

**GOVERNMENT'S RESPONSE
TO THE
HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON SOCIAL
POLICY AND LEGAL AFFAIRS REPORT**

**IN THE WAKE OF DISASTERS
VOLUME 2: THE AFFORDABILITY OF RESIDENTIAL STRATA TITLE
INSURANCE**

GOVERNMENT'S RESPONSE TO THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON SOCIAL POLICY AND LEGAL AFFAIRS REPORT ON THE AFFORDABILITY OF RESIDENTIAL STRATA TITLE INSURANCE

BACKGROUND

In late 2011, the Government became aware of significant increases in residential strata title insurance in far north Queensland, particularly following Cyclone Yasi in February 2011. Large premium increases were also leading to community concerns about the affordability of strata title insurance and the degree of competition in this segment of the insurance market.

In response, on 23 November 2011, the Government requested that the House of Representatives Standing Committee on Social Policy and Legal Affairs inquiry into claims processing by the insurance industry be broadened to also consider issues around residential strata title insurance, particularly in northern Australia. The terms of reference for the inquiry provided to the Committee by the Government focussed on identifying: the magnitude and underlying causes of insurance premium increases; the ability of insurers to price risk; the degree of consumer awareness of different insurance options and the extent of any market failure.

The Inquiry had regard to two key principles:

- that individuals and businesses should be encouraged to insure themselves where practicable; and
- that Government intervention in private insurance markets is justifiable only where, and to the extent that, there is clear failure by the private market to offer appropriate cover.

The House of Representatives Standing Committee on Social Policy and Legal Affairs released its report titled 'In the wake of disasters Volume 2: The affordability of residential strata title insurance' (the Report) on 21 March 2012. The Report made nine recommendations a majority of which call for further investigation into various matters identified by the Inquiry.

The Government notes that the Committee found that concerns about the affordability of strata title insurance are confined to the north Queensland area. The Government also notes that the Committee sees 'no merit in the Australian Government entering the market for strata insurance, nor can it recommend that the Queensland Government do the same'.

The Government's response to each of the recommendations is provided below.

GOVERNMENT'S RESPONSE TO COMMITTEE'S RECOMMENDATIONS

Recommendation 1

The Committee recommends that the Australian Government liaise with the Queensland government and urge them to implement a 12 month moratorium on Stamp Duty charged on strata title insurance for properties north of the tropic of Capricorn.

This moratorium should be implemented for the 2012-13 financial year, and extended for as long as strata insurance premiums continue to rise at a higher rate than the average for general insurance.

Government's response

The Government supports this recommendation. State and territory stamp duty represents a significant impost on insurance and can contribute to under-insurance and non-insurance in classes of insurance that are not compulsory. The recommended moratorium on strata title insurance would be expected to lead to a reduction in insurance premiums, thereby assisting to address affordability. The Government also notes in this regard that the 'Australia's future tax system review' (known as the Henry review) concluded that many state and territory taxes, including stamp duty on insurance policies, are inefficient and should be abolished.

Accordingly, the Minister for Financial Services and Superannuation has made representations to the Queensland Treasurer drawing his attention to this recommendation and calling on the Queensland Government to consider implementing a 12-month moratorium on stamp duty charged on strata title insurance for properties located north of the tropic of Capricorn.

The Government also notes that the Committee considered the merits of placing a 12-month moratorium on goods and services tax charged on strata title insurance premiums. The Government agrees with the Committee's conclusion that such a measure is not justified given the policy intent of the goods and services tax to be broadly based.

Recommendation 2

The Committee recommends that the Australian Prudential Regulatory Authority conduct a review of the risk assessment methodologies used by insurance companies to accurately price risk for strata title insurance coverage.

The review should particularly focus on strata insurance premium calculations in north Queensland in the last five years to determine whether the major driver for premium increases was:

- *a failure to consider changes in building codes,*
- *the costs of reinsurance,*
- *historically inaccurate or inadequate assessment and pricing of risk, or*
- *the result of market forces, including heavy discounting.*

This review should be completed by 1 October 2012 and provided to the Minister for Financial Services and the Australian Competition and Consumer Commission to determine if further investigation is required.

Government's response

The Government considers that APRA is not the appropriate agency to conduct such a review. APRA's role as the prudential regulator is to ensure that, under all reasonable circumstances, insurers are able to meet their obligations to policyholders. It does not extend to the nature or pricing of particular products offered to policyholders, which is a commercial decision for the insurer. As part of its supervision activities, APRA seeks to satisfy itself that the insurer's overall processes for setting and monitoring the premiums charged to policyholders, and understanding the

contribution of various segments of its business to its financial strength, are robust. APRA's review activities do not extend to an in-depth assessment of the specific drivers for premium changes in particular product categories or geographic segments, other than at a high level, in order to be able to form a view of the adequacy of insurers' overall processes relating to assessing and pricing risk.

However, the Government considers that there is merit in further examining the methodologies used by insurance companies to price strata title insurance with a view to identifying the reasons for the large increases in insurance premiums in recent years. Consequently, the Government has commissioned the Australian Government Actuary to undertake this review. The Australian Government Actuary has the expertise to conduct this investigation.

The purpose of this investigation is to determine the reasons underpinning recent changes in strata title insurance premium levels rather than to identify policy solutions to address any particular policy concerns.

Recommendation 3

The Committee recommends that the Australian Competition and Consumer Commission conduct a review to identify the cost drivers, relative profitability and competition in the strata title insurance industry with a focus on the north Queensland market. This review should be completed by 1 October 2012.

Government's response

The Australian Competition and Consumer Commission (ACCC), as the independent regulator responsible for the investigation and enforcement of competition and consumer laws, investigates allegations of anti-competitive conduct across all sectors of the economy, including the insurance sector, and is equipped to take action should evidence arise of a breach in the *Competition and Consumer Act 2010*.

Beyond the general oversight and enforcement role of the ACCC, the Government does not consider it necessary to specifically direct the ACCC (under part VIIA of the *Competition and Consumer Act 2010*) to undertake formal price monitoring of the insurance sector at this time. In this respect, the ACCC advises that it has reviewed the Report and will continue to monitor developments in the strata insurance market.

The issues requiring further examination raised in this recommendation are related to the issues raised in recommendation 2. Consequently, the Government does not support specific investigation by the ACCC in advance of the Australian Government Actuary's review.

Recommendation 4

The Committee recommends that the Australian Government investigate the feasibility of requiring insurance companies which provide types of mandated insurance (such as residential strata title) to offer this type of cover to all regions of Australia as part of their permit to operate in Australia.

The Committee further recommends that this investigation take into account the methodology for risk assessment and pricing for mandatory strata title insurance and how this pricing is applied equitably throughout regions of Australia.

This investigation should be completed by 1 October 2012 and provided to the Minister for Financial Services.

Government's response

The Government does not support this recommendation as it could have two counter-productive consequences.

Firstly, some companies offering strata title insurance in southern Australia may not have the expertise, risk appetite or capital resources to offer strata title insurance in northern Australia. If they were required to offer strata title insurance to all regions of Australia, those insurance companies not wishing to offer strata insurance in northern Australia may choose to exit the strata insurance market altogether. This would potentially reduce the availability of strata title insurance nationwide.

Alternatively, insurance companies may offer products to certain regions because of the Government intervention in the market but at deliberately uncompetitive prices so as to not generate any business. This would make any measure of this kind self-defeating.

For these reasons, insurance companies should be able to make their own commercial decisions on whether they wish to offer insurance products in particular regions.

Recommendation 5

The Committee recommends that the Australian Government investigate and report on the expansion of the Australian Reinsurance Pool Corporation created to provide terrorist risk reinsurance for application to residential strata title schemes.

The investigation should consider the likely impact of the availability of this reinsurance on strata title insurance premiums. The report should be completed by 1 October 2012.

Government's response

The Government does not support this recommendation as it would not lead to a reduction in insurance premiums.

As background, the *Terrorism Insurance Act 2003* establishes a scheme for replacement terrorism insurance coverage for commercial property and associated business interruption, and for public liability claims. The Act establishes the Australian Reinsurance Pool Corporation (ARPC) which provides reinsurance cover for eligible terrorism losses. The Act operates by overriding terrorism exclusion clauses in 'eligible insurance contracts' to the extent the losses excluded are 'eligible terrorism losses' arising from a 'declared terrorist incident'. It makes these clauses ineffective for all classes of insurance included in the scheme. Consequently, insurers are required to meet eligible claims relating to terrorism in accordance with the other terms and conditions of their policies.

Insurance companies can, but do not have to, reinsure their terrorism risk with the ARPC. The ARPC collects insurance premiums from insurance companies who choose to reinsure their terrorism risk with the ARPC. If an insurance company chooses not to reinsure their risk with the ARPC, they could reinsure this risk in the private insurance market or bear this risk themselves. The insurance

company would charge the owner of the 'eligible property' a premium for the cost of terrorism cover.

The scheme is confined to commercial property. The scheme does not cover residential property. In the case of where a building is split between commercial and residential use, the scheme covers those buildings which are predominately for commercial purposes rather than residential purposes.

Extending the scheme to cover buildings with strata title and used predominantly for residential purposes will result in either no change or an increase in strata title insurance premiums rather than a decrease as implied in the Report. This reflects the way the scheme operates.

- In the case where the insurance contract relating to an 'eligible property' excludes terrorism risk, the scheme overrides this exclusion such that terrorism cover is automatically provided. Where the insurer chooses to bear this additional risk itself, it would be expected to raise strata insurance premiums to reflect the provision of cover for this risk. Where the insurer chooses instead to reinsure this risk with the ARPC, strata insurance premiums would be expected to rise by between 2 and 4 per cent based on the reinsurance rates currently charged by the ARPC. It is expected that insurers would generally seek to reinsure their terrorism risk and to do so with the ARPC given the lack of appetite for terrorism risk within the private insurance and reinsurance markets.
- In the case where the insurance contract includes cover for terrorism risk, this cover will have already been reflected in the insurance premium. Therefore, extending the ARPC terrorism insurance scheme to include these properties would have no effect on their insurance premiums.

The Government notes that consideration has been previously given to extending the scheme to include residential buildings, as part of periodic reviews of the scheme conducted in 2006 and 2010. Both reviews recommended that there was no need to extend the scheme to cover residential buildings. This was accepted by the Governments of the day.

Recommendation 6

The Committee recommends that the Australian Competition and Consumer Commission undertake an investigation into the use of intermediaries to negotiate strata title insurance cover, in order to determine whether there is evidence of improper or anticompetitive behaviours taking place.

The investigation should focus on the Queensland market and indicate whether there is evidence to suggest a more thorough investigation is required. The report of the preliminary investigation should be made public by 1 October 2012.

Government's response

The Government considers it unacceptable for businesses to engage in any conduct in breach of the competition or consumer laws. Should stakeholders be concerned that any participant in the insurance sector is engaging in anti-competitive conduct, it is the role of the ACCC to consider their concerns and enforce the *Competition and Consumer Act 2010* when appropriate. Accordingly, the

Government encourages any individual or business that has concerns about potential breaches of the *Competition and Consumer Act 2010* to refer them to the ACCC for investigation.

The Government notes that it is specifically prohibited from giving the ACCC a direction on the performance of its functions or the exercise of its power under the anti-competitive conduct provisions of the *Competition and Consumer Act 2010*. One of the reasons for the ACCC's independence is to ensure that its decisions are, and are seen to be, separate from the political process.

Recommendation 7

The Committee recommends that the Australian Government, through the Australian Consumer Law framework, work with the Insurance Council of Australia and the Queensland Commissioner for Body Corporate and Community Management to improve the information and education resources available to Body Corporates and better equip them in the management of strata title affairs, with a focus on:

- *understanding the cost components specific to strata title insurance, such as unlimited liability, Stamp Duty and GST, and valuations based on full replacement costs,*
- *consumer awareness of the contractual obligations to disclose fees and commissions, and the responsibilities pertaining to the contractual relationships between Body Corporates and their appointed managers or management companies, and and/or insurance brokers, and*
- *recognition of the factors which may contribute to the risk profile of a strata title complex and in particular factors which may assist in negotiating decreased premium pricing, such as varying the agreed excess.*

The Minister for Financial Services should be provided with a summary of the measures undertaken to address these needs by 1 December 2012.

Government's response

The Government notes that the key aim of the Australian Consumer Law (ACL) is to provide core consumer protection provisions prohibiting misleading or deceptive conduct, unconscionable conduct and unfair contract terms. Given that the Committee raised no concerns about such conduct in the insurance sector, the Government considers that the Australian Consumer Law framework would not be an appropriate framework through which to better inform body corporates in their management of strata title affairs.

The Government has discussed this recommendation with the Queensland Commissioner for Body Corporate and Community Management (the Commissioner). The Commissioner noted that some of the issues raised in recommendation 7 do not fall within the area of responsibility of his Office. However, the Commissioner notes that the *Body Corporate and Community Management Act 1997* (Queensland) provides for the insurance requirements for community titles schemes and has strict requirements for disclosure by body corporate managers and caretaking service contractors of commissions, payments or other benefits relating to certain contracts entered into by a body

corporate. The Commissioner plans to review information products prepared by his Office regarding insurance and disclosure requirements under the Act.

The Government has also brought the report to the attention of the Insurance Council of Australia. The Insurance Council has advised that, in the context of this recommendation, it has commenced an internal review of the information it provides publicly in relation to strata title insurance with the intention of enhancing this information.

The Government established the Insurance Industry Advisory Group (IRAG) in 2011. The members of IRAG include the Insurance Council of Australia and consumer groups. IRAG provides a forum to examine emerging issues in the insurance industry. The Government will also canvass the issues raised in this recommendation with IRAG. In particular, it will explore with the insurance industry what the industry can do further to improve the information and education resources available to body corporates and better equip them in the management of strata title affairs.

Recommendation 8

The Committee recommends that the Attorney-General conduct a review of state and territory legislative and regulatory requirements around strata title insurance. The review should consider:

- *options to provide strata title complexes with greater flexibility in their choice of insurance arrangements, including the availability of tailored arrangements that may offer capped insurance cover on non-essential assets or infrastructure,*
- *the need to expand the role of the Financial Ombudsman Service to encompass strata title insurance issues,*
- *regulatory requirements to increase transparency in the disclosure of commissions and fees taken by intermediaries, such as insurance brokers and Body Corporate managers, and*
- *mechanisms to simplify the legal process for the dissolution of strata schemes.*

The review should be completed by 1 October 2012. The findings and recommendations of the review should be raised with the Standing Committee of Attorneys-General.

Government's response

The Government considers that any review of state and territory strata title legislative and regulatory requirements is a matter for state and territory governments, rather than the Attorney-General. This reflects that the states and territories have policy responsibility for this legislation. However, the Attorney-General will raise the specific matter of the legal process for the dissolution of strata schemes with the Standing Council on Law and Justice (SCLJ) (formerly the Standing Committee of Attorneys-General). If Council members were to consider that a national review into the matter is warranted, it would be appropriate that a state or territory government lead such a review. Given the timing of the next SCLJ meeting (to be held later in the year), any review under the SCLJ framework would be likely to extend well beyond the timeframe outlined in the report.

The Government has been advised by the Queensland Commissioner for Body Corporate and Community Management that there is some limited scope for flexibility in insurance arrangements in that state. Specifically, there is a requirement that buildings forming part of a strata title scheme be insured to full replacement value. However, where the body corporate cannot comply with this requirement, it may apply to the Commissioner to put in place alternative insurance arrangements, such as insurance giving cover up to an agreed value.

The Government notes that the Financial Ombudsman Service Limited (FOS) already has jurisdiction under its current Terms of Reference (TOR) to handle certain types of strata insurance complaints, whether brought against a FOS member who is a strata insurance provider or an intermediary, that is, an insurance broker.

The FOS jurisdiction generally covers strata insurance complaints lodged by a body corporate where the strata title insurance relates to a building wholly occupied for residential or small business purposes. Claims for compensation in excess of \$500,000 are outside FOS' jurisdiction. However, if the claim is for \$500,000 or less, FOS may award compensation of up to \$280,000 (or \$150,000 if the claim relates to an insurance broker).

These caps reflect the minimum standards set by the Australian Securities and Investments Commission (ASIC) in ASIC Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes*. They also broadly reflect the definition of a 'retail client', as specified in the *Corporations Act 2001*.

Given the Committee's recommendation in relation to the role of the FOS, this issue has been referred to ASIC so ASIC may consider whether FOS' existing jurisdiction over wholly residential or small business strata insurance complaints remains appropriate.

There are also a number of other types of strata insurance complaints that FOS cannot handle under its TOR. One such exclusion includes disputes over the level of an insurance premium or fee (unless non-disclosure or misrepresentation issues are involved). These types of complaints are reasonably excluded from FOS' jurisdiction as they relate to commercial decisions made by the strata insurance provider. In referring this issue to ASIC, the Government considers that this exclusion does not require review.

The Government considers that disclosure of relevant fees and commissions is best practice for any financial services business. Chapter 7 of the *Corporations Act 2001* includes a range of disclosure requirements that are engaged when financial advice is provided. The Government's Future of Financial Advice (FOFA) reforms enhance these arrangements, by requiring financial advisers who charge ongoing fees for personal financial advice (which may include insurance advice) to provide a fee disclosure statement to the client outlining fee and service information relevant to the client. Disclosure of this kind assists clients to assess whether they receive value for their financial services, including insurance advice. The FOFA reforms are expected to commence on 1 July 2012.

The Government also notes that the National Insurance Brokers Association (NIBA) is currently undertaking a review of the Insurance Brokers Code of Practice. NIBA has appointed Professional Financial Solutions to assist in the conduct of this review. The Government has brought the Committee's report to the attention of NIBA to be considered in the context of this review.

Recommendation 9

The Committee recommends that the Australian Government outline the plan of reforms it will undertake, in conjunction with relevant State and Territory governments where necessary, in order to establish a competitive and affordable insurance market for residential strata title insurance.

The plan should be announced before 1 December 2012, be informed by the reviews and investigations recommended in this report, and have a particular focus on the north Queensland area.

Government's response

The Government notes the Committee's recommendation. The Government also notes that the Committee did not identify any specific reforms which the Australian Government could implement. The Government will carefully consider any proposed reforms to improve the competitiveness and affordability of strata title insurance in northern Australia that may arise from the further work being undertaken.