21st February 2022

The Senate Economics Legislation Committee

PO Box 6100

Parliament House

Canberra ACT 2600

Submission: Inquiry into Treasury Laws Amendment (Cyclone and Flood Management Reinsurance Pool) Bill 2022

As is made clear in the title, this submission only addresses the one area. In general terms I am very hopeful that the proposed North Australian Reinsurance Pool (I've taken the liberty of labelling the pool NARP for this submission's purposes) as devised, has the potential to make a significant improvement to the cost of property insurance in Northern Australia.

My intention is to alert the committee to small but significant anomalies in the proposed Act and to suggest an alteration that not only removes the anomalies but enhances the NARP for all stakeholders.

To put this submission in context there are two broad areas that I trust will assist the committee's comprehension;

- The role of Insurance Brokers
- Current Business and Commercial Property Insurance arrangements (and issues) in Northern Australia

Role of Insurance Brokers:

While I am sure many committee members are aware of an insurance broker's function, particularly if they use the services of a broker. Unfortunately there is a significant misconception that insurance brokers are merely the agents of insurance companies and only serve a function to ensure that the best "deal on price" is struck. Naturally the cost of insurance is a very important factor but the perception of brokers being mere price-chasers is completely and wildly inaccurate.

An examination of my own client files for example will reveal copious advice documentation, written to each SME client's individual circumstances.

It is recognised at law that the broker-client relationship is similar to that of an accountant or solicitor and their client. The advice we give clients is privileged and confidential. On occasion the advice can be robust but it is not something reported back to insurers unless it is with the client's knowledge and approval. In the event of a claim on a policy, an insurance a broker will negotiate and advocate on behalf of a client. If in the opinion of the broker, a client is being unfairly prejudiced by an insurer's policy interpretation the broker will be just as robust with that insurer without fear or favour. In my firm's portfolio we have cases on behalf of our clients where we have successfully managed or are managing claims disputes with the respective insurer or with the Australian Financial Complaints Authority (AFCA)

Most senior insurance brokers have been in the profession, and I use that word deliberately, for the majority of their working lives. In short we have the mind of the insurer but the heart of the client.

The point is – insurance brokers must and generally do act in the best interests of their client at all times. It is in this context, indeed it is the very reason why this submission is tabled for consideration.

Current Business and Commercial Property Insurance arrangements (and issues) in Northern Australia:

There are two types of insurance policies to cover *commercial property*, i.e. in the context of eligible insurance for the NARP;

- Buildings and /or
- Contents / Fixed Plant and Equipment / Stock
- Business Interruption

The two policy types are;

- A Business "Package" policy (BPK)
- An Industrial Special Risks policy (ISR)

A **BPK** policy is generally used for SME businesses. As a very rough rule of thumb it is meant for SME's with a *commercial property* sum insured up to but not exceeding $10 Million. It is a package policy because an Insured client can add other policy sections, for example Money, Burglary, Public Liability and so on. Cover in each of these additional sections is provided or declined based on insurer appetite. As a section is added insurers calculate an appropriate additional premium for that section.

An **ISR** policy has generally been used for all businesses where the *commercial property* sum insured exceeds $10 Million. It is not as flexible as a BPK although that said, within its confines there is a capability to customise the wording. It is predominately a policy cover for commercial property. It will not accommodate Public Liability for example. Unlike a BPK, an ISR has just one premium rate which is applied against an overall sum insured.

  - Traditionally an ISR is regarded as the more appropriate cover for larger businesses
  - An ISR will have heftier Claims Deductibles (Excesses) because it is assumed larger businesses can sustain a higher level of self-insurance

Issues with *Commercial Property* Insurance in Northern Australia:

I assume it is understood by the committee that businesses large and small in Australia like the rest of the world are experiencing significantly increased insurance costs across the range of policy classes. There are numerous reasons why this is occurring but that matter is not germane to this paper.

It is a lesser known fact that Northern Australia businesses have been enduring this "hard market" for several years in advance of the current global hard market-trend. It is not a case of the rest of the country's business insurance costs catching up to Northern Australia premiums or cover restrictions. Our clients have had to endure the hardening market *over and above* the already loaded premiums applied to Northern Risks in the first place.

This is markedly so for any small business that approach the $5 Million *Commercial Property* mark where in Northern Australia the BPK class of policy, according to insurance industry norms must give way to the ISR class.

The effects of this "double-whammy" for Northern Australian businesses have been;

- A double hit of Increased cost of premiums regardless of whether a client is insured under a BPK or an ISR policy
- The "give-way" point of BPK appetite reduced from $10,000,000 in *Commercial Property* to $5,000,000 sum insured (i.e. clients being pushed out of the more cost-effective BPK policies into ISR's)
- Increased Named Cyclone Claims Deductibles– going from the standard $500 in a BPK to a $50,000 Excess under an ISR. We have some cases where the Cyclone Excess has been increased to $250,000.
- In some instances, when moving to an ISR a Named Cyclone Exclusion is applied i.e. no cover if damage or loss is caused by a Cyclone
- A marked reluctance to quote on new business opportunities put to insurers. The writer has observed a distinct pattern of insurers retaining the business they have (although inviting renewal at markedly increased premiums) but declining to quote new risks.

My deduction is that the insurers participating in the Northern Australian Commercial Property cover are reluctant to write new business in the $5 Million plus Sum Insured class because they consider themselves over-exposed.

In North and Far North Queensland there are only four Commercial Property insurers. One of those will only write Commercial Property up to a line across the State at Mossman (Postcode 4873). It is also well known in the insurance industry that this particular insurer's global head office has put its Australian general insurance book on the market. This will reduce *Commercial Property* insurers to one of the remaining three, either by one of the remaining insurers acquiring the insurer's book or its purchase by other insurer-buyers, all with a well-known aversion to North Queensland *Commercial Property.*

Exclusions or caps in the current eligibility criteria:

As I understand it, the eligibility to benefit from the NARP has two caps and/or exclusions.

1. Non-residential strata and small business ($5 Million Sum Insured cut-off)
2. Farm commercial buildings and fixed plant (100% cut-off)

There is a third cap where the mix of commercial / residential has been adjusted to a 50% allowance. In the main, this welcome adjustment will probably eliminate an anomaly. That said, for the sake of this submission we will deem any strata where commercial is greater than 50% as "Commercial" strata.

Anomalies:

<u>Small Business or Commercial Strata assets exceeding $5 Million *Commercial Property* sum insured</u>:

- There has been considerable debate about the definition of "Small Business"
- Given that, any insurance broker will tell you that there are many Small Businesses that have Buildings / Stock / Fixed plant that exceed $5 million. Add in the prudent requirement to basically insure their cash flow (via a Business Interruption cover) the business can be well on the way to a $10 Million *Commercial Property* Sum Insured.

- Many of these small businesses sub-contract to national businesses who simply don't want the expenses and extended logistical problems of operating a North Australian branch. In short they leave it to proven local small business operators.
- Almost all of these small businesses are local family-owned.
- Many have very substantial overheads and borrowings
- Anomalies are created where a business competitor with say, a $4.9 Million *Commercial Property sum insured* gains a substantial unfair advantage in cost savings over its rival with a $5.1 *Commercial Property* sum insured.
- There exists a danger zone where our $4.9 Million business decides for example not to insure its Business Interruption because that will tip it over the $5 Million threshold and wipe out the substantial saving it enjoyed while under the cap threshold
- What happens if one month after renewal of its insurance program review our $4.9 Million business decides to make increases tipping the business over the $5 Million mark? Do the remaining 11 months of NARP savings have to be charged out on the whole Sum Insured or just the increase?
- What is the difference between a $4.9 Million Small Business (A) which happens to be an owner/ occupier in a small Commercial Strata Unit (let's say the value of their unit is $150,000) and Small Business (B) which would have also been at the $4.9 Million mark except Small Business (B) owns a stand-alone commercial building insured for $100,000 thus tipping their *Commercial Property* sum insured to $5.1 Million?

    - In this example business (A) benefits from an insurance saving because it is eligible for NARP reinsurance even though the value of the Unit it owns is even higher than business (B). Business (B) is ineligible because it tips over the $5Million threshold

    - There may be those who believe that Business (A) should also be deemed ineligible because of the value of the Unit it owner occupies. If that is the case under the NARP rules, how could that possibly be enforced? Business A's Unit is insured as a part and in the sole name of, the Body Corporate / Strata Title. It will be insured in a completely separate policy with an unrelated insurer that has absolutely no way of identifying individual owners.

<u>Farm commercial buildings and fixed plant</u>:

- Farm commercial buildings and their fixed plant / contents are 100% ineligible
- Yet many farmers have extensive investments in substantial Machinery sheds.
- They can also have expensive plant for example on-farm produce processing and packing equipment, cold rooms etc.
- If these buildings were located in a township's industrial estate the building and non-mobile contents would be eligible up to the current $5 Million NARP cap

These anomalies are not only unfair, inequitable and in some cases potentially cumbersome they will be seen to be so by scores of small business owners.

Recommendations and Solutions:

In relation to the caps and cut-offs to small business and farm *Commercial Property insurance*;

- <u>Recommendation 1</u>: All farm non-residential buildings to be deemed Small Business.

- Recommendation 2: All businesses (large or small) to benefit from the first $10 Million of their *Commercial Property* sum insured by participation in the NARP.
- Recommendation 3: Any business with a *Commercial Property* sum insured greater than $10 Million to benefit *by the First $10 Million Sum Insured portion* being eligible for participation in the NARP. There can be allowable exceptions to this rule, fine-tuned and worked out with insurers;
  - Where the business enjoys an overall premium rate that is less than the eligible NARP premium charge.
  - Where Northern Australia *Commercial Property* sums insured are less than say "X" percent of the business's national *Commercial Property* sum insured
  - Where the business is an ASX corporation

Advantages

My comprehension of the NARP is that it will appropriately be 'user pays.' The 3 Recommendations have distinct advantages to all stakeholders

- A very considerable increase of revenue to the NARP. There is the counter argument regarding increased risk exposure. However I'm sure that insurers have demonstrated that residential strata and homeowners are the biggest exposures to NARP. Generally speaking, businesses are always keen to get back to operational capacity as soon as possible. And the larger the business, the more robust their systems and infrastructure. My point is that their contribution of premium will result in a more favourable loss-ratio (Claims divided by Premium) for the NARP. *This will strengthen the NARP – and strongly increasing the chances of a Revenue-Neutral model being achieved by government.*

- A fairer approach benefiting all businesses and agri-businesses. *The benefit speaks for itself.*

- A simpler and more efficient system for all insurers. There will be some initial adjustment to systems but of course that will be required with the onset of the NARP. Just as insurers mastered the Terrorism insurance contributions so it will adapt both its systems for each policy and transparency for the NARP

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The writer is a senior broker who has worked continuously since 1973 in the general insurance industry both as an underwriter and an insurance broker. My wife Lynne and I owned a brokerage for seventeen years which we sold to Joe Vella Insurance Brokers Pty Ltd. I am employed by JVIB at 108 Mulgrave Road Cairns QLD 4870. I participated in the Treasury Departments feedback sessions on the proposed Reinsurance Pool with the Northern Queensland consultative committee.

This paper is a personal submission and does not represent any other organisation including my employers, JVIB & the QIB Group. That said the views expressed have had informal consensus with insurance broker colleagues in general discussions.