk, has recently been underlined by research from the Australian Business Roundtable for Disaster Resilience and Safer Communities (ABR).

1.6. The ABR's latest report estimates that, even without climate change factored in, annual extreme weather losses to insured and non-insured infrastructure will grow to $39 billion a year by 2050.

1.7. The benefits of a sustainable insurance industry to Australia however, should not be measured solely through a claims lens. In places with high levels of unmitigated risk, insurance premiums send a strong risk-based price signal. This signal helps inform mitigation and emergency management initiatives that make for more resilient Australian communities. In essence, insurance operates as the 'canary in the coal mine' and needs to be considered in that context.

1.8. The delivery of insurance services in some parts of Australia can be challenging, especially those regions that are highly exposed to natural perils or are remote and expensive in which to operate. In some cases these issues overlap, creating circumstances where premiums must be increased to cover frequent losses and higher-than-average claims rectification costs. This is the case in most parts of northern Australia.

1.9. Unfortunately, these challenges are not well understood by some stakeholders, which can lead to misperceptions that:

1.9.1. Insurers are overcharging consumers and making large profits, or

1.9.2. That a lack of competition is driving premiums upwards.

1.10. Paradoxically, some non-industry stakeholders maintain that both of these conditions are concurrently true. They claim insurers operating in northern Australia make high profits, but competition is insufficient and more licensed insurers should be forced to participate.

1.11. If however, the first part of this paradox was in fact correct (the claim that insurers are making large profits in northern Australia), economic market theory suggests insurers currently absent from this purportedly highly profitable market would make a rational decision to enter the market.

1.12. The reality, as investigated by the Australian Government Actuary[4] (AGA) in 2012 and 2014, is the region has historically been challenging for insurers and remains a difficult environment in which to operate.

1.13. There are many reasons for this situation. Fortunately, most are straightforward, and many have available solutions that only require commitment from governments, the community and the insurance industry to implement.

[4] AGA Strata Premiums Investigation Report 3rd October 2012, AGA Second Strata Premiums Investigation Report 23rd May 2014, AGA Home & Contents Investigation Report North Queensland 3rd November 2014

2. EXECUTIVE SUMMARY – INDUSTRY POSITIONS ON AFFORDABILITY ISSUES

2.1. **The market competitively prices risk**. Insurance operates in a volatile claims environment, with frequent periods of disaster and loss combined with an international climate of poor investment returns.

2.2. The industry is one of the most highly regulated in the world. General insurance operates under the Corporations Act and the Insurance Contracts Act, and federal, state and territory consumer laws. Insurance is overseen by ASIC, APRA and the ACCC, and at times various state government entities such as the NSW Emergency Services Levy Monitor. The Insurance Council of Australia's 48 member companies are signatories to the General Insurance Code of Practice, which commits insurers to provide outcomes for customers that are above and beyond their legal rights. Many members also abide by other codes of practice for relationships with specific industry partners, such as smash repairers.

2.3. Capital holding requirements are some of the highest globally. Insurance pricing naturally reflects these pressures.

2.4. Despite these challenges the general insurance industry is well serviced in terms of the number of participants and the range of products offered.

2.5. The industry accepts raw premiums have grown over the past decade. However, measured nationally and when changes to insured asset values are considered, premiums have grown at a rate lower than average earnings (see section 3).

2.6. **Market practices have changed over time and price signals are now more acute**. Over the past few decades there have been a number of market-wide changes regarding how general insurance for property is priced. These have created adverse price signals for those with acute exposures to hazards. These changes include:

2.6.1. Increasingly onerous risk-relative regulatory and capital holding requirements for insurers

2.6.2. Greater access to government hazard mapping and data showing where natural hazards occur more frequently

2.6.3. Widespread adoption of high-resolution risk-based pricing based on the new data that is now available

2.6.4. The introduction of expanded insurance covers (such as flood) to support consumer needs (see section 4).

2.7. **Price signals directly reflect residual risk; mitigation works to reduce premiums**. Where mitigation is undertaken to reduce risk in a measurable way, insurance premiums are able to be compressed. This can include household-level mitigation (improving a building's resilience to disasters) or through public mitigation works such as flood levees. The insurance sector has many initiatives running to encourage mitigation and stands ready to respond with lower premiums wherever possible (see section 5). Communities where mitigation works have been recently completed have experienced sharp reductions in premiums for the most vulnerable properties.

2.8. **Northern Australia has much higher exposures and claims costs**. The northern Australian insurance market is very small compared with the rest of Australia (only 4.6 per cent of Australian addresses). However, it is also disproportionately exposed to large and frequent natural disaster events. This small and exposed market is also widely dispersed and not serviced by the same infrastructure for goods and services as in the southern states, leading to claims costs being significantly higher following each disaster event.

Rebuilding costs in the region are up to 42 per cent higher than in the south. Insurers that operate in the region have implemented disaster responses plans that access rebuilding and repair capacity from around the country to combat this issue (see section 6).

2.9. **Fewer insurers operate in the north, but competition remains**. Higher claims costs, a higher frequency of events and often extreme operational difficulties in servicing claims due to the remoteness of some areas results in fewer insurers operating in the north. Despite this, consumers have a strong choice of insurance providers, offering a range of products at competitive premiums, priced at individual address level rather than by postcode. These products also compete on product features. Some insurers that cannot provide products in regions that present capital holding or operational difficulties may use postcodes to restrict where products are offered. A postcode embargo should not be confused with claims of postcode-level underwriting (see section 7).

2.10. **It is more expensive to insure in the north, reflective of the risk and claims costs**. The owners of the 4.6 per cent of properties in northern Australia generally pay more for insurance than less-exposed regions that have access to more repair and rebuilding capacity. However, the ICA suggests anecdotes pressed by stakeholders regarding the size of premiums in the north should be set aside and data collected on the actual premiums in force in the region should be preferred. From industry data, the median normalised[5] home building policy in northern Australia is estimated to be $1,350, compared with $575 in the south. While this is clearly more expensive than in the south, the median premium difference is reflective of the additional exposures and is considerably lower than the anecdotal claims made. Excess arrangements entered into by consumers in the north continue to be markedly lower than in the south, signalling that northern consumers are not seeking to lower premiums by retaining risk to the same extent, indicative of a higher propensity to lodge claims (see section 8).

2.11. **Reinsurance**. Insurer access to reinsurance for natural perils remains available and competitive. (see section 9)

2.12. **Insurer performance is satisfactory but not strong**. The Australian market operates in a volatile claims environment and poor investment climate. Net profit after tax for the year ended September 2017 for the industry was $3.0 billion. This is down from $3.1 billion in the previous year, and down about 25 per cent from the 15-year average of about $4 billion. The industry's return on net assets in the year to September 2017 was 11 per cent. This is down from 11.2 per cent in the previous year, and is much lower than the 15-year average of about 15 per cent. The industry's return on investment in the year ended September 2017 was 3.0 per cent. This is down from 4.3 per cent in the previous year and about 3 percentage points lower than the 15-year average of about 6 per cent (see section 10).

2.13. **Insurers have not left the market in northern Australia**. No significant insurers have left the market in northern Australia in the past decade. However, some have modified their underwriting requirements over time, avoiding properties where the risk is considered beyond their capacity to service or expertise to manage. Many state-specific insurers and

[5] Industry has supplied ICA with almost 10 million active policy records (Policy-in-force) covering addresses in northern and southern Australia, showing, amongst other things what each individual policyholder spent on insurance premiums and what sum-insured was purchased. Insurance policies are highly competitive and configurable, in order to meet highly variable consumer needs. Comparing the premiums of neighbors is entirely arbitrary unless both neighbors are insuring for the same amount (sum-insured) and the same retention of risk (Excess). To make comparisons between policies it is important to normalise to a consistent sum-insured and excess. In this paper normalised premiums refer to premiums that have been adjusted as if all policies have been purchased by all policyholders for a consistent $350,000 sum-insured and $500 excess.

speciality providers have never operated in northern Australia due to the increased exposures and challenges with operating in remote areas (see section 11).

2.14. **Independent pricing**. The ICA is not aware of evidence to suggest that pricing independence is impacted between insurers belonging to a group structure. Indeed, the sharing of common systems and logistics can lead to cost savings. There is clear evidence that brands operating within a group offer different products, servicing different demographics at varying prices, and compete with each other (see section 12).

2.15. **Barriers**. The high risks and operational challenges in northern Australia pose barriers to entry for insurers unable to:

2.15.1. Meet the stringent regulatory and capital requirements

2.15.2. Deploy the functional capacity to manage claims in the region.

2.16. Authorised foreign insurers may already operate in northern Australia. Despite perceptions that insurers are making high profits in the region, few foreign insurers have entered the market. The challenges and costs involved effectively restrict sustainable participation to those with the capital and underwriting experience to do so (see section 13)

2.17. **Disclosure**. Improving transparency and disclosure are priority issues for the industry, both of which require further and ongoing work (see section 14).

2.18. **Data for consumers**. The availability of unambiguous risk data for consumers is a prerequisite to consumers making informed decisions about preparing for natural disasters. The ICA's strong view is that providing this data is a matter best left to governments and importantly, should be provided to consumers at the time of purchasing property. However, in the absence of government activity to do so, the ICA has developed consumer-facing resources[6] for industry use and to demonstrate the ease with which it can be achieved. (see section 15)

2.19. **Government taxes, duties and levies**. The impact of taxes, duties and levies on policyholders remains considerable and adds significantly to the cost for consumers. The impost of these government costs on those with acute exposures (and therefore higher base risk premiums) is a disproportionate burden and a strong disincentive to insuring adequately. The ICA strongly encourages the ACCC to carefully examine the significant social and economic benefits of phasing out government charges for northern Australian communities who choose to purchase insurance (see section 16). Any reduction in insurance taxes in northern Australia should ultimately be extended to all insured property owners.

3. INSURANCE COMPETITION IN THE BROADER AUSTRALIAN MARKET

3.1. The ICA recently contributed to the Productivity Commission review of competition in the financial services sector.

3.2. During that process, a number of credible stakeholders and observers were identified as having positive views of the level of competition in the general insurance market, including:

3.2.1. **APRA**. In a recent *submission to the Senate Inquiry* (see page 2) into Australia's General Insurance Industry, APRA submitted that:

[6] The ICA DataGlobe provides address level hazard data (non-underwriting) and the ICA Building Resilience Rating Tool is a pilot providing the capacity for a consumer to determine if there are any aspects of their building that are vulnerable to the hazards in their location.

"*The personal lines market continues to display healthy competition. Incumbents have maintained a competitive position in all classes of business, while coming under increasing pressure from challenger brands such as Auto and General, Youi and Hollard, which continue to grow their market share. Large retail groups are also continuing to have an impact, as they seek to gain market share, particularly in the domestic motor class of business*"

3.2.2. APRA also states (page 20 in its *2015 Annual Report*) a number of new entrants, particularly authorised subsidiaries and branches of foreign insurers, have entered the personal and commercial lines markets over the past decade, offsetting the general trend towards consolidation and adding to the level of competition present.

3.2.3. **Australian Treasury**. In the *Australian Treasury submission to the FSI*, Treasury concluded competition and contestability had intensified across the general insurance sector in recent years. Treasury further states new entrants have been offering a range of general insurance products and capturing market share by advertising aggressively and offering cheaper premiums and/or enhanced product features. It noted a number of new entrants are offering online services only, and that incumbents are responding by establishing low-cost competitors that operate online.

3.2.4. **Financial Systems Inquiry (FSI)**. The *FSI Interim Report* has made a similar assessment on the level of competition in the general insurance industry, observing that although the insurance sector has generally become more concentrated, some trends are moving in the opposite direction. The Interim Report remarked new insurers have entered the market, and added that banks and retailers have also entered the insurance market, some by rebranding products provided by traditional underwriters, others by conducting the underwriting themselves .

3.2.5. **PwC**. The *Insurance facts and figures report* published by PwC in May 2016 reported the insurance industry is experiencing increased levels of competition from new insurers. It stated that two new insurers' market shares consistently increased since their introduction into the general insurance market. The penetration and consistent growth of new industry participants are widely acknowledged indicators of healthy competition.

3.3. Notwithstanding the views of these independent sources, the ICA is aware of significant level of public interest in premium trends and a perceived correlation between those trends and the level of competition.

3.4. To help facilitate a longer-term view of premium trends the chart below (figure 1) includes data spanning more than 15 years[7]. The chart shows that home insurance premiums in Australia increased at an average annual rate of about 8 per cent over the past 15 years to September 2017, with notably subdued growth over the past three years, rising at an average annual rate of about 2 per cent. Importantly, this does not reflect changes in the underlying value of the assets being insured and building costs.

3.5. Growth in costs incurred by the industry is far higher than premium increases. The chart shows the average claim size for home insurance in Australia increased by an average

[7] Based on June quarter 2017 data from Insurance Statistics Australia. Data has been trended to remove short-term volatility.

annual rate of 9 per cent over the past 15 years, noting, the extreme volatility caused by the impact of severe natural catastrophe events.

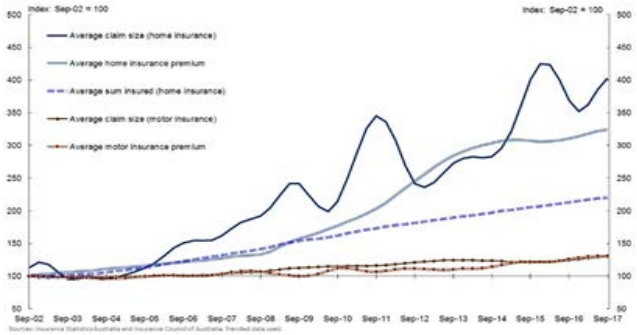

Figure 1 - 15yrs Indexed Premium and Claims Growth, ISA Data

3.6. The perceived correlation between premium trends and competition between providers (or lack thereof) has been the subject of many public inquiries in recent years.

3.7. In particular, this matter was explored in the Senate Inquiry into Australia's general insurance industry (Senate Inquiry) last year, to which the ICA made a submission[8].

3.8. The Report of the Senate Inquiry was released on 10 August 2017 and included a detailed section canvassing its assessment of general insurance premiums. The Senate Committee concluded[9] that

> "… premiums remain commensurate with the level of risk", and that it
>
> "… does not propose to examine premium increases or their justification further …"

3.9. The AGA investigations[10] from 2012 and 2014 also identify strong premium growth across Australia, most notably in the north, correlated with the levels of natural peril risk and claims experience of insurers. The AGA contends that insurers have been able to implement premium growth in the north of Australia unrestrained by competitive forces.

3.10. In something not unlike the 'chicken and egg' dilemma, the ICA submits that the high levels of natural peril risk and consequential amplified claims costs are the pre-existing conditions that in turn restrain some smaller insurers from being able to offer competitive or sustainable products in the region.

3.11. Suggestions that high premiums can most simply be explained by a lack of competition fail to recognise the unique nature of high-risk regions and the regulatory and operational frameworks within which insurance must operate in Australia.

3.12. For example, these suggestions do not consider the different underwriting criteria and risk appetites of different insurers competing in a market. They do not consider the much higher levels of exposure to natural hazard risk. They fail to account for the much greater operational and consequential capital costs involved in offering sustainable cover in remote and non-urban regions.

3.13. The ICA also believes it is critical for stakeholders to consider the underlying claims and underwriting conditions for those markets, as well as changes to insurance products and

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[8] Insurance Council of Australia submission to the Senate Inquiry into Australia's general insurance industry, 17 February 2017

[9] Final Report of the Senate Inquiry into Australia's general insurance industry. 10 August 2017. Pages 20-21.

[10] AGA Strata Premiums Investigation Report 3rd October 2012, AGA Second Strata Premiums Investigation Report 23rd May 2014, AGA Home & Contents Investigation Report North Queensland 3rd November 2014

pricing methods over time, before forming judgments about any relationship between higher premiums and competition in some regions.

3.14. The ICA suggests that, within this context, the broader Australian market should be considered as fundamentally competitive.

3.15. **Premium growth compared with average weekly earnings**. Some stakeholders have referred over time to the growth in insurance premiums compared with growth in average weekly earnings. Though the two factors are unlinked (one does not drive the other in any way) the perception that insurance costs are outstripping household capacity to pay is relevant to address.

3.16. Figure 2, below, shows the indexed growth in premiums (industry data) compared with average weekly earnings (ABS data) from 2008-09 to 2015-16.

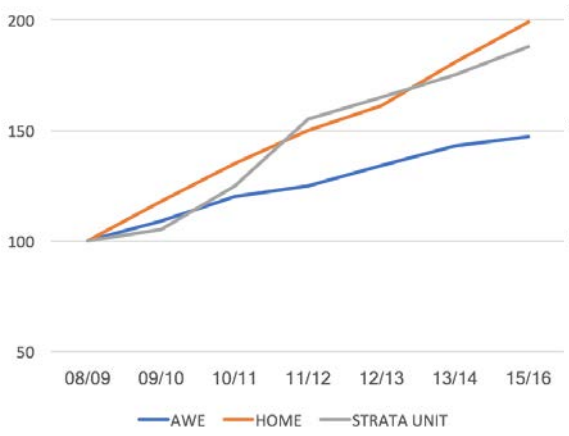

Figure 2 – National Home , Strata Unit Premium growth indexed to Average Weekly Earnings growth

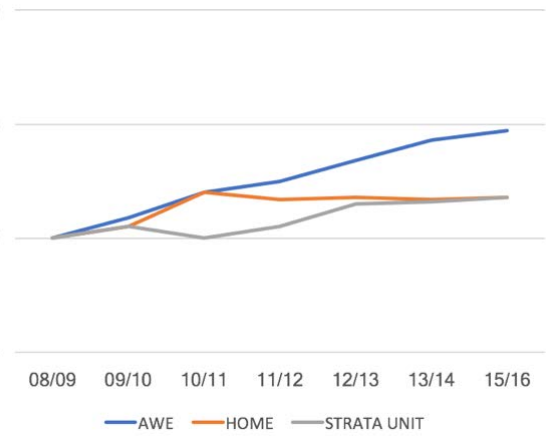

Figure 3 – National Home , Strata Unit Premium growth adjusted for growth in asset value being insured, indexed to Average Weekly Earnings growth

3.17. It is clear from this comparison that the cost of premiums has increased faster than average weekly earnings. However, this comparison encompasses changes to the raw premium alone, and does not accommodate growth in the value of the asset, the sum-insured over that period, or changes to the cost of rebuilding.

3.18. The comparison does not, therefore, reflect the change in value of insurance premiums over time. A different picture emerges once the comparison is normalised for changes in asset value and costs.

3.19. Figure 3, above, shows the nominal cost of cover has not increased significantly compared to average weekly earnings at a nationally aggregated level.

3.20. The ICA submits that this is a simplistic analysis only, provided to give additional context to the discussion about premiums. It should not serve to divert focus away from those regions where insurance costs have indeed escalated sharply. However, in comparing how premiums may have grown overtime, an understanding of precisely what values and costs have been insured is also necessary.

4. MARKET-WIDE CHANGES OVER TIME TO INSURANCE PRICING

4.1. Over the past two decades, and particularly since 2007, the fundamentals of insurance pricing globally has changed significantly.

4.2. Australia has not been immune to these changes. In some respects it has been at the forefront. The four main changes in the fundamentals of insurance pricing have been:

4.2.1. The adoption of higher-resolution risk-based pricing to determine a policyholder's premium according to risk exposure

4.2.2. The introduction of flood cover in domestic policies for the first time, causing a step change in premiums for an identifiable subset (20 per cent) of all policyholders

4.2.3. The escalation over the past decade in prudential requirements for insurers to maintain high levels of capital relative to risk and risk concentration, as well as increased operational costs to meet consumer protection requirements

4.2.4. The very significant increase in costs associated with building and rebuilding in Australia.

4.3. **Risk-based pricing**. There has been wide adoption of risk-based pricing in the industry, the granularity of which has been driven in equal parts by:

4.3.1. Increasingly accurate address-level hazard data based on government hazard mapping initiatives

4.3.2. A greater understanding regarding the performance of buildings that experience natural disasters and how buildings constructed from different eras can be expected to respond

4.3.3. A growing customer expectation that they should pay only for the risks they are legitimately exposed to.

4.4. In simple terms, two decades ago the price of cover for comparable properties would not vary greatly within a geographic area, for example a postcode. Differences in premium may have been caused primarily by other factors, such as an individual's claims history, rather than the differences in natural hazards as they might manifest at a local level.

4.5. Figure 4, below, shows an example of how premiums may have manifested in the past for a specific postcode, where only a crude understanding of hazards may have been held and have been applied to a large area (such as a postcode).

Figure 4 - Historical Insurance Pricing Example, Regional Understanding of Hazards

4.6. In this example, comparable properties attract similar premiums, without taking into account the differences in exposure that actually manifest at a higher resolution, or that

become discernible with access to better information. Those with lower risks, in this model, are subsidising those with higher risks.

4.7. One of the most common complaints received by the industry is based on the misperception that this model is still employed. They believe insurers still charge premiums based solely on a policyholder's postcode and fail to consider that their property is in a low hazard part of the area. Those making this complaint argue they should not be penalised through higher premiums for the higher risks faced by others in their area.

4.8. Today, comparable properties, even those near one another, can experience significant differences in premiums based purely on their proximity to a natural peril.

4.9. Figure 5, below, shows how premiums for the same sum-insured are impacted when recently available evidence concerning flood risks are considered.

Figure 5 - Insurance Pricing Example, Address Level Understanding of Hazard

4.10. In this most basic example, the property with a higher risk is charged a higher premium as it is more likely to suffer flood damage (being located in a 1:20yr flood zone) and submit a claim. This is the foundation of risk-based pricing and represents the single largest shift in how the GI sector now deploys its product to the community.

4.11. Risk-based pricing is however more complex than the scenario above and there is scope for these complexities to be misunderstood. The example given above demonstrates a "one hazard" view of underwriting. Very few communities have only one hazard to contend with. Most are exposed to varying levels of flood, storm, earthquake, cyclone, bushfire and hail. Some are exposed to all of these hazards and some are exposed to acute levels of only one, such as bushfire.

4.12. For the sustainable provision of insurance, each of these risk factors must be accounted for by the insurer at the highest possible resolution in order to calculate a risk premium that will be adequate for the risks that can occur at the policyholder's precise location.

4.13. Figure 6 below demonstrates how considering a second hazard, in this case bushfire, begins to alter the premiums expected for each house in James St. Here we see premiums begin to rise for the householder who finds they are exposed to a bushfire risk.

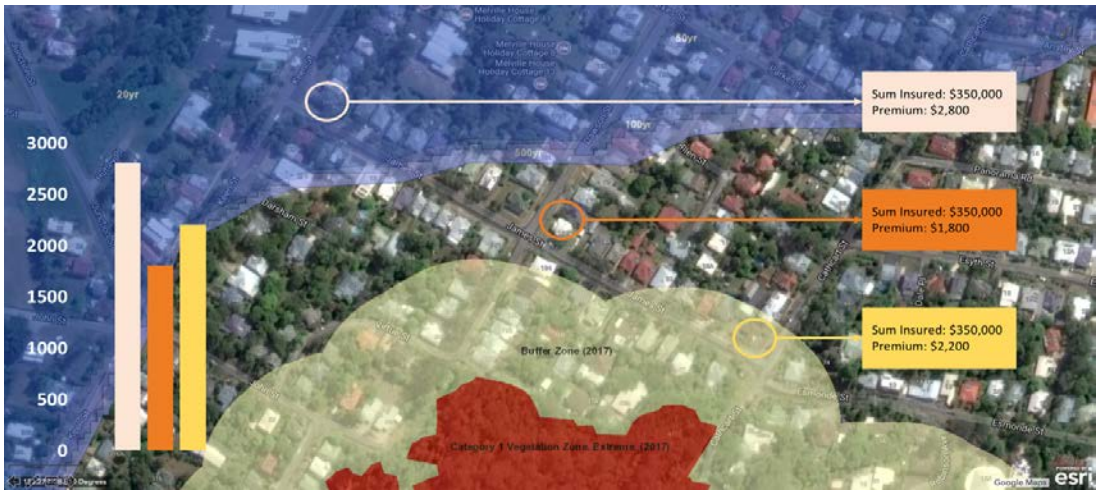

Figure 6 - Insurance Pricing Example, Address Level Understanding of Two Hazards

4.14. The lack of understanding of the complexities involved in pricing for insurance can lead to confusion and a belief that insurers may be price gouging or that a lack of competition is driving increased prices.

4.15. The ICA regularly attends community discussions on insurance pricing in high-risk regions, assisting individuals to understand the hazards that may be driving insurance premiums in their location. It is useful to contemplate what discussions community members from James St in the above examples may be having in the absence of the hazard maps used here.

4.16. Without hazard maps being provided by local government, the community members from James St are likely to have little or only anecdotal understanding of the different hazards that they each face.

4.17. In these circumstances, easily replicated in many risk-exposed towns and communities, it is easy to latch onto a perceived lack of competition to explain higher premiums, rather than accept that something more fundamental, as well as challenging to address, is wrong – that the risks are too high and need to be mitigated.

4.18. The James St example demonstrates the impact of only two hazards. Insurers consider myriad factors, including claims history of the individual. Each insurer naturally weights the risk factors differently to their competitors, giving rise to highly variable premiums being offered to an individual. Policy features differ between insurers and this also affects the premium.

4.19. Another example, raised by some north Queensland politicians, is the township of Julia Creek. Claims are made that the residents of Julia Creek (see Figure 7) have been subjected to premium increases based on sharing a postcode with more cyclone-exposed towns (such as Homestead).

4.20. The reality is much simpler to understand. Julia Creek, as the name suggests, is located around a watercourse. In 2013 the Queensland Government released flood mapping that shows parts of the town are exposed to flooding. The town is also remote (increasing the cost of repairs and supplies). The effect of a step change caused by new knowledge regarding a flood risk, or the introduction of flood cover, is discussed below.

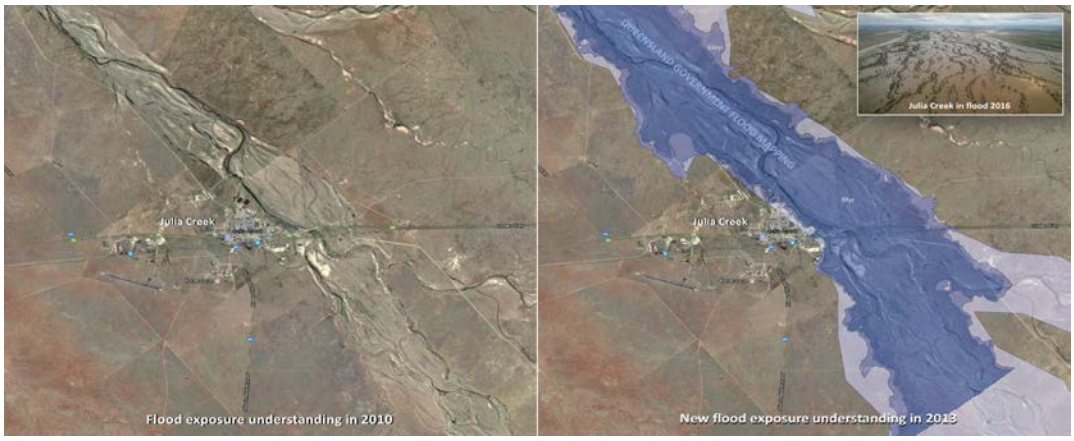

Figure 7 - Insurer understanding of flood impacts before and after release of flood mapping[11]

4.21. **Step change in premiums from the introduction of flood cover**. A significant factor impacting insurance pricing in the past decade is the introduction of flood[12] cover to many policies.

4.22. Prior to 2007, flood cover for domestic buildings was unavailable. To better meet the needs of the economy and its customers, the industry worked closely with governments to gather underwriting data to create market tools that would enable the voluntary and competitive introduction of flood insurance by insurers.

4.23. The collation of flood mapping allowed insurers to create insurance products at prices that reflected a consumer's risk of a flood event occurring. It follows that the introduction of flood cover created, for some policyholders (those with flood exposure), a step change in premium. This step change in premium sends a powerful signal to the exposed consumer that a risk is present. Importantly, it also enables the consumer to access insurance when flood damage has occurred.

4.24. In some cases, an individual policyholder may have poor information regarding the risk of flooding in their location (or more commonly no information at all). It follows that the inclusion of flood cover in their policy, with a price signal indicating significant flood risk, can conflate perceptions that the industry is overcharging, rather than focusing on the true underlying cause (an unmitigated flood risk is affecting the community) and possible solutions.

4.25. The graph below shows the change to technical premium over the past decade considering a notional 5 per cent growth in costs annually, indexed to a $1000 premium without flood cover included in 2006, and with the introduction of flood cover into the policy in 2008. The step change in premium that occurs in this scenario in 2008, for those with substantial flood risks (such as 5 per cent AEP[13]), is not insignificant.

[11] The image of Julia Creek in flood (2016) was sourced from a Courier Mail article dated 2nd January 2016, available here.

[12] The term 'flood' is subject to a single standard definition in all insurance policies, regulated via the Insurance Contracts Act.

[13] **AEP** - Annual Exceedance Probability. Indicates the probability of the event occurring in any given year. A 5%AEP indicates that there is a 5% probability of flooding in that location in any given year. Taken over the life of an average mortgage of 30 years, the probability of a flood occurring would be 150%.

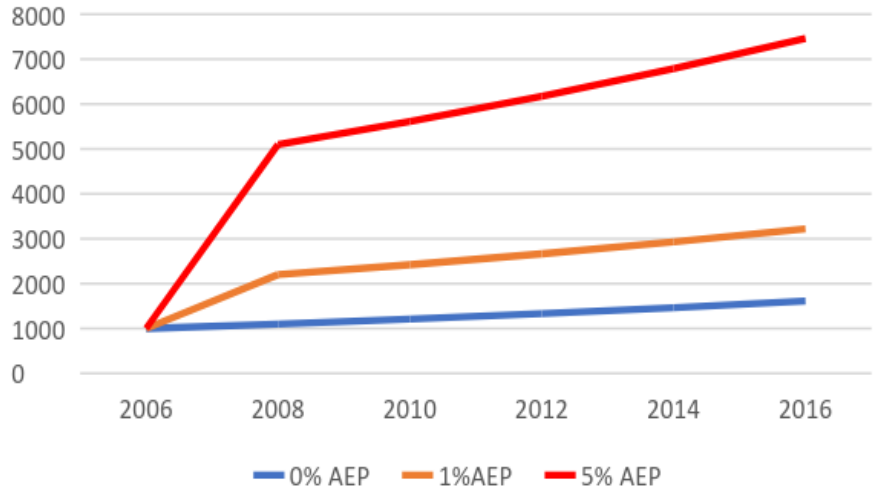

Figure 8 - Step Change in Technical Premium with Introduction of Flood Cover

4.26. During the past decade many insurers have gone to considerable lengths to explain to their customers what the introduction of flood cover would mean[14] and how premiums would change.

4.27. The impact on consumers from a step change caused by the introduction of flood cover has been most notable in locations where other hazards are already prevalent. The accumulation of premium components can amplify the observed price signal. This scenario is most often found in northern Australian coastal communities, where large cyclone exposures are exacerbated by flood exposures and furthermore often occur in tandem[15].

4.28. Three factors have inhibited communication with customers on this point:

4.28.1. First, a strong political focus has been given to cyclone risk over recent years, which is only prevalent in northern Australia

4.28.2. Second, flood risk information used by insurers to set technical flood premiums is typically sourced from governments who may restrict the ability of an insurer (through data sharing agreements) to share the results with a community member

4.28.3. Last, many insurers believe delivering advice on perils exposure to an individual is personal financial advice, which they are restricted from providing, and consider to be the natural responsibility of government and emergency services

4.29. **Capital holding requirements and risk concentration.** The prudential framework introduced following the collapse of HIH requires insurers to appropriately price and manage risks. Prudential regulations introduced over the past two decades relating to the capital necessary for insurers to hold have undoubtedly led to a safer and more secure insurance market.

[14] It should not be inferred from the graph that flood cover was universally introduced to all policies in 2008. Flood cover was introduced by individual insurers at a time that best suited their own customers. Some insurers have chosen to not introduce flood cover at all, while others have made it optional. This graph uses 2008 for example purposes only, to demonstrate how a step change in cover leads to a step change in premium.

[15] The most recent example of this relationship is Severe Tropical Cyclone Debbie, now the 2nd most expensive cyclone in Australia's history. Whilst a portion of the costs is attributable to wind damage from the cyclone, a large proportion of the costs were due to riverine flooding caused a week after the event in northern NSW.

4.30. However, for those contemplating underwriting in highly exposed regions, the costs of this capital are significant and the returns, impacted by higher frequency and more expensive claims, are demonstrably poor.

4.31. This factor is a significant, but necessary, barrier to entry to underwriting in high-risk locations.

4.32. **Growth in claims costs led by repair and rebuilding**. A significant factor that has influenced premiums is the growth in claims costs, at present 11 per cent a year[16]. Claims costs are influenced by several factors (the magnitude of which vary according to region). However, increases to the cost of trades and supplies, as well as the need to service more expensive buildings and upgrade those not built to modern standards, are at the heart of the growth. With claims costs growing at this rate it is challenging for insurers to prevent significant increases in premium on this factor alone.

5. PRICE SIGNALS REFLECT RISK, MITIGATION REDUCES RISK AND REDUCES PREMIUMS

5.1. The ICA submits that mitigation of risks, in all of its forms, to a reasonable residual risk is the only manner in which to sustainably lower insurance premiums in locations where community risks are too high.

5.2. Australia has many communities where the existence or absence of mitigation underlines this fundamental point.

5.3. The Queensland township of Roma has a population of almost 7000 and has been impacted by major flooding on at least three occasions since 2008. Situated on the Bungil Creek, a tributary of the Condamine River, Roma experienced severe flooding in 2010, 2011 and in 2012 when it was devastated by its worst floods in its history, inundating almost 450 homes and large parts of the CBD.

5.4. Figure 9, below, shows addresses (in **red**) where unmitigated flooding was a recurrent issue and where, as a consequence, the insurance price signal delivered by the industry was judged, almost universally by insurers and consumers alike, as unsustainable.

Figure 9 – Properties in Roma QLD exposed to flooding pre-mitigation

[16] Based on June quarter 2017 data from Insurance Statistics Australia

5.5. The price signal delivered by the industry, including a number of insurers no longer being able to offer cover for flood for Roma, stimulated an appropriate response from local and state governments, namely the building of a levee system to protect the town from the most frequent flood events.

5.6. Figure 10, below, shows the results of completion of Stage 1 of a flood mitigation levee completed early 2015 at a cost of $15 million, giving significant flood protection to almost all homes and seeing an average reduction in insurance premiums by about 34 per cent, with a peak reduction for some residents of up to 75 per cent. Flood mapping now shows that almost 90 per cent of houses in Roma are considered to have no flood risk.

Figure 10 – Properties in Roma QLD exposed to flooding post-mitigation

5.7. The ICA submits that this is a prime example of the general rule that reduced risk equates to reduced premiums.

5.8. Further examples[17] can be found in any town where flood mitigation has been implemented to protect the community from experiencing flood damage.

5.9. Launceston in Tasmania provides another vivid case study. Figure 11, below, shows the levee-protected area for the city resulting from construction of the Launceston City flood levee. Median premiums in the levee protected areas (green) are 20 per cent lower than in unprotected areas.

[17] Importantly, the relationship between reducing risk and reducing premiums can only operate where insurers are properly informed about the implementation of flood mitigation. If insurers do not know that mitigation has been undertaken they cannot reduce prices.

Figure 11 – Levee protected areas of Launceston City, Tasmania

5.10. The return on investment value of this levee was independently assessed by the research carried out through the Bushfire and Natural Hazards Cooperative Research Centre (BNHCRC). It found that in a single year (2016), the levee prevented $216 million[18] in community losses, more than four times the investment in the levee.

5.11. Mitigation for flood risks can also be property specific. Raising the floor heights of a property to a level above the anticipated flood heights can have a marked impact on insurance premiums. If the habitable space of a building is predicted to flood, then the anticipated claim will be high, having to account for repairs to floors, furnishings, soft fittings, utilities, white goods and other possessions. If a building is located on a land parcel that floods, but the liveable space of the building is above the flood level, then the anticipated claims costs will be much lower. Anticipated claims costs also vary according to the age of the building and the building materials used, with those more prone to flood damage resulting in higher predicted claims costs.

Figure 12 – Premium differences available for the same flood risk on neighbouring properties with variable floor heights and building material choices from a single insurer.

[18] https://www.launceston.tas.gov.au/News-Media/Report-vindicates-Launcestons-flood-levee-system

5.12. Figure 12, above, provides an example of median premium differences available when accurate floor height data and building material choices are taken into account. Unfortunately, there is little data available for floor heights in Australia, and what is available is inconsistent. This has resulted in only a few insurers being able to incorporate consideration of floor heights in their underwriting and typically only where there has been specific remote collection of the data or reporting by a third party (such as an insurance broker or local government).

5.13. It is also possible to mitigate for other hazards at an individual address level, including cyclone. Effective cyclone mitigation is implemented through the National Construction Code. Homes located in cyclone-exposed regions and built after 1980 are required to have measures incorporated that substantially reduce the buildings vulnerability to total loss during a cyclone. These additional requirements represent an additional cost to the building, but also represents a significant decrease in the probability of total loss. Research carried out by Dr David Henderson of the Cyclone Testing Station following Cyclone Yasi (2011) demonstrated that about 20 per cent of pre-1980 buildings lost roofing, while only 3 per cent of post-1980 buildings had similar damage.

5.14. The year in which a building was constructed (for those in cyclone-prone regions) is a crucial measure for insurers in setting premiums. Older homes tend to attract higher premiums, reflecting the less onerous building codes in place at the time.

5.15. Figure 13, below, shows that 38 per cent of home buildings in northern Australia are pre-1980 buildings, based on year of construction data supplied by policyholders. Most of the buildings assumed to be non-compliant with the national construction code cyclone provisions are in Queensland.

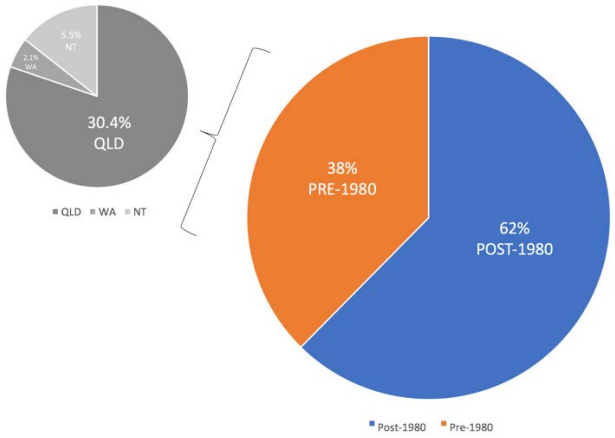

Figure 13 – Pre and Post-1980 constructed buildings in northern Australia (PIF Data 2017).

5.16. Reducing premiums for these properties can be achieved by property-level retrofitting of the building to bring it up to modern standards, or in some cases by recognising measures that have already been incorporated by the building owner[19].

[19] There is a relevant paradox in this data that has been correctly pointed out by some stakeholders. Whilst pre-1980 buildings are more prone to damage, it is clear that there are still a significant number of these buildings still in use in the region. Why are these buildings still standing? It is likely that a significant portion of these buildings, despite being constructed before formal introduction of cyclone construction requirements, were built with local experience that incorporated relevant risk reduction measures, or they have been retrofitted over time. It is important to clarify, at individual building level, which buildings could already be deemed compliant, or that do require retrofitting.

5.17. In its submission to the Northern Australia Premiums Taskforce (October 2015), the ICA proposed a household-level mitigation measure, the 'Third Way', that would reduce premiums in some specific circumstances by up to 20 per cent[20].

5.18. Several insurers have also now included additional questions on insurance enrolment forms to detect if a policyholder with an older property has undertaken any relevant household-level cyclone mitigation. Positive responses can often yield a 10 to 20 per cent reduction in premium.

5.19. The industry has welcomed the Queensland Government's recognition of the need to retrofit older homes. On 9 November 2017, the then-Queensland Treasurer Curtis Pitt MP announced that a re-elected Labor Government would give owners of pre-1980s homes in cyclone-prone areas grants of up to $11,250 or 75 per cent of the cost of replacing their roofs, in 2018. The industry stands ready to recognise, through reduced premiums, the reduction in risk that is achievable for individuals through this scheme[21].

5.20. **Barriers to private mitigation.** There can be a lack of understanding regarding the options, costs, and benefits of undertaking household-level mitigation.

5.21. Of paramount importance is the absence of a clearly defined mechanism for insurers to become aware of the mitigation undertaken and to then offer discounts. The insurance industry's Third Way proposal sought to address this shortfall.

5.22. It is important to note that there is no such thing as a cyclone-proof building. Some stakeholders (especially strata building owners) have highlighted that their building is 'cyclone proof' or has been built to 'Category Five' standards, and that as a consequence they should have lower premiums.

5.23. There are no such cyclone-proof standards or buildings. Buildings built to today's standards are not cyclone-proof, but there are markedly less prone to total loss and causing loss of life to occupants. Buildings built to today's minimum standards will still incur cyclone-related damage, in particular wind-driven water penetration, as shown by work produced by James Cook University, which examined insured losses in strata buildings following cyclones.

5.24. Regarding the difference between minimum building standards and best practice, or practices that might yield lower insurance premiums, there is a large community information gap.

5.25. An initiative suggested and strongly supported by insurers is the strata engineering inspection scheme for properties in northern Queensland that should commence in 2018. This government scheme seeks to provide strata building owners with an engineering report that identifies any issues with the building. Rectification of these issues could lead to a reduction in insurance premiums.

5.26. Insurance has a role in promoting mitigation, but should not be paying for mitigation. The general insurance industry has suffered significant losses over the past 20 years from natural disasters and the potential for greater losses in the future is concerning. The ICA has consistently and continually promoted the importance of effective risk mitigation and management of risks from natural disasters.

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[20] http://www.insurancecouncil.com.au/assets/Urbis%20ICA%20Cyclone%20Mitigation%20Assistance%20Policy.pdf

[21] http://www.cairnspost.com.au/news/queensland-state-election-2015/labor-raises-rooves-and-lowers-premiums-with-cycloneproof-plan/news-story/e4a72b1e0bdc9389c3ca04a6b775ec6f

5.27. The role of insurers in the mitigation process is to price residual risk appropriately and fairly, using the best-available data. The presence of an unwelcome price signal, alerting stakeholders to a residual risk in the environment that is higher than average, is one mechanism through which those who are responsible for mitigation can target their mitigation planning efforts.

5.28. If insurers were asked to contribute to the cost of mitigation, as has been suggested by some stakeholders, this would only serve to increase premiums further as the costs would necessarily be passed on. Insurers must assist to motivate mitigation activity by sending an accurate price signal through premiums. Most importantly, once mitigation is complete, insurers must provide premiums that reflect the reduced risk.

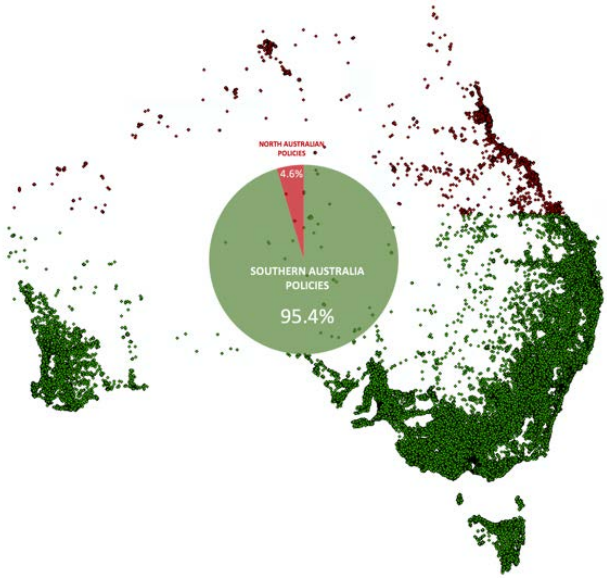
5.29. The ICA stands by its previous submissions over the past decade on the need for more natural disaster mitigation to be carried out in Australia. This need was most recently articulated by the Productivity Commissions inquiry into funding arrangements for natural disasters; the Senate Standing Committee on Economics (August 2017) recommendation for the government to reconsider its rejection of the Commission's call for $200 million a year in federal investment for mitigation and resilience activities.

6. THE NORTH AUSTRALIAN INSURANCE MARKET

6.1. For the purpose of analysing the northern Australian market, the region can usefully be characterised, from an insurance perspective, by a number of core measures:

6.1.1. The geographic area is very large, about 45 per cent of Australia

6.1.2. The population of the area is small compared with the rest of Australia, encompassing about 4.6 per cent of Australian addresses. Correspondingly, about 4.6 per cent of insurance policies in force are located in northern Australia



6.1.3. The natural hazards profile faced by this small population is very high and is dominated by extreme cyclone and flooding risks

6.1.4. Symbiotic with the small population and the large areas involved, strong resource and infrastructure limitations manifest as higher costs for most goods and services, including those relating to the construction or repair of buildings.

6.2. Each of these issues create significant challenges for insurance underwriting in comparison to the less exposed and more densely populated southern areas of Australia.

6.3. Any examination of competition in northern Australia must have at its core a fundamental understanding of these factors, which when combined and then balanced against the risk appetite, underwriting capacity and operational reach of the broader Australian market, reduces the number of insurers that can contemplate sustainable insurance operations in the region.

6.4. Many stakeholders have suggested the smaller number of insurers offering cover in the region compared with the number offering cover in low-risk areas represents a market failure or, at a minimum, a lack of constraint on remaining insurers, who in the absence of competition will simply increase premiums.

6.5. Despite the inherent challenges however, it is clear that a considerable number of insurers do operate in northern Australia.

6.6. ASIC's North Queensland insurance website[22] shows that premiums are available in postcode 4740 (Mackay) from many insurers, for a wide variety of premiums:

[22] http://nqhomeinsurance.gov.au

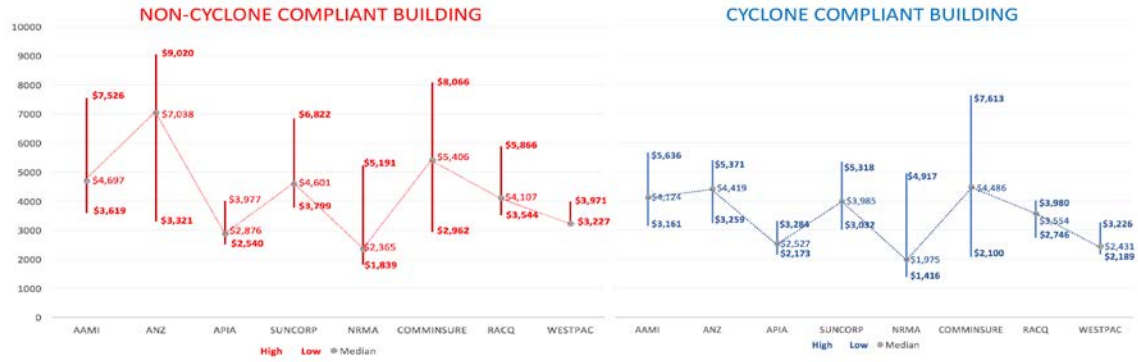


Figure 14
High Low Medium premium range for postcode 4740 from 8 insurers, $350k Sum-Insured, $500 Excess
Non-Cyclone Compliant Buildings v Cyclone Compliant Buildings

6.7. Figure 14 shows the highest, lowest and median premium charged for buildings in the target postcode for a sample of eight insurers operating in the region.

6.8. Several observations can be made from this data:

6.8.1. Consumers in postcode 4740 have considerable choice in terms of insurance provider, product terms and inclusions and premium.

6.8.2. There is a considerable variance in the highest and lowest premiums offered by each individual insurer in the postcode, which signals that premiums are risk-based, with the highest premiums being allocated to those in the postcode with the highest exposures.

6.8.3. There is a large variance in the premiums offered between each insurer, signalling that each insurer is employing its own competitive methodology and underwriting rules.

6.8.4. ASIC's information indicates that insurers consistently acknowledge the lower risk (cyclone compliant) building by providing a lower premium, again calculated with their own competitive methodologies, which arrives at a premium different to their competitors.

6.9. Though the ASIC website shows premium ranges offered by insurers in the region, the ICA's policy-in-force (PIF) dataset[23] shows the actual consumer uptake of insurance policies.

6.10. PIF data for postcode 4740 shows that the median normalised premium paid is $1,850 and more than 97 per cent of consumers pay a premium of less than $3,000. The highest premiums (those above $3,000) are predominantly for those with a coincident flood risk, or a property built before 1980 (or both).

6.11. Though the ICA agrees with the general proposition that fewer insurers offer products in parts of north Australia, given the complexities and risks involved this does not mean that insurance is unavailable or reduced to the point where consumers lack adequate choice.

[23] The PIF is an ICA collated dataset that contains policy records for approximately 10 million building insurance policies in Australia that were in-force as at 1 November 2017. This dataset is useful as it represents actual consumer behaviours, rather than anecdotal information and speculation. The PIF shows, for each address, what the policyholder purchased, including; the sum-insured, the premium paid, the age of the property and the excess payment preferred for making a claim.

7. HOW IS INSURANCE FOR CONSUMERS IN NORTHERN AUSTRALIA PRICED?

7.1. From an insurance perspective, northern Australia is no different from the rest of Australia regarding the methodology for how individual premiums are calculated. Like the rest of Australia, premiums for policies within any given area are typically calculated at an individual address level.

7.2. Despite the adoption of address-level risk-based pricing by all insurers, one of the most repeated statements from community members and politicians is that many insurers underwrite using only postcode-level data, leading to those who do not have exposures at their specific address being charged unfairly.

Figure 15 - Online quotes from the same five insurers, for identical buildings in different locations within the same postcode[24]

7.3. Figure 15 shows the results of online quotes for an identical building in four separate locations within postcode 4740 (Mackay, North Queensland). Quotes were obtained from five insurers for a building constructed in 2016 and for an older building constructed in 1975. The graphs in Figure 13 show how premiums offered by the market vary.

7.4. It is relevant to note that quotes were available online or over the phone from 15 insurers, and ASIC's north Queensland home insurance website shows comparison data from 11 participating insurers for the Mackay postcode[25].

7.5. It is clear from Figure 15 that:

7.5.1. Each individual insurer provides a different premium (for the identical house) for each location within the same postcode.

7.5.2. Noting the differing risks there is a wide variance in premiums between locations within the same postcode.

[24] Online quotes were gathered from 5 separate insurers, for $350,000 sum-insured, $500 excess, with the building being insured described with the same parameters in each case. The only variable if the location/address of the property and the nominated year of construction.

[25] http://nghomeinsurance.gov.au/ Not all insurers participate in this website. However, postcode level median premiums are available here from AAMI, Allianz, APIA, Suncorp, NRMA, QBE, Westpac, CommInsure, Youi, RACQ and ANZ, showing a healthy range of premiums and availability.

7.5.3. Year of construction for a building is a key factor, with older building being more expensive to insure.

7.5.4. The perception that most insurers underwrite based on hazard information allocated by postcode is incorrect.

7.6. Taking a narrow view of competition measures, Figure 15 shows considerable competition (based on price alone) exists between the five insurers in this sample set. The principle demonstrated by this example – that multiple insurers operate and deliver competitive prices – is replicable in virtually any location throughout Australia.

7.7. The level of competition between these five insurers is best demonstrated by looking in greater detail at the most expensive location to insure. All insurers polled consider the address at location 3 (see figure to the right) to be exposed to a higher degree of risk.

7.8. Several insurers clearly consider that this property is more than twice as expensive to insure, compared with locations 1, 2 and 4. For other insurers the differential is approximately 1.2 times higher.

7.9. This location has the same approximate exposure to cyclone events, with an 11 per cent probability of a cyclone tracking with 50km of the address in any given year.

7.10. Unlike the other addresses in Figure 15, this address has an extreme flooding risk. However, the way insurers calculate each of these risks and the interplay between them remains highly competitive, giving rise to different premiums offered in the market.

7.11. **A possible source of confusion – postcode restrictions.** Insuring property in high-risk regions takes considerable capital and operational capability to manage claims when they occur. Claims frequency and costs are considerably higher for the 4.6 per cent of addresses that are in the north. Insurers who do not have the risk appetite or capital to operate in these regions may indicate to a consumer that they do not operate in a region by responding to the postcode submitted - a postcode embargo should not be confused with claims of postcode-level underwriting.

7.12. **Northern Australian exposures are higher and the implications are not always well understood by some stakeholders.** The difference in exposure is a subject of little dispute at national level. Most stakeholders accept that northern Australia is subject to additional natural perils risk compared with locations in the south. By way of overview, Figure 16 (below) captures the historical tracks of tropical cyclones over the previous 100 years.

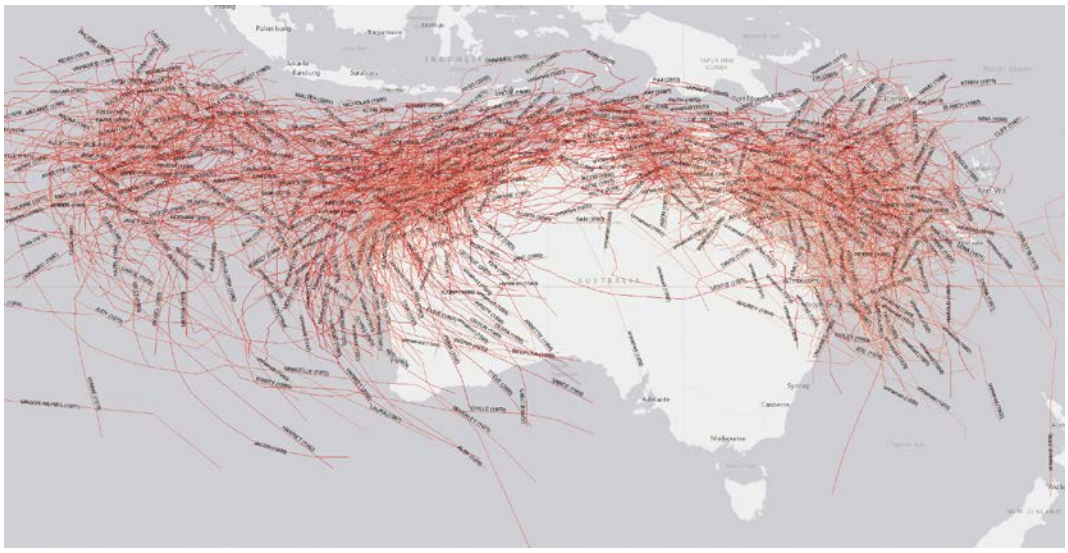


Figure 16 - ICA DataGlobe extracts of northern Australia cyclones over the past 100 years

7.13. It is important to note the north is also acutely exposed to flood risk. An exploration of the ICA's DataGlobe shows most northern Queensland towns and cities have significant exposure to riverine flooding and little infrastructure to prevent the worst of the impacts.

7.14. **Southern cities also experience expensive disasters**. Some stakeholders maintain that southern cities experience far more expensive natural disasters and therefore insurance premiums in those locations should be higher than in the north. From an insurance perspective, this interpretation is deeply flawed as it does not recognise the relative differences in the number of claims incurred in each disaster and therefore the difference in average claims cost.

7.15. In a severe storm event in Brisbane, Melbourne or Sydney, the aggregate claims costs can quickly escalate to $1 billion or more, equivalent to many cyclones. However, this aggregate is the sum of many tens of thousands of claims, each claim having a relatively small cost for incurred damage, for example the cost of broken guttering, windows and repairs to soffits.

7.16. In the case of cyclone events and other natural disasters in the north, where only 4.6 per cent of addresses are located, the individual damage experienced by a smaller number of buildings (in relative terms) will typically be orders of magnitude worse, including much more expensive repair issues such as roof replacements and other major works.

7.17. **Individuals can have an imperfect understanding of their exposures and consequently how premiums reflect the risk**. Consumers typically have an imperfect understanding of their own exposures. Individual policyholders, often those reporting concerns over higher premiums in their location, are often poorly informed[26] regarding the extent to which they are exposed to natural disasters. Failure to have a reasonable understanding of the quantum of exposures being covered by their policy often leads to failure to understand why a premium may be higher than expected and what actions may be available to mitigate risks.

[26] There are myriad factors that contribute to a homeowner not recognising the hazards that can occur at their location. In a general sense everyone is subject to behavioural biases that can limit temporal recognition of a hazard, in practical terms we can all have short memories. Governments are responsible for community safety information and many have done a great job at informing some communities about some hazards.

83 POWELL STREET,BOWEN,QLD 4805

FLOOD: *1% probability of flooding in any given year.. Depth of flooding at 1% flood is 0.3m.Depth @ PMF -1m. [Don Basin Study Queensland Reconstruction Authority 2013]*

STORM: *High rainfall intensity for 60minute 1:100yr Storm. Predicted to receive 104.10mm, or up to 657.20mm over 3 days. This location experiences an average of 16 days per year where severe thunderstorms occur. You should ensure that your roof is well maintained. Having the correct gutters, correctly installed, is critical for your location.*

STORM TIDE: *Potentially exposed to storm tides 6m or greater. Elevation above sea level at centroid of property is 6m and distance to coastal high tide mark is 681m.*

CYCLONE: *Extreme Exposure to Tropical Cyclones.. Estimated return period for cyclones in this location is 5yrs.*

Figure 17 - ICA DataGlobe extract for cyclone and flood exposed land parcel in Bowen Queensland.

7.18. This extract (Fig. 17) from the ICA's DataGlobe shows a relatively high natural peril risk for an individual address. Taking one set of commonly available damage curves, the technically correct premium for the flood exposure[27] in this location is about $850 and the technical premium for cyclone damage is about $3,000[28]. After adding in other natural peril risks, along with theft and the risk of accidents and the insurer's costs and margin, the commercial premiums for this location range from $9000 for an older property with a sum-insured of $350,000, to a low of $3080 for a modern property of the same value[29].

7.19. The relatively wide variance in premiums quoted for this property, and the multitude of variables upon which the differences are based, is (on the one hand) evidence that there is competition in the market. In this case multiple insurers[30] were willing to offer a premium on each scenario, for widely differing values reflecting their competitive assessment of the risks and potential claims costs.

7.20. On the other hand, without consumers having some understanding of the complexity of the risk assessment being performed, or an understanding of the initial exposures that they face, a tendency to assume that the insurer is overestimating the risk is easy to contemplate and a perceived lack of competition can quickly be settled upon by most stakeholders as a likely cause.

7.21. **Claims cost differences**. Claims costs are estimated by insurers based on a combination of historic claims statistics, cost models, actuarial models and forecasts. This involves analysing past exposure and claims information to derive assumptions that are expected to represent future trends.

7.22. One practical example of the differences in costs between northern Australia and lower-risk regions can be seen by using recommended sum-insureds as a proxy for estimated rebuilding costs.

[27] 1% probability in any given year of 30cm of flooding equates to an annualised average damage of approximately $850.

[28] 20% (1:5yr) probability in any given year of a cyclone within 50km equates to an average annualised damage of approximately $3,000

[29] Based on online quotes for $350,000 sum-insured from 6 different insurers, using a 1975 built property and then a 2015 built property.

[30] Seven insurance quotes were obtained at this location to ascertain a reasonable upper and lower premium estimate.

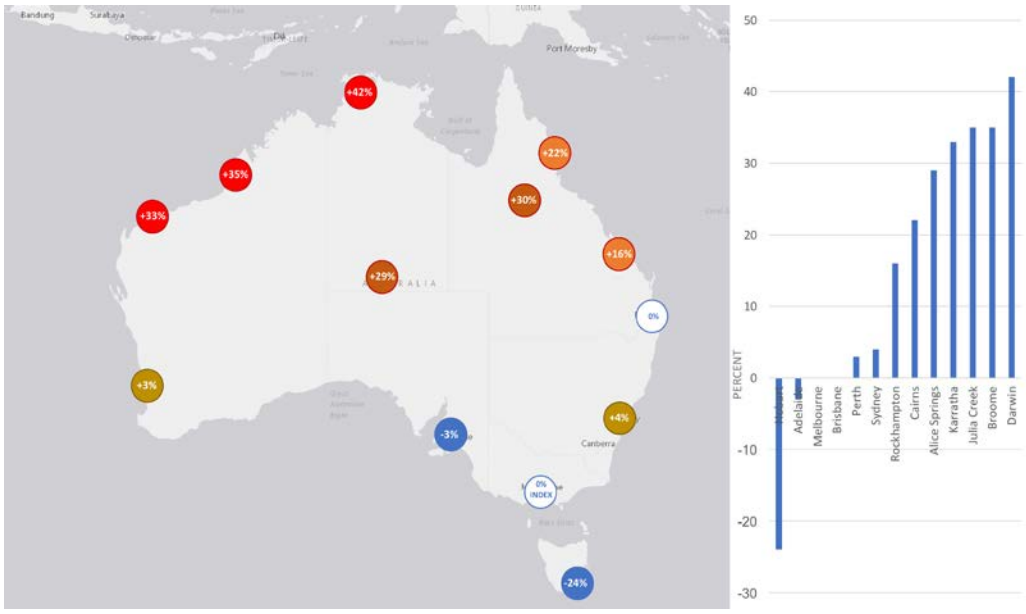


Figure 19 - Indexed rebuilding cost difference as a proxy for estimated claims costs, Cordell Building data December 2017

7.23. The figure above shows the recommended sum-insured differentials for an identical home in separate locations around Australia, using Frankston (Victoria) as the index.

7.24. The recommended increase in sum-insured for each location is a suitable proxy for the anticipated difference in the cost of rebuilding a property in each location, taking into account local building codes, professional fees, removal of debris, labour and material costs.

7.25. From this example, it can be seen that rebuilding a property in Cairns will be 22 per cent more expensive for an insurer, than rebuilding the same property in Brisbane or Melbourne.

8. PREMIUMS PAID IN NORTH AUSTRALIA – WHAT INDUSTRY DATA SHOWS

8.1. Media and concerned stakeholders frequently state that many policyholders in north Queensland are paying extreme premiums for property insurance, typically $5000 to $15,000 per policy.

8.2. Some anecdotes provide even higher values, most of which turn out to be quotes for cover never even considered for purchase by the policyholder, who typically finds another policy for a price willing to be accommodated.

8.3. Are these anecdotes accurate? What are policyholders actually paying for household and strata unit[31] premiums in Queensland? Though the industry does not dispute that premiums have increased in northern Australia, it does disagree with the:

[31] **Strata Unit premiums vs Strata Building Premiums** – The ICA frequently hears shocking stories from stakeholders and media of strata premiums that might cost $100,000 or much more. Put simply, no individual strata unit owner pays a premium of this magnitude. The body corporate may pay a premium of (for example) $100,000, but the individual strata unit owner will only pay a share of the overall premium. If there are 50 strata units in a complex being insured with a premium of $100,000, the cost to the individual strata owner would be $2,000, a much more reasonable and less newsworthy expense. The analysis carried out with PIF data in this response calculates costs and other data using the number of units in the strata scheme in order to provide a realistic estimate for what a strata unit owner must contribute for insurance on their building, making it more comparable to the data for home-building insurance costs. Any challenge raised by a strata unit holder regarding a high insurance premium being charged for their building must be accompanied by information on how many units there are sharing the cost and therefore what is the impact on a single strata unit holder.

8.3.1. Perceptions that the changes are not reflective of the underlying risk and costs, including capital, operational and claims

8.3.2. Magnitude of the premiums being suggested as commonplace or normal in northern Australia by stakeholders using anecdotal evidence

8.3.3. Anecdotal cause-and-effect argument suggesting that fewer insurers operating in the region has driven higher premiums, rather than higher risks having led to fewer insurers being able to operate sustainably in the region.

8.4. To assist with a proper understanding of consumer outcomes that arise from risk-based pricing the ICA has created the policy-in-force dataset, described in section 6 of this document.

8.5. The PIF dataset allows analysis of actual consumer insurance purchases at address level from across Australia, providing an accurate picture of the premiums actually paid by policyholders and, when correlated with hazard data, the drivers for higher and lower premiums.

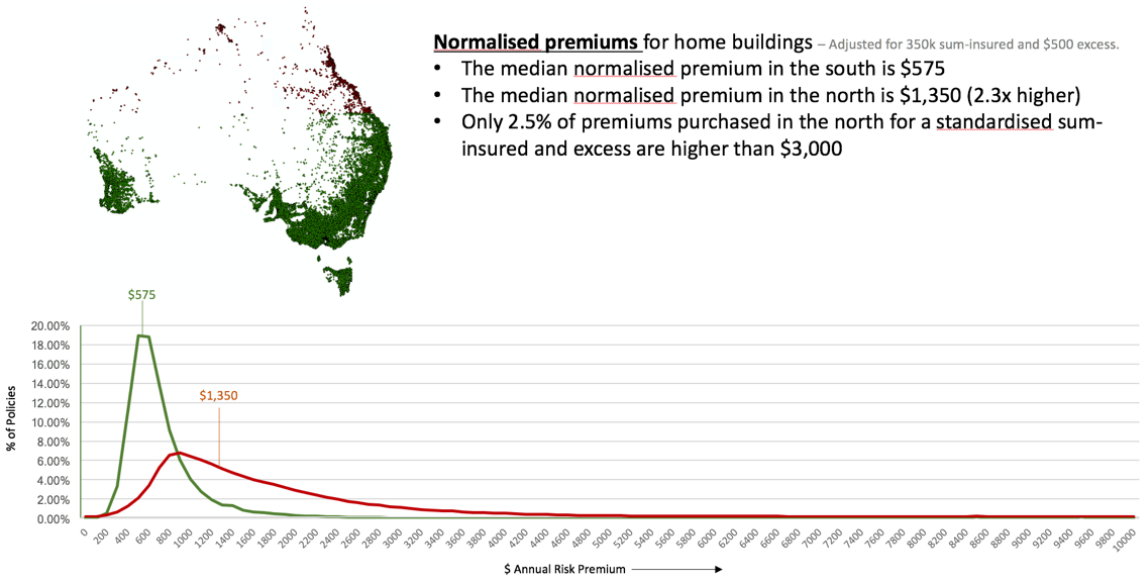


Figure 20 – Premium costs ($) for normalised home building policy north v south

8.6. The chart above shows the distribution of home building insurance premiums paid by policyholders, normalised to $350,000 sum-insured and a $500 excess. The data confirms that home building owners in northern Australia pay significantly more for comparable insurance than their southern counterparts. Importantly, less than 3 per cent of policyholders are paying more than $3,000 for insurance.

8.7. Those in the north paying more than the median price for cover ($1,350) have the following characteristics:

8.7.1. Older properties. 66 per cent of premiums above the median relate to homes built before the introduction of cyclone building codes

8.7.2. Extreme cyclone exposure. 74 per cent of premiums above the median relate to homes within 10km of the coastline, exposed to the greatest frequency and intensity of cyclone events

8.7.3. High flood exposure. 8 per cent of premiums above the median relate to homes with a high exposure to flooding and a lower exposure to cyclones

8.7.4. Cyclone and flood exposure. 89 per cent of premiums above $5,000 in premium relate to pre-1980 homes with both a cyclone and flood exposure.

8.8. A similar analysis is being prepared for strata insurance policies and will be supplied as part of an analysis package for stakeholders.

8.9. **Consumer behaviours – retaining risk through an excess**. Another key difference in the insurance markets for northern and southern Australia is able to be observed by what excess arrangements policyholders choose.

8.10. A higher excess payment, selected upon commencement of the policy, can substantially reduce the premium payable. Those facing higher premiums, coupled with a belief that their exposures to risk are low, will tend to take a higher excess to reduce their premium.

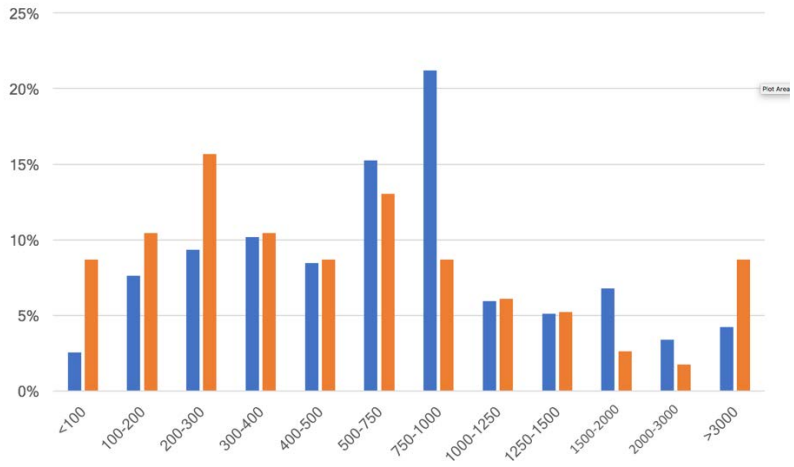


Figure 21 – $ Excess Selection for normalised policy north v south

8.11. Figure 21, above, shows more consumers in the north (orange) generally select lower excess payments than in the south (blue), reflecting a greater propensity to lodge claims (more frequently) and an unwillingness to lower the annual premium payable. There is a spike of higher excess payments (>$3000) in the north, reflecting named cyclone excess arrangements that are generally not available to southern policyholders.

8.12. Consumers in northern Australia can reduce their premiums by selecting a higher excess. The data in figure 21 shows that many consumers in the north are consistently selecting lower excess arrangements. This choice facilitates the lodgement of more frequent claims, but leave premiums at higher levels.

9. REINSURANCE IN NORTHERN AUSTRALIA

9.1. Though the level of required capital for insurers is determined through the application of APRA's risk-based capital standards, insurers have some flexibility in how they can retain or manage their risk profile and capital requirements using reinsurance. The cost of capital or reinsurance is a contributing factor to pricing of any risk – regardless of location – along with cost of claims and operations.

9.2. Reinsurance pricing is risk-based. The biggest risk factors impacting northern Australia that drive reinsurance costs are the high levels of building activity in areas prone to cyclones and flooding. Each of the reinsurers operating in the Australian market has its

own approach to risk-based pricing, risk appetite and margin expectations, which results in variations in the reinsurance rates offered.

9.3. However, the increasing competition in reinsurance markets ensures rates remain reasonable as local reinsurers compete with offshore and alternatives.

9.4. Munich Re, Swiss Re and GenRe are members of the ICA. They are multinational companies with worldwide commercial interests. Australia is also serviced by many other reinsurance entities. Many insurers have established co-insurance arrangements to complement reinsurance arrangements.

9.5. Reinsurance markets have intensified in competitive activity, with the number of players increasing and appetites broadening significantly. Local reinsurance also competes with London syndicates, offshore providers and alternative solutions (such as ILS). Combined with the extended soft market the industry has been experiencing, reinsurance markets are highly competitive.

9.6. There is no evidence to suggest a current lack of availability or competitiveness in the reinsurance market.

10. INSURER PROFITABILITY & PERFORMANCE IN AUSTRALIA

10.1. Profitability for the insurance sector, given the nature of its business, must necessarily be viewed against a longer timeframe than many other industries. Though there are many other factors to be considered, the profit/loss cycle for insurers is critically dependent on at least three strategic trends:

10.1.1. Impacts of low investment returns

10.1.2. Claims volatility driven by climate cycles, most notably La Nina and El Nino

10.1.3. Changes to the operating environment, including scheme reform, price regulation on statutory classes, heightened consumer demands, increased competition, growth of online insurance services.

10.2. Making assumptions about the profitability of the industry for any given year, without establishing decade-long context based on the strategic trends above, will lead to inaccurate conclusions.

10.3. It is important to balance any views on changes in general insurance premium levels against the broader financial performance of the industry. An analysis, using APRA data, indicates a deterioration in the financial performance of the general insurance industry over recent years relative to historic long-term performance.

10.4. The total net profit after tax in the year ending 30 September 2017 for the Australian general insurance industry was $3.0 billion. This is down from $3.1 billion in the previous year, and down about 25 per cent from the 15-year average of about $4 billion.

10.5. The lower level of industry net profit has had a noticeable impact on industry returns on net assets, which measures how effectively and efficiently the industry has been able to use its assets to generate earnings. The general insurance industry's return on net assets in the year ended 30 September 2017 was 11.0 per cent. This is down from 11.2 per cent in the previous year, and is much lower than the 15-year average of about 15 per cent.

10.6. In relation to the general industry's investment performance, analysis shows returns have been markedly lower over recent periods relative to historic long-term performance.

10.7. The general insurance industry's return on investment in the year ended 30 September 2017 was 3.0 per cent. This is down from 4.3 per cent in the previous year and is about 3 percentage points lower than the 15-year average of about 6 per cent. Return on investment is a widely used financial performance measure for evaluating the efficiency of investments.

10.8. The ICA's analysis is consistent with recent analysis by others, which found lower investment returns, accompanied by continuing low premium growth, mean the financial outlook for the general insurance industry will be satisfactory but not strong.

10.9. An additional measure for insurer performance is loss ratio. The loss ratio simply divides claims costs by premium. For home building and contents business an insurance loss ratio of 60-65 per cent might be regarded by many as indicating adequate premium rates. Higher loss ratios than this might be regarded as indicating inadequate premium rates.

10.10. This adequate loss ratio is less than 100 per cent because the insurer needs to collect sufficient premium to meet not only expected claims costs, but also any policy administration expenses, the cost of reinsurance and to provide for a reasonable margin. Other related costs include those marketing and differentiation to help drive competition in the market.

10.11. In 2014 the Australian Government Actuary[32] (AGA) conducted a review of pricing in northern Queensland from 2005-06 to 2012-13. The report shows that the actual northern Queensland loss ratio during the investigation period averaged slightly more than 140 per cent. This means that insurers paid out more than $1.40 in claims for every $1 of premium that they collected during the period.

10.12. Critically, the AGA also found that normalised **claims costs** in northern Queensland **are five times greater** than the claims costs incurred in Sydney, Brisbane and Melbourne. This is especially stark given the number of addresses in northern Queensland is a small fraction (4.6 per cent) of the number of addresses in these large urban centres.

10.13. Though it has not been recalculated, the increase in premiums since 2011 to more technically correct levels should have gone some way to addressing the extreme loss ratio calculated by the AGA. It is unlikely insurers are continuing to suffer a 140 per cent loss ratio in this region.

11. INSURERS EXITING THE NORTHERN AUSTRALIAN MARKET

11.1. Insurers in Australia are free to provide insurance products in any location. They operate on a commercial basis with private capital at risk in a highly regulated industry. They must focus on areas where a reasonable loss ratio can be maintained. This will mean charging premiums that (at a minimum) will cover losses due to claims and the operating costs of the insurance process.

11.2. Given the long-term loss ratio previously found by the AGA to exist in northern Australia, some smaller insurers cannot operate in the north and absorb the anticipated losses.

[32] AGA Report 2014 para 4.1 and Interim Report, page 11.

11.3. Insurers that choose to operate in the north must do so carefully. This caution typically manifests in tighter underwriting conditions, preventing the acceptance and concentration of extreme risks, and in premiums that are high enough to help offset losses.

11.4. Despite anecdotes, there are relatively few examples of insurers having left the market in northern Australia.

11.5. Some insurers have tightened underwriting conditions, which may have precluded older and higher-risk properties from obtaining a policy from a specific insurer. It has always been the case that some insurers cannot operate in the north of Australia for prudential and operational reasons.

12. INDEPENDENT PRICING, AVAILABILITY, TERMS – BRANDS WITHIN AN INSURANCE GROUP

12.1. All licensed insurance companies are operated as independent businesses with different business models and risk appetites.

12.2. Australia's general insurance industry comprises many insurers providing a diverse range of insurance products for consumers. As at 30 September 2016, 109 APRA-authorised general insurance businesses were operating in Australia, largely unchanged over the past year but representing a net decline of 24 insurers over the past decade.

12.3. As recently pointed out by APRA[33], the decline largely reflects approved mergers and acquisitions, and rationalisation within some insurance groups that held multiple licences arising from past acquisitions. Rationalisation includes the privatisation of state government insurers and demutualisation of mutually owned insurers and, in a number of such cases, their subsequent takeover.

12.4. Notwithstanding the net decline, APRA explained in its 2015 Annual Report[34] several new entrants, particularly APRA-authorised subsidiaries and branches of foreign insurers, have entered the personal and commercial lines markets over the past decade, offsetting the general trend towards consolidation and adding to the level of competition present.

12.5. APRA has also observed[35] strong levels of competition are evident in most classes of general insurance. In the personal lines market, the presence of various foreign insurers as well as large retail groups is having an impact as they seek to build market share, particularly in the domestic motor class of business.

12.6. There is no evidence to suggest that pricing, availability and terms offered by insurers owned by a group are uncompetitive either between themselves or with insurers external to the group. Most insurers within a group target specific demographics that their stablemates do not, or operate in separate jurisdictions. Product features, claims limits and excesses can also lead to significant variations in premiums.

12.7. Seeking a premium quote on a single house from multiple insurers within the same group quickly reveals that a range of different premiums are offered, for various products.

13. BARRIERS TO ENTRY OR EXPANSION IN THE SUPPLY OF INSURANCE

13.1. If insurance is to be economically efficient and commercially viable, rigorous risk assessment should determine the underwriting criteria and pricing. This is the basic principle that underpins the sustainable operation of insurance models.

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[33] APRA Submission to the Financial System Inquiry, 31 March 2014. Page 9.

[34] APRA 2015 Annual Report, released 7 October 2015.

[35] APRA Insight, Issue 3 2013. Page 8

13.2. The premiums paid by insureds need to be sufficient to cover costs of claims, taxes, levies and stamp duty, reinsurance, internal expenses and margins.

13.3. On top of this, insurers must meet strict regulatory requirements and set aside enough regulatory capital to meet the prudential capital requirements set by APRA, so that there are sufficient funds to potentially pay many claims at once, such as to respond to a natural catastrophe. The costs incurred by insurers can also be partly offset by investment income that may be made on insurance and capital reserves.

13.4. A substantial barrier to entry or expansion in the supply of insurance to northern Australia is being able to satisfy the prudential regulations satisfactorily while being able to deploy an insurance product that is competitive in cover and on price.

13.5. Non APRA-authorised foreign insurers may already legally operate in northern Australia through exemptions under which a broker can place business off-shore. It is telling that, to a considerable extent, they do not participate. The challenges and costs involved in operating in northern Australia effectively restrict sustainable participation to those with the capital and underwriting experience to do so.

14. INFORMATION, DISCLOSURE, TRANSPARENCY & CONTRACT TERMS

14.1. The mandated product disclosure regime[36] requires insurers to provide specific information to consumers when they are purchasing a new, or renewing an existing, policy.

14.2. This comprehensive regime was designed to optimise transparency. The industry has recognised that the provision of information without a clear objective to aid decision-making has not always effectively engaged consumers.

14.3. Delivering information at the right time, and in the right way, to improve decision-making, is complex. It is a challenge for consumer contracts of all kinds around the world.

14.4. Taking on this challenge, the ICA is facilitating a wide-ranging industry work program to enhance disclosure. The ICA has completed a ground-breaking research project to better understand consumer experiences with disclosure and how decision-making is currently informed.

14.5. The research confirms the often-subjective process of selecting “the right” policy is tackled by consumers in varied ways, and the industry needs to be nimble and innovative in engaging with a diverse range of consumers.

14.6. The research suggests the industry needs to do more to ensure consumers are not just focused on the price of a policy, but recognise the importance of selecting the right type and level of cover.

14.7. The legislated content requirements for a general insurance Product Disclosure Statement (PDS) are comprehensive. However there is potential for more strategic engagement with consumers about targeted information, particularly at the point of sale. The ICA submits, for the Commission’s consideration, two areas of regulatory change to facilitate these improvements to disclosure:

14.7.1. The delivery of disclosures electronically

[36] Insurers are required to meet the disclosure requirements contained within the Corporations Act 2001 and Insurance Contracts Act 1984.

14.7.2. The provision of advice.

14.8. **Electronic disclosure.** Electronic forms of disclosure have the potential to enable insurers to better target information that is relevant to a consumer.

14.9. The PDS fulfils an important function of setting out the terms and conditions of a policy, but electronic disclosure can enable a consumer to more easily identify the information that they are seeking. Digital innovation also opens opportunities to provide information in more personalised ways.

14.10. Recognising the benefits to consumers of electronic disclosure, in July 2015, ASIC issued revised guidance and issued relief to remove barriers to electronic disclosure in the *Corporations Act 2001* (the Corporations Act). One of the key changes made by ASIC was to enable a product issuer to provide a disclosure document electronically without the need to seek a client's explicit consent. ASIC has also implemented relief to allow disclosure using any digital method to be made by notifying the client that the disclosure is available.

14.11. Unfortunately, insurers cannot take advantage of the relief and guidance provided by ASIC as it is confined to requirements under the Corporations Act. The disclosure requirements for insurance are not only set out in the Corporations Act, but also the *Insurance Contracts Act 1984* (the IC Act).

14.12. ICA acknowledges it was not ASIC's intent to limit the scope of the proposals in relation to insurers; rather, ASIC is not empowered to provide relief under the IC Act to the same extent as it is under the Corporations Act. Nevertheless, there is no compelling policy reason for there to be a different regulatory approach to electronic disclosure for insurers relative to other providers of financial services.

14.13. The ICA has sought law reform[37], but understands Treasury has not yet been able to consider the legislative changes required due to competing legislative priorities.

14.14. **Providing advice.** The industry has long argued the current regulatory framework unnecessarily constrains its ability to provide simple product information appropriate for the consumer's circumstances.

14.15. The current personal advice regime requires onerous training for advisers, a complex needs analysis and the comprehensive documentation of any recommendations.

14.16. Therefore, most general insurance is sold on a 'no advice' business model. Where advice is provided, care is taken that it falls within the less-onerous definition of 'general advice'.

14.17. The industry is not commonly called upon to provide complex advice. Research suggests consumers do not want or need personal advice, but require guidance in making decisions about their insurance needs.

14.18. Consumers generally prefer experience-based and contextual information that supports independent decision-making. However, the fear of unintentionally coming within the legal definition of personal advice hinders insurers from being more innovative in the guidance they provide. This is detrimental for both industry and consumers.

14.19. For example, under a no-advice or general advice model, insurers often struggle to engage with consumers who are seeking to validate a decision. Insurers are also constrained in pointing out to consumers the shortcomings in the choices they are making. Given the range of exclusions and limits that may apply to a policy, it is unlikely

[37] Insurance Council of Australia (10 August 2016), *Facilitating electronic disclosure in the insurance sector*, submission to the Treasury,

many consumers have the patience to be taken through each of them by a call centre operator. There seems to be general interest in insurers bringing the consumer's attention to the exclusions/caps that could be relevant to them. However, this raises issues of potentially giving personal advice and creating liability for the insurer if an exclusion that turns out to be relevant was not specifically mentioned.

14.20. The industry would welcome further engagement with Treasury and ASIC on reform options that would make the advice regime work better for insurance product issuers that are distributing their own products.

14.21. **Unfair contract terms.** In April 2017, Consumer Affairs Australia and New Zealand provided consumer affairs ministers with its final report on its review of the Australian Consumer Law[38].

14.22. One of the proposals was to apply unfair contract terms protections to insurance contracts regulated by the *Insurance Contracts Act 1984*.

14.23. As the ACCC would be aware, the Final Report was considered at the 31 August 2017 Legislative and Governance Forum on Consumer Affairs (CAF). Ministers asked officials to undertake a public regulatory impact assessment of the UCT proposal (and others) and to report back to CAF in August 2018 for subsequent decision.

14.24. Additionally, in its final report following the Inquiry into Australia's General Insurance Industry, the Senate Economics References Committee also recommended the Government introduce legislative changes to remove the exemption for general insurers to unfair contract terms laws[39].

14.25. The ICA is exploring how unfair contract terms could be incorporated into the *Insurance Contracts Act 1984*, and how to assist the Government and regulators to develop an appropriate solution, if a decision is made to accept the ACL Review proposal and/or the Senate Committee recommendation.

15. AVAILABILITY AND USE OF DATA

15.1. Insurers hold detailed and sophisticated data to underwrite a range of risks faced by consumers and businesses.

15.2. Underwriting data is a commercial asset for insurers. It is also the basis on which insurers compete against each other. This is highly technical, commercially sensitive and often proprietary information, which will have limited value to consumers.

15.3. However, the ICA believes consumers may better understand their risks if they are provided with access to non-commercially sensitive hazard data, rather than the competitively developed underwriting data used by each insurer.

15.4. **Hazard Data**. State and local governments should provide clear, concise and consumable hazard data for every household and business. Various efforts have been commenced over the past decade and some jurisdictions have made progress.

15.5. The ICA has played a role in collecting, centralising and making this data available to insurers. Individual insurers often combine this common data with their own data for use in underwriting, making it commercially sensitive.

[38] Australian Consumer Law Review, Final Report, March 2017.

[39] The Senate Economics References Committee, Australia's general insurance industry: sapping consumers of the will to compare, August 2017.

15.6. Each insurer will apply different methods for measuring risk. This will result in diverging assessments of the same risk. Therefore, while the provision of natural hazard information to consumers is likely to be beneficial, its disclosure by individual insurers may well lead to consumers receiving inconsistent and conflicting information from different insurers.

15.7. For example, one insurer may assess a household's flood risk to be medium, based on data collected by the ICA. Another insurer may have more detailed data from past claims experience and assess this same household as a high flood risk. The provision of inconsistent natural hazard data to consumers could create confusion, rather than be informative.

15.8. For this reason, the industry believes governments remain in the best position, and have the responsibility, to provide natural hazard data to the public.

15.9. In lieu of a national solution being created by governments, the ICA has developed its own national portal for consistent hazard data (not insurer-specific underwriting data) to assist industry members to educate policyholders about the hazards present in their location.

15.10. This solution assists the industry and specific consumers with whom they engage. It also serves to demonstrate that creating a national portal for this type of information is achievable within very modest constraints[40].

15.11. Understanding the hazards that might impact at a specific address is only one part of understanding the risk. Consumers also need to understand if their building is likely to be vulnerable to the predicted events, by virtue of the design or building materials used.

15.12. To assist consumers with understanding potential issues with their buildings, the ICA has piloted a Building Resilience Rating Tool. This tool allows a consumer to construct their property in a virtual sense, identifying materials used and other issues. The tool then provides feedback to the consumer on any vulnerability issues that may exist because of the use of an inappropriate building material or technique.

15.13. The pilot of this rating tool can be accessed at www.resilient.property for anyone who wishes to explore issues with their building. The tool may be developed beyond the pilot stage in the future.

15.14. **Consumer data.** The Productivity Commission[41] has recently considered the potential benefits to consumers of being able to access their own data. The rationale is that, by accessing data about their consumption behaviour, consumers are better able to assess the value provided by alternative products and to compare products in the market.

15.15. However, unlike other products that are "consumed", insurance transaction data is unlikely to assist consumers to make more informed decisions. A consumer making a claim against a policy might be the only point at which the product is consumed, and most consumers purchase insurance without an insured event occurring and triggering this point of consumption.

15.16. From a general insurance point of view, consumer knowledge about their own risks, and the different options available in the market for covering that risk, represents the most valuable information to a consumer.

15.17. However, access by individuals to detailed insurer risk data collected about them is unlikely be useful in making consumption decisions. This is because individual insurers will

[40] The ICA DataGlobe is available at http://icadata.link/hazards All aspects of the program cost approximately $1.5 million annually.

[41] Productivity Commission (8 May 2017), *Data availability and use*, Public inquiry final report.

use different data and have varied assessments of risk depending on their underwriting models. From a consumer's point of view, access to risk data that will differ from insurer to insurer is unproductive.

16. IMPACTS ON AFFORDABILITY FROM TAXES, STAMP DUTIES AND LEVIES

16.1. The ACCC's Issues Paper highlights the fact the combination of taxes, levies and stamp duties can significantly inflate the cost of general insurance premiums for households and businesses.

16.2. It is critical that the ACCC examines this issue in more detail, as those charges contribute to the incidence of non-insurance and underinsurance in Australian communities.

16.3. As the ACCC may be aware, the removal of insurance taxes has long been advocated by major national inquiries, including the Australian Government's Review of Australia's Future Tax System (the Henry Tax Review) and the Productivity Commission's 2014 Inquiry into Natural Disaster Funding Arrangements.

16.4. Phasing out taxes, levies and stamp duties on general insurances would provide significant social and economic benefits to Australian communities. It would reduce the incidence of non-insurance and underinsurance and lead to net increases in private household consumption and tax revenue collected by state and local governments.

16.5. As the ACCC's Inquiry is considering the materiality of taxes, levies and duties to the affordability of insurance in northern Australia, the ICA strongly encourages the ACCC to carefully examine the significant social and economic benefits of phasing out those charges for northern Australian communities. However, any changes to taxes on insurance in northern Australia should ultimately be extended to all policyholders as a matter of fairness and equity.

16.6. **Reducing non-insurance and underinsurance.** Research from the ICA in 2015[42] examined the impact of removing State and Territory insurance premium taxes on the take-up of house or contents insurance. The research estimated the change in take-up if stamp duties (and the Emergency Services Levy in NSW) were removed from States and Territories.

16.7. The research found the removal of all insurance taxes and charges would result in a $643 million (or 13 per cent) increase in household expenditure on pre-tax insurance premium on house or contents insurance across Australia.

16.8. The consequences of Australian households or businesses underinsuring or not insuring is unfortunately too commonly demonstrated following natural catastrophes. Where they are either uninsured or underinsured, they leave themselves financially vulnerable by risking their properties and other valuable assets. Inefficient insurance taxes, which can increase base premiums by up to 45 per cent[43], have a substantial impact on insurance affordability and continue to operate as a significant barrier to purchasing adequate insurance coverage.

16.9. **Increasing net household consumption and taxation revenue.** Additional research undertaken for the ICA in 2015[44] found significant economic benefits could arise from removing insurance-based stamp duties and raising the revenue forgone through alternative, more efficient means – namely, a commensurate increase in municipal rates

[42] Research by Dr Richard Tooth, *Sapere Research Group*, commissioned by the Insurance Council of Australia in 2015.

[43] In NSW, the ESL, GST and stamp duty can lead to effective taxes of around 45 per cent on a home insurance policy premium.

[44] Research by *Deloitte Access Economics*, commissioned by the Insurance Council of Australia in 2015.

(a broad-based tax on land) – that would have a neutral impact on State and Territory government budgets.

16.10. The ICA's research found that removing all insurance-based stamp duties across Australia, including the ESL in NSW, and replacing them with commensurate increases in municipal land rates, would lead to a net increase in:

16.10.1. Real private consumption across Australia of $5.52 billion

16.10.2. Tax revenue collected by state and local governments of $575 million after five years if this reform was implemented Australia-wide.

16.11. As pointed out in the ACCC's Issues Paper, in July 2016, the ACT became the first State or Territory jurisdiction to abolish insurance stamp duties after completing a five-year transition.

16.12. Without the removal of stamp duties, we estimate[45] that the average combined ACT home building, contents and motor insurance premium would be about $185 higher.

16.13. The ACT Government's decision to phase out insurance stamp duties is a clear acknowledgement that reform of state/territory insurance taxes is achievable. The reform also recognises that encouraging insurance take-up is a major part of building a community's long-term resilience to natural disasters and other catastrophes. The ICA strongly encourages all jurisdictions to follow the ACT Government's lead.

17. CONCLUSION

17.1. The issue of ensuring that premiums remain affordable has been foremost in the minds of insurers for over a decade now. Multiple government inquiries, at all levels, have investigated the drivers of affordability and all have arrived at broadly similar conclusions:

17.1.1. The market is generally competitively pricing risk and is well serviced by market participants, with regulatory provisions in place for international competitors to participate where local insurers cannot reasonably do so.

17.1.2. Market pricing practices and available covers have changed over time and price signals are now more acute. Adverse price signals for those with high exposures now exist and should serve to focus activity on targeted mitigation to reduce risk.

17.1.3. Price signals directly reflect residual risk. Investing in mitigation works to reduce premiums.

17.1.4. Northern Australia has much higher exposures and claims costs.

17.2. The ICA submits that the ACCC should carefully consider these factors, and in doing so recognise that:

17.2.1. Fewer insurers have capability to operate in the north, but competition remains.

17.2.2. It is more expensive to insure in the north, reflective of the risk and claims costs.

17.2.3. Reinsurance for natural perils remains available, is competitive and is currently not a significant factor in affordability for northern Australian premiums.

17.2.4. Insurers are operating in a difficult underwriting and investment environment, and that as a result insurer performance is satisfactory but not strong.

[45] Insurance Council of Australia Media Release, 1 July 2016. The average combined cost of ACT home building, contents and motor insurance in 2016 was $1851. With a 10 per cent stamp duty applied, that cost would rise to $2036.

17.2.5. Despite perceptions, insurers have not left the market in northern Australia.

17.2.6. The pricing of premiums is highly independent, even between brands operating within a group structure.

17.2.7. Improving transparency and disclosure are high-priority issues for the industry, both of which require further and ongoing work.

17.2.8. The availability of unambiguous risk data for consumers is a prerequisite to consumers making informed decisions about preparing for natural disasters. Governments need to do more work to inform community members about hazards.

17.2.9. The industry continues to provide premiums reductions where mitigation is shown to have reduced risk. This industry also stands ready to facilitate further government actions to educate the community about hazards. Industry actions include:

17.2.9.1. Developing proposals for the retrofitting of homes to increase resilience to cyclone events

17.2.9.2. Creation of consumer-facing hazard data resources

17.2.9.3. Creation of consumer-facing resilience rating tools to improve understanding about the performance of buildings

17.2.9.4. Participation in government schemes such as the Queensland roof replacement and strata engineering schemes

17.2.9.5. Developing the ICA's consumer financial capability initiative Understand Insurance (www.understandinsurance.com.au) and helping consumers to identify product providers through the Find an Insurer service

17.2.10. The removal of government taxes, duties and levies should remain a priority for all governments. This is an essential and immediate mechanism to reduce the cost of all insurance products that government believe community members should purchase in order to protect themselves.

17.2.11. The most sustainable way to reduce premiums in high-risk areas is to reduce the exposure of the community, through targeted mitigation strategies.

If you have further questions regarding this submission please feel free to contact Mr Karl Sullivan, the ICA's General Manager for Risk and Disaster Planning, on (02) 9253 5155 or via email at ksullivan@insurancecouncil.com.au

Yours sincerely

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