ADDRESSING THE HIGH COST OF HOME AND STRATA TITLE INSURANCE IN NORTH QUEENSLAND

Allianz Australia

Introduction

Allianz's submission focuses on the high cost of home insurance in North Queensland. The submission discusses some of the drivers of high home insurance premiums, particularly a property's vulnerability to the specific natural perils of cyclone and flood. Flood risk is, of course, not limited to Nth Queensland. However, for affected property owners, it creates as much as a home insurance affordability issue as cyclone risk. As a result, any discussion about home insurance affordability cannot be limited to cyclone risk or to Nth Queensland. It is also relevant, that affordability issues are most acute for homeowners that are highly vulnerable to both floods and cyclones.

In this broader context, Allianz submission focuses on 'addressing' the high cost of home insurance. In relation to the discussion paper, these issues are discussed as the context of increasing consumer awareness. Put simply, in Allianz's view, increasing consumer awareness about the high cost of home insurance will make no contribution to addressing the high cost of insurance.

Allianz suggests that consumers are already painfully aware of the high cost of home insurance, particularly in Nth Queensland. On the presumption that at some time in the future an Australian Government may give serious consideration to how the high cost of insurance facing some homeowners could be addressed, Allianz submission briefly discusses how such an outcome could be achieved.

Allianz does not believe that allowing unauthorised foreign insurers easier access to Nth Queensland insurance markets (or, in the context of flood insurance affordability, Australia's flood plain insurance markets) would have any material impact on the cost of home or strata insurance. Allianz's submission therefore does not discuss this proposal. Allianz generally supports the submission of the Insurance Council of Australia on this issue.

Allianz is not a major provider of residential strata title insurance in Nth Queensland or, indeed, in Australia more generally. As a result, we have not provided comment on the issues raised in respect of promoting resilience of strata buildings. Allianz also does not have comprehensive direct information about the extent of the affordability issue in relation to the premiums paid by lot owners in strata title developments. The discussion below therefore focusses on the issue of a lack of affordability for stand-alone residential houses.

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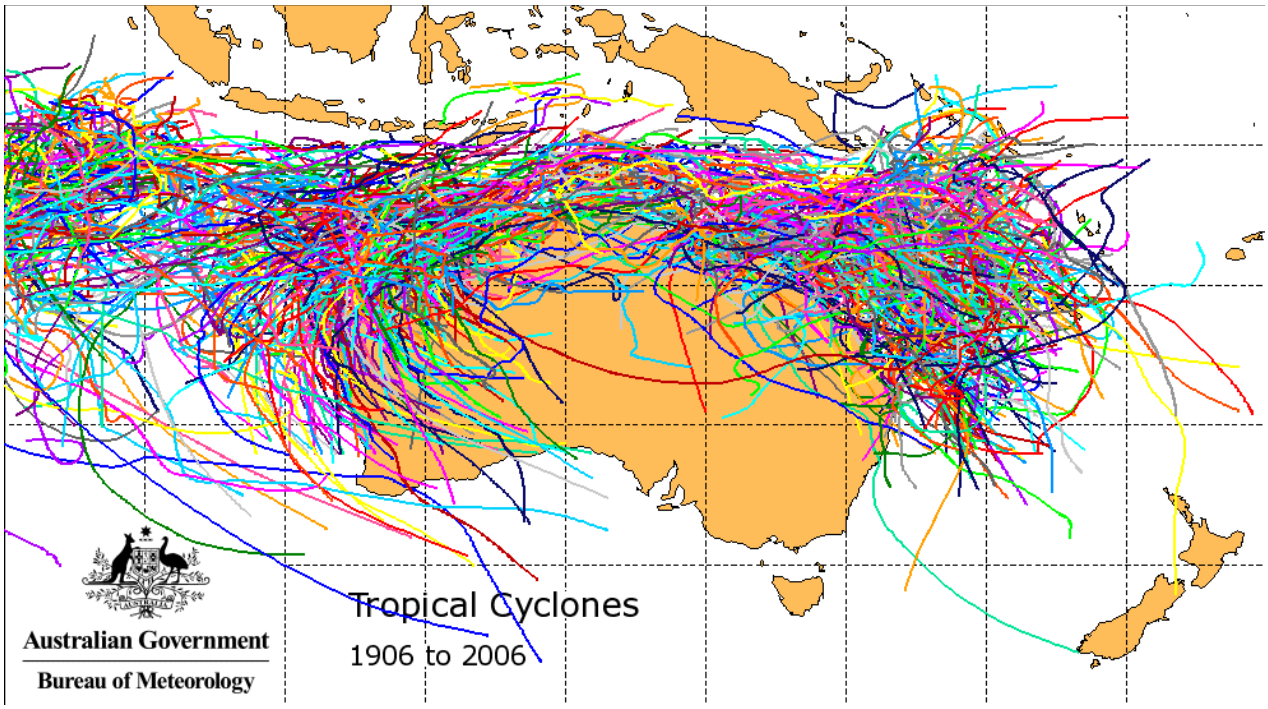
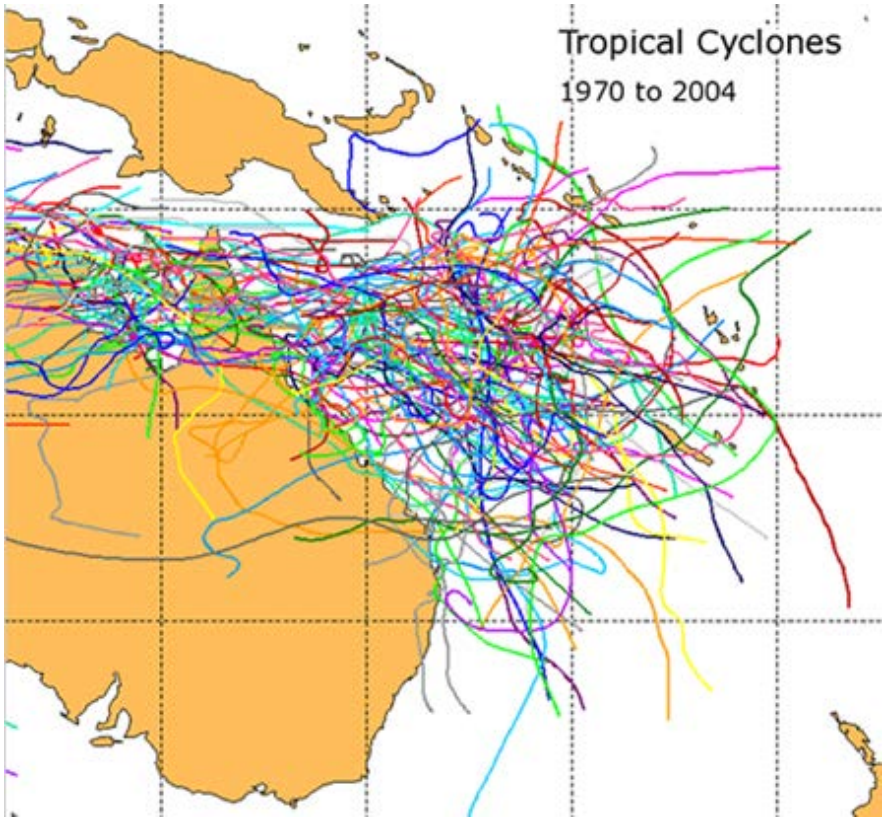
North Queensland cyclone risk and residential home and strata insurance premiums

The high prices of home and strata insurance in North Queensland reflect the risks associated with the extreme weather perils facing the area and northern Australia more generally. In particular, northern Australia is vulnerable to cyclones, which for the most part do not impact the southerly regions of the country – see pictures below. There have been 214 reported tropical cyclones that have crossed the East Coast of Australia in the last 155 years; an average of 1.4 per annum. The overwhelming majority of these cyclones have cross the cost of Queensland, particularly Nth Queensland.





Allianz's submission focuses on residential home insurance. Many of the issues raised and solutions discussed apply equally to residential strata insurance however Allianz does not generally provide residential strata insurance in Nth Qld. A key reason for this is that, in Allianz's view, cover for strata properties in Nth Qld has been under-priced and hence unprofitable for many years, if not decades. For example, in the eight years to 2012-13, Allianz made cumulative profits of $16,857 from total Gross Earned Premiums of around $350,000. Over the period, Allianz's cumulative losses (inclusive of reinsurance recoveries) were around $1.15 million. In other words, over this period, Allianz incurred losses of more than three times the amount collected in premiums.

Allianz notes that the first report of the Australian Government Actuary (AGA) on the Nth Queensland residential strata insurance market (conducted soon after Cyclone Yasi) demonstrated that residential strata was been an unprofitable class of insurance over the period 2007 to 2011. According to the AGA analysis, significant price rises following Cyclone Yasi resulted in this class of insurance potentially achieving a positive underwriting margin in 2012 (depending on the cost of reinsurance, which was not factored into the AGA analysis). In Allianz's view, even after those premium increases, the future financial sustainability of residential strata pricing remains an open question.

While the government's discussion paper focuses on the affordability of cover in Nth Queensland in the context of cyclone risk, Allianz has been concerned for some time about the growing lack of affordability of residential home insurance for Australians that are subject to the risk of both floods and cyclones. To the extent that the private market, charging premiums based on risk, is not able to provide affordable home insurance to all Australian homeowners, Allianz has considered how this lack of affordability could be addressed. These issues are discussed further below in the context of both flood and cyclone risk. Allianz believes any discussion of home insurance affordability needs to consider both flood and cyclone risk because:

- while cyclone risk may be creating home insurance affordability issues in Nth Queensland, flood risk is creating arguably more acute affordability issues for some homeowners all over Australia. In fact, if it was not for Allianz (and only one other insurer that we are aware of) that, in Queensland, currently allowed people to opt out of flood cover if they cannot afford it, large numbers of homeowners would be forced out of home insurance; and

- Nth Queensland residents can be subject to both flood and cyclone risk, resulting in extremely high home insurance premiums.

Affordability of home insurance premiums

In recent years, home insurance premiums have increased for all Australians. One of the significant drivers of these increases has been a large number of extreme weather events, including the 2009 Victorian Black Saturday bushfires, the March 2010 Melbourne and Perth hailstorms, and 2011's Queensland and Victorian floods, Cyclone Yasi and Melbourne's Christmas Day hail storm.

The impact of these events on insurers' claims costs and the cost of catastrophe reinsurance has flowed through to higher premiums for all homeowners. However, increases have been even more pronounced for those vulnerable to extreme weather events – specifically, flood and cyclone.

Affordability of insurance for cyclone risk

Insurance premiums for properties exposed to cyclone risk, which affects northern Australia, particularly North Queensland, can also be very expensive. The Government's discussion paper notes that average premiums for combined home and contents insurance in Nth Queensland "are around 2.5 times those in Queensland's southern cities", ranging from around $3,000 to around $6,000 for an average property (ie building sum insured of $300,000 and contents of $80,000). The paper also indicates that these prices relate to "properties with no or negligible flood risk.

If, all things being equal, home owners in Nth Queensland paid 2.5 times the amount for home insurance than homeowners in non-cyclone risk areas (eg all Nth Queensland home owners faced premiums of around $4,500, compared to average premiums of $1,500 elsewhere) Allianz suggests that such price differences properly reflect the different risks being faced and are consistent with the desirability of retaining an appropriate risk signal to homeowners. In such circumstances, it is far from clear that a case for any government intervention in the home insurance market is required.

However, from its own experience, Allianz knows that underlying average insurance premium figures in Nth Queensland there are wide variations in the prices faced by homeowners. For example, in Allianz's experience, the annual premium for a home building and contents policy (eg total sum insured of $400,000) for a property in Nth Queensland can be as much as $20,000.

Allianz undertakes regular competitor pricing analysis and can confirm the figures in the discussion paper that average premiums in Nth Queensland for combined building and contents home insurance with a total sum insured of around $400,000 and no flood risk are generally in the range of $3000 to $6000, compared to areas of southern Queensland where average premiums are between $1500 and $2000. However, as discussed, these average figures disguise large variations, particularly above the average.

For example, market data available to Allianz indicates that during Q1 2014, competitor quotes (brands not disclosed) for different property profiles in Nth Queensland included the premiums in the following table.

Type of cover	Location	Sum Insured	Flood risk	Premium
Building only	Holloways Beach, Nth Qld	$345,000	Yes	$8626.45
Building only	Cairns Qld	$465,000	No	$9289.86
Building and Contents	Goondi Bend, Nth Qld	$291,693	Yes	$10,031.43
Building and Contents	Newell, Nth Qld	$341,438	No	$9,868.77

As the table indicates, considering affordability issues based on a comparison of average premiums can be instructive, but it has limits in any broader discussion about home insurance affordability, the extent of the problem and the potential responses that could be considered to address community concerns about affordability.

Arguably, average premiums between Nth Queensland and elsewhere involving multiples of 2.5 times reasonably reflect differences in risk. And if premiums were limited to such differences, it is not clear that a case for a regulatory response from government would exist. However, this conclusion becomes harder to sustain in light of evidence that some

homeowners face premiums of ten or fifteen times those of other Australians, and where the cost of home insurance could be equivalent to the annual income of an aged pensioner that owns the property.

At such extreme levels, premiums cease to act as an appropriate price signal and drive other behaviours and decisions which have a range of negative consequences. Some of these include non-insurance, intentional underinsurance, disincentives to invest in residential property, discouraging population growth in whole regions (as opposed to on flood plains, which is entirely desirable) and lower overall levels of economic activity.

A high level of underinsurance creates a vicious cycle for insurers because it reduces the efficient size of the premium pool. For example, all things being equal, underinsurance reduces the premium pool available to fund claims, increasing insurers' loss ratios. To maintain, or more closely reach, target levels of return, insurers are likely to respond by increasing premiums. This only serves to exacerbate the underinsurance problem further, resulting in a vicious cycle of further premium rises etc.

Availability and affordability of flood insurance

Similar affordability issues arise in respect of flood cover for residential properties with medium to high flood risk.

Insurance cover for 'riverine' flood damage is relatively new in the Australian market. Historically, residential insurance policies *excluded* cover for flooding. Widespread community awareness of this increased most recently in the aftermath of the 2011 Queensland floods.

Over the last decade, the technology insurers need to 'price' flood risk and the availability of government flood risk data has improved. As a result, residential flood cover has been progressively introduced into Australia since around 2007 and, today, most Australian insurers offer flood cover.

However, the price of cover in flood risk areas can be extremely high. For example, the annual premium of a home building and contents policy for an 'average' property (ie a total sum insured of $400,000) with a high flood risk can be as much as $20,000. Premiums at such levels are likely to be unaffordable for most Australians. The annual premium for the relatively small number of homes that are subject to both high flood risk and cyclone risk can be in excess of $30,000.

Thus, while only around 5% of residential properties in Australia are clearly exposed to riverine flood risks which results in very high premiums, the insurance market is unable to provide affordable home insurance for some Australians living in high flood risk areas.

Allianz and affordability of flood cover

The impact on non-insurance and underinsurance of the high cost of flood cover differs compared to cyclone risk because of the ability, at least at this point in time, for homeowners who cannot afford flood cover to opt out of it. The development in the availability of riverine flood insurance has resulted in two approaches to the provision of residential flood cover currently being adopted by insurers:

- Mandatory flood cover – where inclusion of flood cover is standard in the policy, like other risks such as cyclone, fire, storm and earthquake; and
- Customer Choice – where flood cover is optional and the policyholder can choose whether or not to purchase it.

Most insurers in the Australian market have adopted the mandatory flood cover approach. Allianz, on the other hand, offers Customer Choice of flood cover.

In both cases, the premium charged will reflect the flood risk faced by the specific property, although the flood component of the premium may only be separately shown on policies that provide optional flood cover.

For insurers that provide mandatory flood cover, customers that do not wish to pay the additional premium for flood cover, or cannot afford to, are forced to seek insurance from another company if they wish to remain covered for the traditional home insurance risks (eg fire). If all insurers adopted the mandatory approach, home owners that could not afford flood cover would be forced out of the home insurance market altogether.

As noted, so that our customers are not faced with this dilemma, Allianz currently adopts the Customer Choice approach. As a result, even if our policyholder cannot afford flood cover, they can still obtain insurance protection against other risks such as fire, storm, earthquake, burglary etc.

Unfortunately, however, due to the high cost of flood cover for many properties with a material flood risk, most customers opt out of flood cover. As a result, if their property is affected by 'riverine' flooding, they are not covered for flood damage. It is true that, in terms of the number of insurers offering cover, there is a wide availability of flood insurance compared to even a few years ago. However, this is not all that instructive in terms of the extent that this has resolved the underlying problem of lack of insurance for properties vulnerable to flood. For example, industry figures that indicate that around 90% of insurance policies cover flood, say nothing about whether the less than 10% of properties with a material flood risk are covered. Allianz's optional approach to flood provides some data that can assist in answering this question.

For the purposes of analysis and discussion (as opposed to pricing, which is significantly more sophisticated), Allianz has established six flood risk categories where category 6 represents the highest flood risk and category 1 the lowest. Following our roll-out of flood cover in 2012, Allianz collected some information on flood cover opt-out rates in NSW and Queensland, which are shown in the table below.

Building flood cover opt-out rate: New business – 31 Dec 2011 to 31 July 2012

	Category 6 ARI[1] 1-49yrs	Category 5 ARI 50-99yrs	Category 4 ARI 100-499yrs
NSW	98.44%	87.07%	82.77%
Qld	94.5%	67.397%	61.86%

As the table indicates, in a flood risk category that extends to an Annual Return Interval (ARI) of 49 years, opt-out rates in NSW and Queensland exceeded 90%. While in Category 5, which encompasses properties with an ARI of between 50 and 99 years, which could be described as a 'medium to low' flood risk, opt-out rates were nearly 90% in NSW and nearly 70% in Queensland.

[1] ARI – Annual Return Interval – The frequency/probability in years of a flood occurring. Eg ARI 20 years means that, over the 'long term' a flood will occur 'on average' every 20 years. Or, for premium setting purposes, in any year there is a 5% probability of a flood occurring.

Greater sophistication of insurance risk pricing and the impact on premiums

To provide some information on the impact of flood risk on home premiums, the following table shows indicative average and minimum/maximum premiums. These figures were compiled at the time Allianz commenced offering optional flood cover, for the most part, over the course of 2012.

Allianz Flood Premiums (including taxes): NSW – New business – 31 Dec 2011 to 31 July 2012

	Category 6 ARI[2] 1-49yrs	**Category 5 ARI 50-99yrs**	**Category 4 ARI 100-499yrs**
Building Ave sum insured	$322,526	$309,738	$294,917
Building: **Ave non-flood premium**	$860	$908	$844
Building: **Ave flood premium**	$1884	$666	$255
Building: Min and Max flood premium	$655-$13755	$312-$5020	$60-$2390
Building **Total Ave Premium (Incl Flood)**	$2744	$1574	$1099
Contents: Ave sum insured	$65,916	$70,406	$59,493
Contents: **Ave non-flood premium**	$392	$415	$377
Contents: **Ave flood premium**	$1539	$679	$190
Contents: Min and Max flood premium	$595-$9045	$315-$3671	$52-$1551
Contents **Total Ave Premium (Incl Flood)**	$1930	$1093	$567
Total Ave Building and Contents (Exc Flood)	**$1252**	**$1323**	**$1221**
Total Ave Building and Contents (Incl Flood)	**$4704**	**$2667**	**$1666**
Total Min and Max Building and Contents (Incl Flood)	**$2502-$24052**	**$1950-$10014**	**$1333-$5162**

The table highlights the issue of home insurance affordability for properties vulnerable to flood compared to properties vulnerable to cyclone. For example, the average non-flood building and contents premium for houses in the highest flood risk zone (Category 6) is $1252. The average premium including the cost of flood cover in this zone is $4704.

In other words, like the premium differences between Nth Queensland and the south of the State referred to in the discussion paper, in Allianz's experience, the average premium for properties vulnerable to flood are also around 2.5 times that of properties with no flood risk. However, like cyclone risk, underlying such averages is a wide range of premiums. In the case of Category 6 flood risks, some properties face premiums 20 times the non-flood risk average. Even for properties subject to medium to low flood risk (Category 5), premiums are over 7 times the non-flood risk average.

[2] ARI – Annual Return Interval – The frequency/probability in years of a flood occurring. Eg ARI 20 years means that, over the 'long term' a flood will occur 'on average' every 20 years. Or, for premium setting purposes, in any year there is a 5% probability of a flood occurring.

As discussed above, for Nth Queensland properties, premium extremes above the non-cyclone risk average range up to similar magnitudes, depending on the vulnerability of the property. For example, a Nth Queensland property can face premiums of more than ten times that of a similar property not vulnerable to cyclone risk, if the property:

- was built before 1982, when higher cyclone building standards were introduced;
- is constructed of weatherboard, rather than brick;
- has had recent claims and is, for example, ineligible for no claims bonus discounts;
- is located on low lying land close to the coast, and is thus also vulnerable to storm surge, which is often caused by cyclones or extreme low pressure storm events that cross the coast; and/or
- is located on the side or top of a hill (where windshear in an event can result in wind speed nearly twice that impacting adjoining flat areas).

The discussion paper referred to improvements in technology and the sophistication of insurance pricing. The relatively recent ability of some insurers (including Allianz) to price at the address level (ie geocoding), rather than by postcode or suburb, has been a key driver of the ability for insurers to offer types of cover where pricing needs to vary house-by-house. Flood is a perfect example of this because flood risk between properties can vary dramatically over a matter of metres (ie up hill). An example, of this is the table below which represents premium calculations Allianz conducted on two addresses[3] located in the same street in Townsville. The premium differences highlight the significant impact that flood risk can have at the address level for two houses that are literally across the road from each other and less than five houses apart.

[3] The examples are based on an assumed 'profile', that is, the underwriting assumptions used (eg age and construction of building) were the same for both properties. The premiums are the actual premiums that Allianz would offer to customers located at those addresses if their answers to the underwriting questions matched those assumed. Note, the street name has been de-identified for privacy reasons.

Table: Identical property profile for two blocks in the same street – impact of flood risk on premium

				46 XXX Street, South Townsville QLD 4810			
Calculated Premium		- Buildings					$ 10,611.69
		- Contents					$ 1,446.63
		- Buildings - Flood					$ 6,628.71
		- Contents - Flood					$ 5,971.74
Total							$ 24,658.77
Apply Charges				**FSL/SESL**	**GST**	**Stamp Duty**	**Cover Total**
		- Buildings		$ -	$1,061.16	$ 1,050.55	$ 12,723.40
		- Contents		$ -	$ 144.66	$ 143.21	$ 1,734.50
		- Buildings - Flood		$ -	$ 662.87	$ 656.24	$ 7,947.82
		- Contents - Flood		$ -	$ 597.17	$ 591.20	$ 7,160.11
Total Premium				$ -	$2,465.86	$ 2,441.20	$ 29,565.83
				55 XXX Street, South Townsville QLD 4810			
Calculated Premium		- Buildings					$ 10,611.69
		- Contents					$ 1,446.63
		- Contents - Flood					$ 7.50
		- Contents - Flood					$ 7.50
Total							$ 12,073.32
Apply Charges				**FSL/SESL**	**GST**	**Stamp Duty**	**Cover Total**
		- Buildings		$ -	$1,061.16	$ 1,050.55	$ 12,723.40
		- Contents		$ -	$ 144.66	$ 143.21	$ 1,734.50
		- Buildings - Flood		$ -	$ 0.75	$ 0.74	$ 8.99
		- Contents - Flood		$ -	$ 0.75	$ 0.74	$ 8.99
Total Premium				$ -	$1,207.32	$ 1,195.24	$ 14,475.88

Note: FSL/SESL refers to fire and emergency services levies that do not apply in Qld

The table indicates that there is a difference of more than $12,500 in the risk premium between to two addresses due solely to their different flood risks. Another point in terms of insurance affordability that is not lost on insurers or their customers, but remains unresolved by governments, is the impact of taxation on insurance. Indeed, the Queensland Government recently increased Stamp Duty on property insurance by 33% (from 7.5% to 9%), at the same time it expresses concern about the cost of insurance in Nth Queensland. For example, the tax paid on the flood-risk property in this example is nearly $5,000, or around four times what an equivalent property owner with no flood or cyclone risk (eg in South East Queensland) would pay for their entire home insurance premium.

The cyclone maps above indicate that insurers have never required address-level pricing capabilities to determine which areas should be subject to premium loadings for cyclone risk. However, this capability now enables insurers to further refine pricing in cyclone areas to take into account some of the issues outlined above. For example, proximity to the coast and storm surge risk, the direction a property faces and its elevation in relation to windshear risk.

The impact on premiums of this growing pricing sophistication will, all other things being equal, see premiums for some properties fall (generally to a modest degree) and premiums for some properties rise (possibly by a significant degree). Thus, while 'average' premiums could even remain unchanged, the range of premiums, particularly at the upper end, will continue to widen. As a result, constantly improving risk pricing will only further exacerbate affordability issues for some homeowners.

Solutions to home insurance affordability issues

If the problem the government seeks to address through increased consumer awareness is that the residents of Nth Queensland are not aware of the high home insurance premiums some of them face, then initiatives that provide additional price information will solve it.

However, as indicated above, Allianz is of the view that the upper range of premiums associated with properties subject to cyclone and flood risks have reached levels that *are* unaffordable for many affected homeowners. Moreover, that homeowners are already more than aware of this fact. Concerns about a lack of affordability of home insurance will never be addressed unless action is taken that directly reduces the premiums faced by affected homeowners.

That said, there is a range of measures that can be taken to reduce homeowners' vulnerability to loss from cyclones and floods. Examples include:

- investment in adaption (eg upgrading buildings);
- mitigation (eg flood levies);
- land use planning (eg preventing development on flood prone land);
- development controls (eg building height standards in flood areas); and
- building standards (more resilient structures).

However, not all properties can be assisted by these measures. For example, Australia has a significant legacy of properties built in flood zones and not all flood risk can be mitigated. Even where mitigation would be effective, it would take tens of billions of dollars of investment over decades to undertake all the flood mitigation works that could be carried out. Many homes in Nth Queensland were built before the current cyclone building standards were put in place, and retrofitting such improvements would be prohibitively expensive for many homeowners. Even then, the cyclone risk still exists and those that promote mitigation as a solution to Nth Queensland insurance costs are yet to articulate how cyclones can be mitigated.

Allianz has concluded that, for many properties highly vulnerable to flood and cyclone, affordable home insurance can only be delivered through some form of subsidy arrangement. Such an arrangement should not eliminate the price signals insurance can provide about risk, but there is a need to strike a better balance between retaining an appropriate risk price signal, while at the same time making home insurance affordable for those for which it has become

out of reach. Premiums do not provide an efficient price signal to customers that intentionally underinsure or drop insurance altogether. A traffic light does not provide a signal to a car that never drives down that street.

There are existing examples in Australia where private insurance markets are not able to provide affordable cover to individuals with high insurance risks, for example, private health insurance and compulsory third-party (CTP) motor accident insurance. In these instances, governments use regulation to force insurers to introduce hidden cross subsidies into their pricing. Allianz's view is that such lack of transparency distorts insurer behavior and has other negative impacts, and that premium cross subsidies should be explicit, for example, funded by separately identifiable levies.

Another example of government regulatory intervention which is instructive when considering responses to catastrophe risk is the scheme currently used to ensure affordable commercial property insurance in Australia. Following the 9/11 US terrorist attacks, the international reinsurance market ceased offering terrorism cover. In response, governments around the world intervened in their insurance markets to ensure the continued provision of affordable commercial property insurance that included cover for terrorism events.

In Australia, the Commonwealth Government established the Australian Reinsurance Pool Corporation (ARPC). The ARPC manages a 'terrorism pool' which, in the event of an eligible terrorism event, can be drawn on to help pay insurance claims. The ARPC is funded by an explicit levy on non-residential commercial insurance policies.

Insurance 'pool' arrangements are also used in other countries to assist in the provision of affordable flood insurance, such as the United States and United Kingdom. For example, in the UK, the government and the insurance industry have agreed to the establishment of a non-profit reinsurance pool, called Flood Re, to facilitate the provision of affordable flood cover to high-risk households. The pool, which commences operation in 2015, will be funded by a modest levy (around £10) on household insurance policies.

Following the 2011 Queensland floods, the Australian Government established the Natural Disaster Insurance Review (NDIR) in response to issues that arose in the aftermath of the event, such as the widespread lack of flood cover.

Allianz's submission[4] to the review suggested that flood insurance could be made more affordable through the establishment of a 'reinsurance pool' as a mechanism to provide a subsidy to homeowners facing unaffordable flood premiums. The NDIR made a number of recommendations relating to the affordability of insurance, including:

"That an agency…be created to…operate a system of premium discounts and a flood risk reinsurance facility." – (Pivotal Recommendation 1)

[4]http://www.ndir.gov.au/content/submissions/issues_paper_submissions/Allianz_Australia_Insurance_Ltd.pdf

"…an investigation be undertaken to ascertain whether there is a basis for granting affordability discounts for cyclone risk." – (Recommendation 27)

The report acknowledged Allianz's contribution to the review, stating:

"The idea of…the reinsurance pool was originally inspired by the Allianz Australia submission to the Review. (p61)

The NDIR's recommendations in relation to insurance affordability have not been adopted by the Government. However, Allianz remains of the view that a peril-specific reinsurance pool could be used to address the lack of affordability of home insurance premiums for those Australians facing high flood and cyclone risks.

The design of such a pool is a complex exercise, as it would need to fit within the broader regulatory environment impacting on cyclone and flood risk. For example, it would need to ensure that premiums retain an appropriate price signal to homeowners and to ensure that 'access' to the pool creates appropriate incentives in relation to adaption, mitigation, and land use regulation, particularly in respect of new buildings.

A key design feature worth highlighting is that the pool would only provide reinsurance for claims arising from the events that are driving the lack of affordability, currently 'named' cyclones and floods. Insurers would continue to rely on their own claims reserves and reinsurance arrangements for all the other claims they might receive in respect of a property that is eligible for support from the pool. The provision of subsidised reinsurance for cyclones and floods would remove the high level of uncertainty associated with insurers' exposure to these events and the concentration risks that limit their appetite for business in areas such as Nth Queensland.

With appropriate government regulation, a cyclone/flood reinsurance pool could be established and operated by the insurance industry and funded by a modest levy on residential insurance policies, similar to the way the 'terrorism pool' is funded by a modest levy on commercial property insurance policies. No government or taxpayer funding would be required to establish and operate such an arrangement.

There are different ways in which such a pool could operate. For example, it could operate like traditional catastrophe reinsurance, where the pool pays an insurer's claims over a certain deductible. Alternatively, insurers could price cover on the basis of a high 'named' cyclone excess (eg $50,000[5]) and the pool then assists eligible homeowners to pay all or part of that excess, recognising that, for most homeowners, a $50,000 excess would be unaffordable. This approach is similar in concept to the way the New Zealand Earthquake Commission operates,

[5] Allianz has undertaken a preliminary examination of its claims data from Cyclone Yasi, which suggests that a high cyclone excess would need to be of the order of at least $50,000 in order to have a substantial impact on improving the affordability of premiums for houses vulnerable to cyclone.

which pays up to a maximum of NZ$100,000 (plus GST) for insured building losses and up to NZ$20,000 (plus GST) for insured contents damaged as a result of an earthquake.

Increasing consumer awareness

As noted, Allianz does not believe that lack of consumer awareness underpins concerns about the affordability of home insurance in Nth Queensland. Thus, measures to enhance consumer awareness will do little to solve the essential problem, that is, that the nature of the risks faced by properties in Nth Queensland means that the market price for cover is unaffordable for some residents.

Consumer information site

If, however, the Government sees a need to do 'something' in response to concerns about home insurance affordability by increasing consumer awareness, Allianz prefers the proposal to establish a customer information site, along the lines of that provided by the Victorian Fire Services Levy Monitor, specific to the availability of home and strata insurance in North Queensland. The main reason for this preference is the significant difference in compliance costs of the different consumer awareness options set out in the discussion paper. Allianz estimates that the cost of providing and updating pricing information on, say, ten postcodes, would be up to $200,000.

The site could provide information on which insurers provide direct insurance in Nth Queensland as well as some indicative prices based on a selection of profiles differentiated by features relevant to premiums (eg construction date and building materials) in a range of locations (eg cities and major towns). Quotes could be obtained from relevant insurers and updated regularly or, probably at lower overall cost, purchased from companies that specialise in the collection of such data. A link to insurers' websites could also be provided where consumers could go and quickly get a quote for their own specific circumstances and, if it was acceptable, purchase insurance cover.

Such an insurance information site should be limited to insurers that offer cover direct in Nth Queensland, rather than extending to insurance provided through agency agreements (eg via financial institutions) or insurance brokers. Including insurance sold through intermediaries would result in an overwhelming number of providers and simply create confusion and unintended consequences. For example, many financial institutions (eg banks, credit unions, building societies, mutual banks, mortgage brokers) offer home insurance to complement the provision of home mortgages for their customers. In an environment where insurers are seeking to limit their exposure to cyclone risk, creating an unanticipated demand for insurance cover from non-customers could result in financial institutions restricting the availability of their insurance to their customers only.

The discussion paper suggests that such an insurance information site should enable a "comparison not only of price, but of the features of different insurance products" otherwise consumers "may be lured by lower prices into a policy that doesn't adequately cover their risk." The latter point highlights one of the key problems with 'aggregator' websites. However, to suggest that the provision of succinct additional information could materially reduce the focus this sort of information site (or any other form of price comparator) would place on the price rather than the suitability of cover is a vein hope.

Insurers are currently facing the introduction of a Key Facts Sheet (KFS) for home insurance which, at two pages long, is barely capable of helping customers distinguish the features of different insurance products. For example, Allianz has prepared legally compliant draft KFSs for its two fundamentally different types of home policy, that is, a Defined Events policy and an Accidental Damage policy. The KFSs for each of these are 99.9% identical, virtually down to the last word, except that one is headed Defined Events and one Accidental Damage. Despite these two different types of policy providing potentially significantly different claims outcomes for the customer, the KFSs are identical and the template we are required to use provides no opportunity to explain to customers the important difference between the two types of policy types.

If two pages of information cannot provide sufficient information to customers about the qualitative difference between two fundamentally different types of home policy, it is unlikely that any sort of policy comparison or aggregator site could address the key risk identified in the discussion paper, that is, of encouraging customers to focus on price rather than understanding whether the cover matches their needs and/or expectations.

Live quote aggregator

Concentration risk is one of the key factors driving insurers' appetite for business in areas prone to natural disaster risk. Insurance is not like a retail product where a supplier would be happy to have the entire market share available. Insurance is based on spreading risk. Insurers, for example, seek to spread their exposure across different perils (eg earthquake, bushfire, cyclone, flood) and, specifically, across different geographical areas.

The largest natural catastrophe risk modelled by Australian insurers for capital and reinsurance purposes is a Sydney earthquake. No Australian insurer would want to insure every house in Sydney. If they did, the resulting concentration risk would flow through into higher capital requirements and reinsurance costs and make that insurer uncompetitive in the home insurance market. Certainly this would be the case in the Sydney home insurance market if capital requirements and catastrophe reinsurance costs were allocated to policies geographically.

For the same reasons, no insurer would want to insure every flood prone property along the Brisbane river (or any other major river), or insure every bushfire prone house in the NSW Blue

Mountains. And, unsurprisingly, no insurer would want to insure every house in cyclone prone Nth Queensland. It is quite possible that most, if not all, insurers operating in the Nth Queensland already have their appetite for home insurance risk satiated (if not overly so). This is certainly the case for Allianz. Allianz notes the results of the recent One Big Switch home insurance campaign, which failed to find an insurer that wanted to a material portfolio of additional risks vulnerable to flood and cyclone.

In these circumstances, how would an insurer respond if it was required to participate in a live Nth Queensland home insurance aggregator? As discussed, the natural inclination of customers would be to direct their purchasing attention to the lowest priced policies on such an aggregator. If an insurer already had its appetite for Nth Queensland residential property cyclone risk satisfied, it would respond in one of two ways (or ultimately possibly both).

First, an insurer that did not want to accumulate more exposure to cyclone risk would seek to ensure that it was not a lower priced provider of cover on the aggregator. This could be achieved by increasing prices to ensure other competitors' prices were lower. The alternative approach, which might simply be adopted in response to being required to participate in an aggregator, or adopted in response to the failure of increased prices to achieve the desired objective, would be to cease offering home insurance in Nth Queensland. Neither of these outcomes would serve the best interests of home owners in Nth Queensland.

Allianz suggests that the proposal for a live quote aggregator demonstrates a fundamental misunderstanding of the complexities of the provision of insurance in areas where insurers are mostly seeking to limit risk exposure. Proponents of a live quote aggregator point to the experience of aggregators in the UK motor market over the 2000s. Apart from destroying the profitability of that class of insurance for several years, which has since been corrected through price increases (ie the price impact was only temporary), it was a market in which insurers were generally seeking to gain or protect market share. Insurer pricing was also influenced by the aggressive competitive behaviour of new supermarket entrants into the market. Neither of these factors exists in respect of the Nth Queensland home insurance market.

In home insurance, insurers will generally target a profit margin of around 5% of premium. Thus, even if home insurance premiums in Nth Queensland are achieving sustainable shareholder returns and assuming aggressive price competition drove profit margins to zero or less, which would not be a sustainable outcome and likely encourage even more insurers to exit that market, the best a live quote aggregator could deliver would be a temporary fall in premiums of around 5 per cent. In other words, the Queensland Government could deliver a larger and more permanent reduction in premiums by removing Stamp Duty on home insurance sold in Nth Queensland.

Consumer burden and confusion

To obtain a quote and/or purchase insurance online, insurer websites will commonly require the customer to answer around 30 questions. While many will be common among insurers, differences also exist. For example, questions vary for different types of home insurance such as Defined Events (DE), Accidental Damage (AD) and Total Replacement (TR) policies. To ensure the aggregator was able to provide consumers with an accurate price, the cumulative combination of all the questions asked by the different participating insurers would need to form part of the aggregator's question set. The total amount of questions will depend on the number of insurers participating on the aggregator, but it would be reasonable to expect that the number of required questions could easily exceed 100.

In addition to the different policy types referred to above, insurers also offer a range of policy options, for example, electrical fusion and flood cover. A consumer seeking the lowest price may also be interested in separately comparing the different prices insurers charge for building and contents. To just display the range of different home cover types and options for Allianz would result in more than ten prices. If there were ten insurers on the aggregator with a similar range of policy options, the consumer would be confronted with around 100 different products to 'choose' from. If products sold through various intermediaries were also required to be placed on the aggregator, the consumer would be confronted with hundreds of potential product options and prices.

Compliance costs

A live quote aggregator would impose significant compliance costs on insurers, depending on their required level of participation. As a part of Allianz's exposure management strategy in respect of Nth Queensland cyclone risk, we do not provide residential home insurance through direct retail distribution channels, that is, via the internet or through our call centre. The reason is that Allianz's appetite for Nth Queensland domestic property cyclone risk is fully satisfied by the policies we sell through intermediary business partners, such as brokers and financial institutions.

As a result, Allianz would not be a participate in a live quote aggregator that provided prices for home insurance sold direct to customers in Nth Queensland. In these circumstances, we would not incur compliance costs as a result of the establishment of a live quote aggregator. If, however, insurers were required to post prices for products sold through intermediaries, Allianz estimates that the information technology costs alone of participating in a live quote aggregator would be around $4 million per annum.

Residential strata

As indicated, Allianz does not generally provide cover for residential strata properties in Nth Queensland. Other insurers that specialise in this market will presumably provide views on the practicalities of a live quote aggregator for residential strata cover. A key difference with home insurance is that strata is a commercial class of insurance, which is often written through insurance brokers, and which covers complex insurance risks. For example, this additional complexity includes the need to cover the property damage and liability associated with things like gyms, pools, child play areas, parking areas, driveways and balconies.

A pre-requisite for a live quote aggregator would appear to be the ability to obtain an accurate quote for insurance online. Allianz is not aware that any insurers currently sell residential strata insurance online. This is simply because such complex risks require the analysis of a significant amount of detailed information and are, hence, manually underwritten, with cover tailored to the specific characteristics of the strata development in question. It is Allianz's view that it is simply not practically feasible or even technologically possible to develop a live, online quote aggregator for residential strata insurance.

Website to provide indicative or sample prices

Allianz does not support the second option in the discussion paper, that is, a website to provide indicative or sample prices based on postcode, sum-insured and building construction type. Allianz suggests that it would be possible to provide similar information through the first option of a consumer information site, without the materially higher compliance costs that an indicative price website would impose on insurers.

The discussion paper gives two examples of such a website. The first is the helpinsure.com website of the Texas Department of Insurance. Allianz suggests that the nature of home insurance regulation in the US, where insurers file rates with State-based regulators, probably allows for a website such as this to be developed with a much lower compliance burden (possibly with no ongoing insurance company involvement outside the rate filing mechanism) on participating insurers.

In an Australian context, the simplified question set (eg postcodes and round figure sums insured) and the inability to account for flood risk or other address-specific locational rating factors, would mean the prices produced by this sort of website would be of little, if any, greater accuracy than those that could be provided through the consumer information site model. Yet, if an indicative price website was to be kept up to date, insurers would be required to continually provide information to the website operator every time premiums or other pricing factors were adjusted, which would be much more frequently than under the US rate filing regulatory model.

The second example provided of such a website was the Private Health Insurance Ombudsman's privatehealth.gov.au site. Allianz notes that this site provides comparative premiums down to the last cent, based on less than ten questions. If these premiums are accurate (which one assumes they are), then clearly the community rating nature of private health insurance regulation in Australia makes for a significantly more simplified underwriting model than that which applies to home insurance.

This site appears to produce specific premium information; therefore, replicating it for home insurance would result in the same costs and consequences as the live quote aggregator option (see discussion above).

Conclusion

In short, Allianz is of the view that there is a problem with the affordability of home insurance for many residential land owners vulnerable to floods and cyclones. The issue is the *existence* of these very high market premiums for home insurance, not a lack of awareness about them. Measures to increase the awareness and transparency of the high levels of some home insurance premiums will, therefore, not address the underlying issue causing concern among home owners in Nth Queensland vulnerable to cyclones and those in all parts of Australia vulnerable to floods.

Allianz also suggest that, in general[6], home insurance affordability issues for those vulnerable to these particular weather perils will only increase over time and, at some, point the Government will need to give serious consideration to putting in place a solution to the problem. Allianz suggests that this is best done through a considered policy development process starting now (eg, through a reference to the Productivity Commission), rather than through a poorer process in reaction to a jump in premiums after the next cyclone or flood that causes large insurance losses.

[6] The exception is areas where investment in flood mitigation can materially reduce flood risk and, hence, home insurance premiums.