# Submission to Parliamentary Inquiry

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| **TO:** | Inquiry Into Residential Strata Insurance. |
| **FROM:** | Graham Janz, Cairns QLD 4870 |
| **FOR:** | Consideration and investigation under the Terms of Reference to address the threat to property owners of insurance premiums rising exponentially, and the prospect that all insurers might withdraw from our market and decline to offer insurance cover. |
| **PURPOSE:** | Briefing regarding the residential strata insurance market for a body corporate in far north Queensland that has a building sum insured.exceeding $20m, the buildings are less than 75% holiday lett, and it is not managed by a professional hotel chain. |

**URGENCY:**

- Government intervention is needed to ensure that building insurance remains viable.
- The trends in our insurance premiums show that bodies corporate are being crippled financially after all but one insurer withdrew from our market.

**ISSUES**:

- Market failure with no competition between insurers for our category of bodies corporate in northern Australia.
- Insurance premiums rising in disproportion to the risk.
- Relationships between body corporate managers, insurance brokers, and underwriters that are not conducive to containing the increases in insurance costs.
- Inability of body corporate office bearers to devise strategies to control or contain insurance costs.

**BACKGROUND**:

- I am the owner of a unit in the [redacted], White Rock in a southern suburb of the city of Cairns. The insured sum of our buildings including common area contents exceeded $[redacted] last year, but it has been reduced through a revaluation to [redacted] this year.
- Insurance is currently our second largest item of expenditure after Caretaker Fees, but is likely to become our largest item of expenditure next year.
- Cairns Regional Council evacuation maps show that our property is not in an evacuation zone, and there is not even a moderate risk of flooding from a cyclone storm tide.
- Tropical cyclone events are not a new threat, it would be reasonable to suggest that cyclones have been a threat to dwellings constructed in a large part of Australia for many

thousands of years..

- Historical information published on the internet indicates cyclone damage occurred in Cairns on 20 occasions from 1878 until 2004, an average of 1 cyclone every 6.3 years, and records from 1864 show significant cyclone damage to southern Queensland and northern New South Wales as well as in northern Australia. Cyclones have caused damage inland (even crossing the inland continent from west to east in March 1937) and as far south as:

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| Feb 1990 | Byron Bay | $28^{0}$ South |
| Jan 1964 | Coffs Harbour | $30^{0}$ South |
| Feb 1957 | Port Macquarrie | $31^{0}$ South |
| Jan 1950 | Sydney | $33^{0}$ South |
| Mar 1976 | Botany Bay | $33^{0}$ South |

- The buildings on our property were constructed in 1999, and because of their recent construction it is rational to conclude that the buildings were designed and constructed to meet or exceed cyclonic standards.
- The renewal notices issued by our insurance broker [redacted]) show that our insurance policy is written through [redacted].
- We had only 19 insurance claims lodged in the period from 21 Oct 1998 until 8 Dec 2011, an average of less than 1.5 claims per year.
- Our annual renewal notices show the number of optional quotations obtained by the broker each year from other insurers (in addition to the quote from the existing insurer):

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| 2003 | 2 optional quotations |
| 2004 | 2 |
| 2005 | 2 |
| 2006 | 2 |
| 2007 | 3 |
| 2008 | 2 |
| 2009 | 1 |
| 2010 | 0 |
| 2011 | 0 |

- In November 2009, [redacted] issued our renewal notice, indicating that [redacted] would not quote, and that Allianz had quoted $74,270.14 which was much higher than the $65,620.11 quoted by [redacted].
- In 2010 the market was reduced to only one insurer, and again in 2011, there was only one insurer in our market for properties located in far north Queensland where our building sum insured exceeds $20m, our buildings are less than 75% holiday lett, and we are not managed by a professional hotel chain.
- The annual increases for insurance premiums compared to building values for the period are:

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| 2003 | 4% (buildings) | 16% (premium) |
| 2004 | 3% | 3% |
| 2005 | 2% | 2% |
| 2006 | 5% | 4% |
| 2007 | 5% | 27% |
| 2008 | 99% | 131% |
| 2009 | 5% | 36% |
| 2010 | 5% | 8% |
| 2011 | -29% | 37% |

- Our insurance invoice issued in 2009 shows that under our policy with [redacted], we had an excess of $15,000 for all Named Cyclone Damage, an additional $250 per earthquake claim or series of claims occurring over a period of 72hrs, and only $500 for all other claims.
- Our body corporate manager [redacted]) informed owners at our AGM in 2009 that there was only one insurer in our insurance market, however I did not accept that advice and in 2010 I compiled all of the information needed for an insurer to be able to quote on our insurance without the involvement of any broker.
- In December 2010, [redacted] had already provided a quote to [redacted] but indicated they would offer a quote direct to us if we provide a letter from [redacted] specifying that the body corporate wishes to deal direct with [redacted] instead of with [redacted]
- I sought quotes from other service providers, however insurers including [redacted] and

[redacted] declined to quote as our level of risk did not fall within their criteria, especially because we are in a renowned cyclone-prone area and our insured value exceeded their limit.

- Our body corporate issued a letter to [redacted] so that [redacted] could offer a quote directly to [redacted] for our residential strata insurance policy, because we expected a significant saving on broker fees.
- Brokers fees disclosed by [redacted] in the annual renewal notices are:

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| 2003 | $50 fee disclosed by the broker |
| 2004 | $50 |
| 2005 | $50 |
| 2006 | $50 |
| 2007 | $60 |
| 2008 | $100 |
| 2009 | $60 |
| 2010 | $10,000 |
| 2011 | $100 |

- Following representations and complaints to [redacted] concerning our insurance premiums, [redacted] provided quotes showing the following totals:

  $84,356.40 with $500 excess (original premium)

  $78,300.32 with $500 excess (discounted premium)

  $74,607.89 with $1,000 excess (original premium)

  $70,567.49 with $1,000 excess (discounted premium)

- A comparison of the 2009 and 2010 invoices shows that with the discounted premium and a $1,000 excess, we incurred an increase in the order of 7.53% for 2011, avoiding a likely further 19.54% increase by doubling our excess (bringing a reduction of 10.95%) and by agitation that resulted in a further 7.73% discount.
- The email message from [redacted] showing the quotes contained advice from the broker that the insurer has generally advised that they do not negotiate renewal premiums however the broker was happy to report that he had achieved success "based on the excellent claims history and the relationship that [redacted] and [redacted]

have with the insurers".

- The final invoice issued by [redacted] shows that the discounted premium with $1,000 excess comprised the following:

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| Premium | $50,318.39 |
| UW Levy | $60.00 |
| Stamp Duty | $4,151.27 |
| Broker Fee | $10,000.00 |
| GST | $6,037.84 |
| Total | $70,567.50 |

- The quote issued directly by [redacted] with $1,000 excess comprised the following:

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| Premium | $62,897.99 |
| UW Levy | $0 |
| Stamp Duty | $5,189.10 |
| Broker Fee | $0 |
| GST | $6,289.80 |
| Admin Fee | $60.00 |
| Admin Fee GST | $6.00 |
| Total | $74,442.89 |

- When the quote was requested from [redacted], I informed them that our body corporate agrees to the payment of a commission to body corporate services to cover the cost of preparing, lodging and monitoring insurance claims and attending to arrangements for the repair or replacement of the insured property or assets — therefore the only significant criterion difference impacting on the quotes would have been the $10,000 brokers fee charged by [redacted], so the [redacted] quote should therefore have been much cheaper.
- [redacted] quote offered directly to our body corporate was paradoxically 5.49% higher than the quote from the same insurer offered by the broker.
- [redacted] advised in an email message dated 29 December 2010 that the premiums for locations in north Queensland are heavily influenced by the high costs of catastrophe reinsurance that insurers have to meet as part of insuring property in North Queensland.
- The advice from [redacted], and further advice from [redacted] shows that there are exclusive relationships between insurers and brokers that restrict free competition from other brokers who might be willing to offer

lower fees.

- [redacted] dominates the market for managing bodies corporate in Cairns, and [redacted] offers a 3-year standard contract with attractive fees for managing a body corporate.
- Schedule B to the standard contract with [redacted] for Engagement for Administrative Services shows that where [redacted] is in receipt of commission from an insurance broker then [redacted] will prepare, lodge and monitor insurance claims of a routine or minor nature, attending to arrangements for the repair or replacement of the insured property or assets.
- We were informed by [redacted] at our AGM that if we did not agree to [redacted] receiving a commission to process our insurance claims, then our committee members would need to process the claims in coordination with each and every unit owner who had a claim.
- The body corporate committee therefore agreed that [redacted] could receive a commission to provide this service. Our contract with [redacted] shows that [redacted] will receive up to 20% of the base premiums in commissions from [redacted], and the explanatory schedule to voting papers provided prior to the 2011 AGM revealed that a commission of $7,547.75 was payable to [redacted] by the broker, compared to $8,307.16 for the previous year.
- We approve our annual budgets at each AGM without knowing how much our insurance premiums will amount to. Our body corporate has a financial year that ends each September, and then the budget estimates are prepared and levy amounts recommended for our AGM in December, prior to the insurance renewal notice being issued for insurance that commences on 1 January — and we therefore have a history of our insurance costs significantly exceeding the budgeted amount, impacting on the other activity that we have planned each year. Our committee therefore obtained a policy that expires on 30 September 2012 to improve the management of our budget and levies.
- [redacted] have stipulated that they will only obtain quotes from insurers that are rated AAA, and [redacted] employees have insisted in our committee meetings that the insurers must be rated AAA, without giving any reason for this stipulation. This stipulation has however been accepted by a majority of our risk-averse committee members. It seems that the rating of the underwriter does not qualify a potential insurer, and there seems to be no explanation why an insurer with a AA rating should be excluded.
- The alternate quotes in the renewal notice issued for our current policy show that increasing the excess to $50,000 for all named cyclones and $2,500 for all other claims would have resulted in a reduction of only $3,381.86 in our

premium.

- Under Section 178 of the Body Corporate and Community Management (Standard Module) Regulation 2008, the body corporate must insure, for full replacement value, the common property and the body corporate assets.
- Our committee has implemented strategies to reduce our insurance premiums — the buildings were revalued in November 2011, the excess has been increased, and consideration was given to options to open the brokerage market up to competition.

**DISCUSSION**:

- We had only 2 residential strata quotes for the year ended 31 Dec 2010, and despite the efforts of the broker engaged by our body corporate manager, together with my own approaches to a range of insurers, brokers, and other body corporate managers, only one insurer could be found to offer a quote to cover our risk for the year ending 31 Dec 2011.
- The attached chart showing the criteria affecting our insurance cover reveals that our premiums increase regardless of our building sum insured and our catastrophe cover. Furthermore, the cost of claims settled does not have much bearing on our premium, whereas our excess may have a small bearing. There is no indication of any real connection between the extent of risk exposure and the cost of our insurance.
- Assessment of the historical data suggests that the insurance industry has failed to identify the extent of Australia that is prone to cyclone damage, and has been imprudent in targeting only northern Australia.
- Despite all of the demand for residential strata insurance, the complete absence of other insurers in supplying insurance to bodies corporate in renowned cyclone-prone areas where the building sum insured exceeds $20 million over the last two years reveals the need for government intervention in the market to alleviate the crippling increases in insurance costs which are rising exponentially. The attached chart showing the trends in our insurance costs indicates that our insurance costs will double within the next 2 years.
- The increases in body corporate levies needed to finance our insurance policies are affecting the market value of our real estate investments, and there is a high likelihood that we will have negative equity in our properties caused by low demand from buyers.
- The inexplicable massively higher premium quoted directly by [redacted] with the broker fee eliminated — together with the restrictions on free competition between brokers — demonstrate that the arrangements between

insurers and brokers are fundamental market flaws.

- If the sole remaining insurer withdraws from our market then we will not be able to obtain insurance for our assets and we will be unable to meet our statutory obligations through no fault of the body corporate, but as a result of a failed market for our insurance.
- The massive spike in brokers fees disclosed in 2010 as a consequence of close scrutiny by our committee is a red flag warranting further inquiry.
- A government insurance scheme is needed to cover our risk until such time as insurers are willing and capable of competing in our market.
- There is a profit disincentive for body corporate managers to take measures towards facilitating an insurance market that would reduce our premiums, and further government intervention is needed to address the conflict of interest for body corporate managers who profit directly from increasing premiums through their percentage commissions.
- There is not much justification for a body corporate manager being paid more than $7,000 to process an average of less than 1.5 insurance claims per year, especially considering that the contract wording contains a restriction that this commission is only as payment for claims that are of a routine or minor nature, and there is therefore no obligation on the body corporate manager to process major claims such as those that would be needed after an extreme weather event.

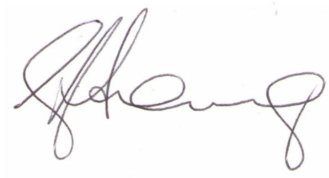
**RECOMMENDATION:** That the Inquiry:

(a) investigates the market failures and industry practices revealed in this submission.

(b) consider legislation (by either the Commonwealth or the States) to deliver a statutory residential strata insurance scheme to alleviate the crippling financial impact upon unit owners of the market failures.

(c) consider legislation (by either the Commonwealth or the States) to exclude body corporate managers from receiving commissions from brokers or insurers, thereby establishing a new market for service providers processing insurance claims for bodies corporate and unit owners, and eliminating the profit disincentive for body corporate managers who effectively control the residential strata insurance market for bodies corporate with a building sum insured more than $20 million.

**SUBMITTED BY:**



Graham Janz
15 January 2012

**SUPPORTING DOCUMENTS:**

1. Aerial photo showing Trinity Links Estate and Trinity Links East.
2. Cairns Regional Council map 1-304 “Area 1 – CBD (South) Evacuation Routes”.
3. Cyclone data southern impact
4. Insurance Renewal Notice 2003-04
5. Insurance Renewal Notice 2004-05
6. Insurance Renewal Notice 2005-06
7. Insurance Renewal Notice 2006-07
8. Insurance Renewal Notice 2007-08
9. Insurance Renewal Notice 2008-09
10. Insurance Renewal Notice 2009-10
11. Insurance Renewal Notice 2010-11
12. Insurance Renewal Notice 2011-12
13. Chart showing trends in insurance costs.
14. Chart showing criteria affecting our insurance cover
15. Email message dated 10 Jan 2011 showing quotes offered by Body Corporate Brokers.
16. Renewal quotation from Strata Unit Underwriters
17. Email message dated 7 Dec 2010 from Jodie Richardson, Underwriting Assistant, Strata Unit Underwriters.
18. Email message dated 6 Dec 2010 from Michael Balfe, BJS Insurance Brokers.