

Decreasing risk and increasing market competition

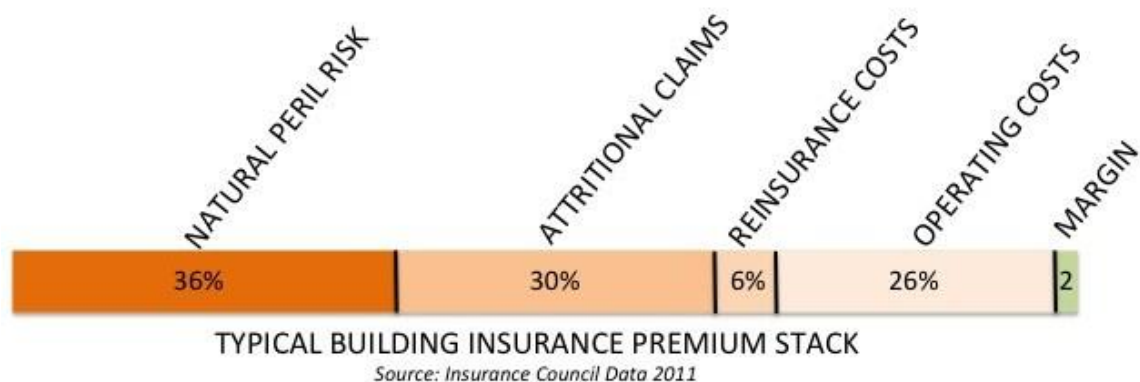
- 3.1 Residential strata title insurance is becoming unaffordable for many people, particularly in the north Queensland region. This situation will become more critical if premium prices continue to rise.
- 3.2 A healthy strata title insurance market in north Queensland is reliant on two factors – *decreasing* the assessed risk levels and *increasing* market involvement to increase competition and disperse risk.
- 3.3 This chapter examines the following cost components that are factored into assessing risk and subsequently setting premiums:
 - natural peril risk,
 - attritional claims,
 - reinsurance, and
 - operating costs and profit margins.
- 3.4 In this chapter, the Committee considers how these components are priced and the evidence given regarding which of these factors may be contributing to price increases for strata title insurance. There are also characteristics of strata title complexes which, insurers argue, increase their risk profile and claim costs. These are discussed as costs specific to strata title insurance.
- 3.5 The Committee notes that much of this evidence is contradictory and unsatisfactory.
- 3.6 Alongside claims of increased risk exposure from insurers, unit holders have cited the decreased competition in the north Queensland strata title insurance market as a key reason for excessive premium increases.

- 3.7 This chapter examines the evidence the Committee has received relating to these two arguments, and the actions required to address distortions in these two drivers of premium price.

Assessing risk and setting premium prices

- 3.8 Evidence supplied by the ICA shows building insurance premiums are comprised of five factors. The focus of this inquiry is on the proportions assigned to natural peril risk (36 percent), attritional claims (30 percent), and reinsurance costs (6 percent).
- 3.9 Figure 1 provides a breakdown of the typical building insurance premium stack.

Figure 1 Insurance Council of Australia: typical building insurance premium stack



Source ICA, submission 380, p.4.

- 3.10 In this figure, 'natural peril risk' refers to the risk of an event occurring that would result in an insurer needing to pay out a large number of claims (for example, as a result of a tropical cyclone or major flooding).
- 3.11 'Attritional claims' refer to the probability of regular, minor claims on insurance policies.
- 3.12 'Reinsurance costs' refer to the cost of insurance that is taken out by insurance companies. The main purpose of reinsurance is to transfer risk from the insurer to the reinsurer. Typically, reinsurance companies are large multinational corporations.
- 3.13 It should be noted that the premium stack breakdown is based on national data and is not specific to the north Queensland area. Some insurers allege that the Queensland market has a higher number of claims pay-outs than

other parts of the country, and that construction and repair costs are also higher which results in increased claim costs.

- 3.14 The Committee did not investigate these allegations, although there is some discussion of strata title claim frequency and reconstruction options to reduce risk costs in Chapter Four of this report.
- 3.15 The following sections examine the three key cost components of the premium stack, the methodologies for calculating these cost components, and the, at times, contradictory evidence from the insurance industry regarding relative increases to each of these cost components.

The cost of reinsurance and capital adequacy

- 3.16 Despite only contributing six percent to overall premiums, the requirement for capital adequacy and rising costs of reinsurance were cited by some as crucial factors contributing to dramatic increases in premium prices.
- 3.17 As mentioned in the preceding chapter, the main responsibility of APRA in the area of insurance is to ensure that insurers operate in accordance with prudential regulation and are able to meet their Prudential Capital Requirements. This means that, in the event of a major disaster event, insurers have adequate capital to meet their responsibilities to policyholders, whilst remaining solvent.
- 3.18 Insurers generally insure themselves against the risk of high levels of large claims by buying reinsurance. Reinsurance helps insurers to meet their capital adequacy requirements by passing on their risk to the reinsurer.
- 3.19 Mr Robert Whelan, CEO of the ICA, acknowledges the rises in strata title insurance premiums but refuted suggestions that the pricing of premiums was not soundly based. He refers to the highly regulated nature of insurance and the capital requirements to cover risk as drivers of price increases:

we recognise that there have been significant increases in residential strata insurance premiums. However, these increases have not occurred on a speculative basis. Premiums are risk based and the practice for prudently managing operations of an insurer is highly regulated in order to avoid the risk of insurer failure. This regulation is administered by the federal government

through APRA who mandates levels of capital to be maintained and risk management practices by insurers.¹

- 3.20 Zurich Financial Services Group (Zurich) remains one of the few insurers still operating in the north Queensland strata title insurance market. In their submission, Zurich claims that growth in the number of strata title properties has been accompanied by decreased market involvement by other insurers which in turn increases Zurich's risk exposure. This lead to a 20 percent premium rise in 2010:

Following the withdrawal of other insurers from the region, Zurich's strata property portfolio in North Queensland continued to grow in late 2009 and throughout 2010. Due to the cost of capital associated with this growth, and the poor performance of this portfolio, Zurich implemented a further premium increase of 20% on 16 October 2010.²

- 3.21 Increased risk exposure followed by recent Queensland disasters placed further pressures on their obligations to meet capital adequacy requirements for their underwritten risk. Zurich asserts that the required capital allocation for strata title insurance in north Queensland is far in excess of its capital requirements elsewhere in Australia.
- 3.22 Zurich claims that further premium price increases of around 300 percent on average represent the recalculation of capital allocation based on capital adequacy requirements. Zurich trace the bulk of premium price increases to these drivers of price:

It has also been necessary for Zurich to allocate additional capital against its exposure to catastrophes in North Queensland. Zurich's capital allocation for North Queensland strata business is 220%, driven by the high volatility of catastrophe claims. This is more than double Zurich's capital allocation for strata insurance outside of Queensland.

As a result of a further review conducted in late 2010, the increase in capital allocation to North Queensland strata business and further increases in reinsurance costs, Zurich determined it would be necessary to either cease offering its strata product in North Queensland or charge the appropriate technical premium. The technical premium is the premium Zurich needs to charge in order to cover all costs of supplying the product and generate Zurich's

1 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 3.

2 Zurich Financial Services (Zurich), *submission 330*, p.2.

minimum required rate of return on capital. Once the technical premium was calculated, it was determined that current premiums would need to increase on average by 302% to implement the technical price.³

3.23 Consequently, Zurich continues to offer insurance renewals to its customers, but decided not to take on any new business in this portfolio.

3.24 CGU Insurance Limited (CGU) similarly argues that premium price rises reflected cost rises in ensuring capital adequacy. Mr Brad Robson explained that CGU is:

under very stringent prudential requirements to ensure we have adequate capital available – the cost of capital has increased – so that we are writing business in a sustainable fashion and can be here to pay and settle claims.⁴

3.25 A crucial element of insurers meeting their capital adequacy requirements is their capacity to purchase reinsurance. The reinsurance market is a global one and so the capacity of insurance companies operating in Australia to seek reinsurance has been affected to some degree by international catastrophes such as the recent tsunami in Japan and the earthquakes in Christchurch, New Zealand.

3.26 Mr Whelan notes the impact of local disasters on the reinsurance market:

Reinsurance costs are also increasing due to the large number of extreme weather catastrophes in recent years. As noted in our earlier evidence to the committee in relation to claims handling, the extreme weather events experienced around Australia in 2010-11, particularly flooding in Queensland and Cyclone Yasi in Northern Queensland, flooding in Victoria, severe storms in Victoria and bushfires in Western Australia, were unprecedented in their scale and geographic spread.⁵

3.27 Mr Whelan indicates that these Australian disasters have occurred at the similar time as a series of disasters in other countries. This has serious implications for Australian insurers seeking reinsurance on a tight global market:

in 2011 alone there were catastrophic losses across the planet totalling something of the order of \$380 billion in economic loss. Of that, something of the order of being in excess of \$150 billion

3 Zurich, *submission 330*, p.2.

4 Mr Brad Robson, CGU Insurance, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 4.

5 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 2.

was borne by the insurers, and that means largely the reinsurers — so in one year a \$150 billion loss. That was contributed to in no small part by the sorts of catastrophic events we experienced in Australia and New Zealand.⁶

- 3.28 The consequences of these global costs, coupled with recent disasters within Australia, are a changed risk profile and subsequently increased costs of reinsurance. Mr Whelan claims that the increased premium costs to policy holders reflected the increased reinsurance costs borne by insurers:

the reinsurance companies, on whom we rely to be able to provide insurance to the insurance companies so that we can put product into the marketplace, decided that they needed to review our risk profile as a region and they substantially repriced their products to us, and that is what has occurred.⁷

- 3.29 How these reinsurance changes may have affected individual insurers will be determined by their assessed risk exposure and involvement in different markets. However, Mr Whelan claims that all insurers would have been significantly affected by the reinsurance market and further increases could be expected.

- 3.30 Citing figures obtained from APRA, Mr Whelan comments that:

the costs of reinsurance to Australian insurers had increased by at least 50 per cent. How that is factored into individual programs by individual insurers is a very complex matter and that is a subject to be addressed by individual insurers, but it is a significant increase and it is not the end of the increase.⁸

- 3.31 Mr Raymond Pavey, a Townsville insurance broker, told the Committee that he believes reinsurance costs were the most significant factor contributing to strata premium increases. Mr Pavey claims that the north Queensland area was particularly affected by this reinsurance loading:

Insurers who operate in North Queensland are penalised by overseas reinsurance companies by way of a tropical storm zone premium loading. The greater the percentage of the insurer's book of business held in North Queensland the greater the premium loading they receive from their reinsurer. So the insurers who

6 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 5

7 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 5.

8 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 5.

continue to do business in North Queensland receive a higher reinsurance loading.⁹

- 3.32 Mr Pavey also predicts that the situation could deteriorate if further insurers withdrew from the north Queensland market as this would increase the perceived risk exposure and, in turn, reinsurance costs for those that remained:

The more insurers withdraw from the North Queensland market the more lopsided the books of business become in terms of risk held in North Queensland for the insurers who remain; consequently, the more costly it is for those remaining insurers to do business in North Queensland – north Australia, for that matter. Ultimately, this cost passes on to their North Queensland clients.¹⁰

- 3.33 Mr Pavey asserts that the best thing the Government could do to ameliorate the problem of strata premium increases, is to attract insurers back to the strata insurance market in north Queensland. Mr Pavey adds that this would spread the exposure and allow insurers to reduce their ‘book of business in Northern Queensland and should flow through to their reinsurance’.¹¹

- 3.34 The issue of increased competition is discussed later in this chapter.

The cost of claims

- 3.35 The cost assessment of attritional claims is a ‘loading’ that reflects the average amount typically paid out through claims made on this type of insurance cover. Attritional costs can be influenced by the frequency of claims in a region, the frequency of claims for a type of building, and the frequency of claims for the particular building for which insurance is sought.
- 3.36 It was claimed that recent disasters in Queensland have increased capital adequacy and reinsurance costs, and this is reflected in increased premiums in these regions. However, it was also asserted that, as a region, Queensland has historically had a higher claim rate than other parts of Australia.

9 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 23.

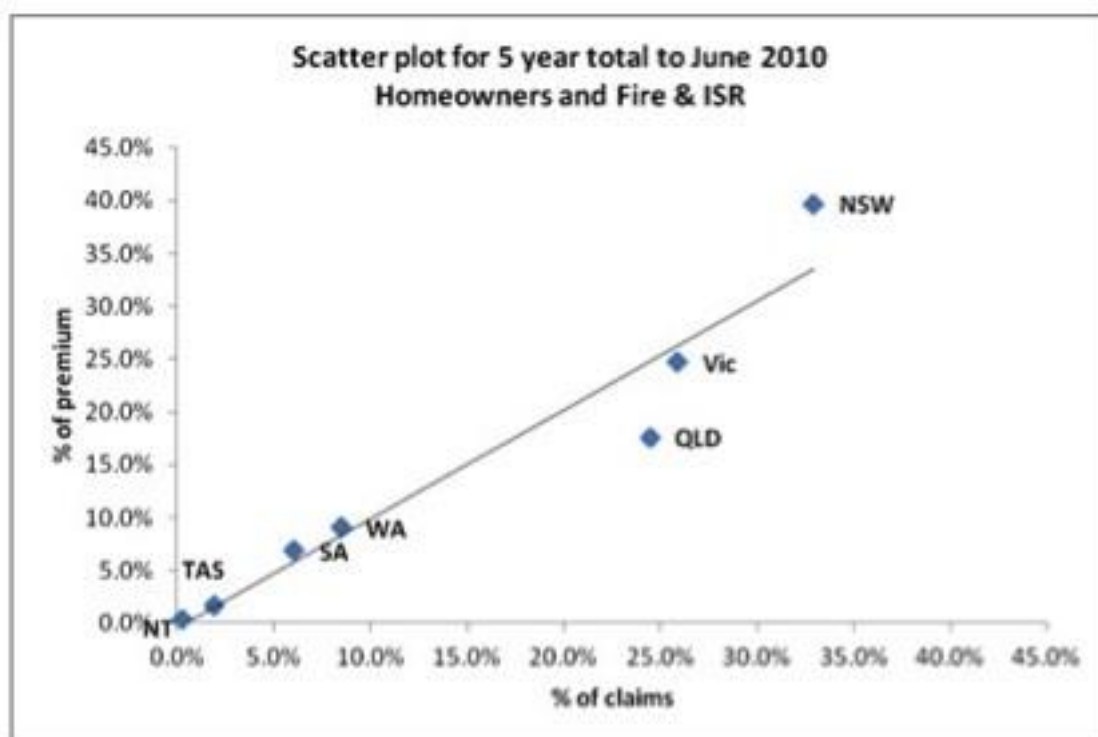
10 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 23.

11 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 23.

3.37 The ICA provided the Committee with evidence that Queensland:

experiences significantly more claims than other states compared to the contributions made into the national premium pool. In other words, in the five years to June 2010, for all property classes, Queensland has drawn some 25% of all national claims despite contributing around 15% of premium into the national premium pool. By contrast, NSW, despite contributing some 40% into the national claim pool, draws under 35% in national claims.¹²

Figure 2 Comparison of each state's percentage of gross premiums and percentage of gross incurred claims for five years to June 2010



Source ICA, submission 380, p.4.

3.38 In addition to these increased regional pay-out rates, insurers suggested that the attritional costs of strata title cover were often higher than that for other types of residential insurance. They assert this is because claim rates for these types of buildings were generally high and excess levels were typically low.

3.39 Insurers assert that this has resulted in higher claim pay-out costs for strata title policies than experienced with other types of residential housing policies.

¹² ICA, submission 380, p. 4.

- 3.40 Zurich reports that across their policy holders, owners in residential strata schemes generally carry lower excesses and make more frequent claims on their policies than owners of houses:

Zurich's experience on claims frequency on strata insurance in North Queensland is around 30-40%. This means for every 100 customers, we are getting 30-40 claims each year. In comparison, a personal lines home building insurance portfolio generally runs at less than 10%.¹³

- 3.41 Zurich cites 'the main reason for such a high claims frequency in strata insurance is historically low excesses'.¹⁴

- 3.42 Zurich adds that:

Many strata managers and body corporate negotiate excess payments as low as \$100 for the entire strata complex, meaning the annual premium can become very expensive. This is done by some strata managers so that many small claims can be made during the year to help with the overall costs associated with running a strata titled property. However using insurance to cover general maintenance issues rather than responding to larger claims and disaster events only puts upward pressure on insurance premiums.¹⁵

- 3.43 Similarly Mr Whelan describes the relationship between higher claims frequency and low excesses as having a feedback effect on premium costs. He suggests that strata schemes that have an 'increased excess will reduce the premium but it also reduces the claims which continue to feed back into premiums'.¹⁶

- 3.44 Mr Whelan asserts that policy holders need to be aware that they can 'dial up' their level of excess and 'dial down' their premiums. This serves to 'prevent people putting in small claims which would build the constant claim profile'.¹⁷

- 3.45 The ICA also put forward a number of recommendations to assist Body Corporates in best determining appropriate excess levels and understanding how claim frequency can impact on premium levels. These are discussed further in Chapter Four.

13 Zurich, *submission 330*, p. 5.

14 Zurich, *submission 330*, p. 5.

15 Zurich, *submission 330*, p. 5.

16 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 13.

17 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 13.

Box 3.1 Excessive insurance premiums land investors on 'struggle street'

'The rental margins were always modest, but the investment was intended to bring an increased capital gain as I neared retirement. I am on a minimal income and this investment has become a deadweight' (Marion MacLennan, *submission 30*, p.1.).

'The increases have threatened the viability of Queensland properties as investments and will lead to forced sales and financial hardship for many owners.' (Graham Young, *submission 409*, p.1.)

'...the insurmountable increases being inflicted ... [are] farcical and...restrict investment in Far North Queensland. (Dave Reynolds, *submission 407*, p.1.)

'...my wife and myself are on a struggle street to make mortgage payments on 2 investment properties.' (Cecil & Lila Wati Prasad, *submission 275*, p.1.)

'...the investment potential will be severely affected. Who would want to buy a unit that has no chance of Capital Gains and Body Corporate Fees of \$6 000-\$8 000...' (K.J. & R.L. Shepherd, *submission 84*, p.2.)

'Increases as predicted of 800% can mean a significant financial burden to the average small time investor.' (Natalie Pawlik, *submission 167*, p.2.)

'Steps should be taken to remove the disincentive to investment in northern regional areas caused by the burden of excessively high insurance...' (Ian Cruickshank, *submission 130*, p.2.)

'This substantial increase in strata insurance makes rent too high if passed onto tenants (untenable) and unviable for owners to keep their investment unit if they don't.' (Amanda Newton, *submission 334*, p.1.)

'This unfair and unsustainable situation in FNQ has become untenable... It has become such a major issue in this region that it is impacting on....current and future investment.' (Name withheld, *submission 150*, p.2.)

'Extensive rises in strata insurance will cost people their homes, livelihoods and investments.' (Chris Sergeant, *submission 310*, p.1.)

'This has to be the...worst investment in Australia.' (Geoff Everett, *submission 405*, p.1.)

'The increases have threatened the viability of Queensland properties as investments and will lead to forced sales and financial hardship for many owners.' (Graham Young, *submission 409*, p.1.)

'My premiums have increased by 300%, making my position as a property investor/landlord virtually untenable....apartments are not a good investment due to increasing insurance costs.' (Mia Lacy, *submission 109*, p.1.)

The cost of natural peril

- 3.46 The ICA cites recent increases in the pricing of risk as being another key driver of increases in residential strata title insurance. They assert that natural peril risk makes up the largest proportion of insurance premiums and that the profit margins for insurance companies are comparably small.
- 3.47 The main argument put forward by the insurance industry to explain the recent significant increases in strata title premiums is that, in the past, strata premiums in north Queensland have been underpriced.
- 3.48 Mr Whelan says that:
- whilst there are a range of factors which have contributed to these increases, fundamentally it is in the insurance market correcting premiums in high-risk locations which have historically been heavily discounted for risk.¹⁸
- 3.49 The ICA asserts that some unit owners were ‘paying less than a third of technical risk prices’.¹⁹
- 3.50 Mr Whelan defends the insurance industry’s past underpricing of risk with the rationale that risk assessment is an ‘evolving science’. He explains that:
- the whole pricing process, subject to risk, is an evolving science, and it is based essentially on experience, which gets factored into the overall risk assessment of individual locations and individual properties.²⁰
- 3.51 Mr Whelan concludes that recently increased premium prices for strata title insurance now represent a more accurate assessment of risk, based on natural perils and attrition claims. He asserts that premium increases are a corrective to previous underpricing of risk; in effect, they are a realisation based upon improved data:
- [prices] are now starting to reflect the risk premium that is associated with the risk assessments that have accumulated over a fairly long period of time.²¹
- 3.52 While this was the view argued by the ICA, other insurers were not consistent in the reasons they gave for underpricing risk in the past. Some insurers conceded that, until relatively recently, competition for a
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18 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 2.

19 ICA, *submission 380*, p. 1.

20 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 3.

21 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 3.

burgeoning market share led companies to heavily discount strata premiums, particularly in some tropical zones like the north Queensland coast.

- 3.53 CGU concedes that market competition led to reduced pricing at one point. However, CGU claims that this reduced pricing was not sustainable and did not reflect the actual risk represented by strata title insurance coverage in these areas. It was, they assert, an historic underpricing of risk driven in part by the rapid growth in the strata title market:

The distribution of residential strata insurance in Northern Australia, particularly in Far North Queensland, became increasingly competitive a number of years ago in response to the rapid urban development in this region. The growth in the number, size and density of strata developments was, for a period, accompanied by an increase in the residential strata insurance 'capacity' for this region.

This high level of competition, particularly when compared to the distribution of strata insurance in southern Australia, led in some sub-regions of Northern Australia to premium pricing at unsustainable levels.²²

- 3.54 Conversely, CGU deny that premiums were deliberately underpriced. Mr Brad Robson suggests that underpricing resulted from insufficient data to accurately price risk in the past, and the market is now experiencing the necessary pricing adjustments:

Our product may have been underpriced but it was not underpriced knowingly. That is a discovery process as you apply your actuarial studies to your statistical performance combined with the reinsurance cost factors that change together with the claims costs. There are inflationary pressures put on claims costs with general repairs. A lot of buildings have become more sophisticated in high-end asset values and there has been an accumulation of buildings being built in coastal regions, which unfortunately do bear the brunt of winds. It is those key factors that have contributed to our discovery as we have looked at our pricing. The pricing was not adequate or accurate to offset the risk of taking on that business.²³

22 CGU Insurance, *submission 379*, p. 3.

23 Mr Brad Robson, CGU Insurance, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 4.

- 3.55 So, on one hand insurers concede that, until relatively recently, competition for business led to heavy discounting on strata policies, while on the other they claim that risk assessment was inadequate or inaccurate in the past.

Costs specific to strata title insurance

- 3.56 The premium cost components considered above (the cost of natural peril, the cost of attritional claims and the cost of reinsurance) are common to all types of residential building insurance, though the proportions may vary depending on type of building, region, scope of cover etc.
- 3.57 In relation to strata title insurance, the ICA argue that there exist specific characteristics of strata title properties which increase their risk profile and so the risk exposure for insurers.
- 3.58 The assessment of risk and the relative cost components as they apply to any individual policy is obviously a complex and commercially sensitive process. The ICA state that insurers employ actuarial experts so that they price risk correctly and take into account many detailed factors to determine costs.
- 3.59 For strata title properties, these factors may include the following:
- Portfolio costs:
 - The estimated cost of future claims
 - reinsurance and capital costs
 - management costs
 - Broker costs
 - Building specific issues:
 - The level of cover requested and liability provisions
 - Risks at the location
 - The age of the building and claims history
 - Special limits on the building such as heritage listings
 - Building materials and design used
 - The number of units and floors, floor space etc,
 - Fire protection systems and other mitigation present
 - Presence of an onsite manager or measures to lower claims frequency
 - The number of pools, car parks, lifts, etc

- The primary use of the building, owner occupied, rental, commercial etc.²⁴
- 3.60 Differences in these factors can result in different premiums applying to strata title complexes which are in close proximity and or which may appear to be of a similar value or size.
- 3.61 CGU state in their submission that there are distinct features of residential strata title insurance that have ‘conspired to magnify recent premium increases’. These include:
- The total value of a residential strata building is higher than a home, so the scale of losses is potentially higher.
 - Concentration of risk – as opposed to insuring 100 homes dispersed over a large area, a residential strata building may represent 100 homes on a smaller square footage. If a storm hits that particular area it could lead to a higher number of insurance claims in terms of value and severity of damage, than if the risk was spread across a broader geographical area.
 - Clustering – residential strata buildings are often clustered together in particular areas of a town, which further exacerbates the concentration risk.
 - Location – residential strata buildings in Northern Australia are often along or near the coastline and built for their sea views or holiday letting potential. This puts them at higher risk of cyclone and storm damage than other properties located inland.
 - Repairs – costs are influenced by availability to materials and labour. Major catastrophes can result in a sharp rise in costs due to high demand. The engineering involved in large residential strata complexes can require specialist attention unlike that of traditional homes. This draws upon specialist skills that may not be readily available within the local region further exacerbating the cost to repair. Equally, in many cases the high value plant and equipment used for the provision of services (water, electricity, air-conditioning, etc) in residential strata complexes is centrally located in flood prone areas, such as basements, significantly adding to the cost of repairs incurred in even minor events.
 - Increases in peripheral costs – residential strata policies provide temporary accommodation costs to tenants in the event the premises is temporarily uninhabitable. This cost is magnified with multi-tenanted risks, such as a 50 dwelling apartment building.²⁵

24 ICA, *submission 380*, p. 4.

25 CGU Insurance, *submission 379*, p. 4.

- 3.62 These factors, CGU assert, increase the risk exposure of those insurers operating in the strata title market. While the natural peril risk may not be higher than that of nearby residential standalone houses, the claim pay-out costs potentially incurred by the insurer are likely to be substantially higher in the event of a major damage to the area.
- 3.63 Regardless of these particular characteristics of strata title and recent massive increases in premium prices, the ICA claim that premium increases do not disadvantage strata title unit owners compared to standalone residential house owners. They deny that strata insurance is unaffordable and assert that it is on par with general insurance.
- 3.64 The ICA claim that despite recent premium increases:
- Strata unit holders now pay the same or less than householders. Strata title insurance in some areas of Australia has been heavily discounted in the past, compared to the technical risk price. Recent corrections to price, whilst very significant, now better reflect risk levels and the cost of capital associated with providing cover. Strata title property owners in high risk areas now (on average) pay a premium comparable or lower than the premiums payable by owners of stand alone households.²⁶

Table 2 **Comparison of north Queensland average insurance rates: strata vs household property (2011)**

	Average Annual Premium Per Strata Unit (\$)	Average Annual Premium Per Standalone House (\$) (with \$500 excess)
Cairns	1,120	2,312
Airlie Beach	2,210	2,410
Townsville	2,116	2,398

Source ICA, submission 380, p.5.

- 3.65 The ICA provided the Committee with comparative data for average annual premiums per strata unit and per standalone house at three locations in north Queensland (reproduced in Table 2). The ICA included this information to show that strata unit owners are, on average, 'not currently disadvantaged compared to their householder neighbours'.²⁷

²⁶ ICA, submission 380, p. 2.

²⁷ ICA, submission 380, p. 5.

- 3.66 Based on their comparative data, the ICA assert that:
- The increase in strata title premiums have moved average premium to sum insured ratios closer to parity with household property.²⁸
- 3.67 The ICA also refute that the square metre area covered by strata title insurance is less than that for standalone houses, noting that many strata title complexes have large common areas, with costly assets, more electrics, amenities and infrastructure than is usually found in standalone residential homes.
- 3.68 Despite these arguments from insurers, some unit owners express doubts about the capacity of insurers to accurately assess risk. Mr Mark Beath, a unit owner-resident from north Queensland, states that:
- Only three insurers would provide quotes via our broker for our building last year. The highest quote was more than 100% above the lowest. There is an enormous disparity even between the two lowest bidders of approx. 40%.
- For the previous year (2010) the highest of three quotes was more than 40% above the lowest. Either that is a market failure or evidence of extreme variance in risk assessment methodology by insurers?²⁹
- 3.69 Other anecdotal evidence was received regarding variations in premium prices and discounting by insurance companies when challenged.

Committee Comment

- 3.70 The Committee heard two main arguments put forward by insurers to explain the extraordinary premium increases in strata title insurance in north Queensland. Insurers have variously claimed that:
- increased reinsurance costs have driven price rises, and/or
 - price increases are a result of past inadequate or inaccurate pricing of risk.
- 3.71 Based on information provided to the Committee by the ICA, reinsurance costs make up only six percent of the overall average premium. The

28 ICA, *submission 380*, p. 5.

29 Mr Mark Beath, *submission 298*, p.1.

Committee does not accept that fluctuations in costs within that range can fully explain reported premium increases of above 500 percent.

- 3.72 If poor risk assessment in the past is the true reason for such drastic readjustment, the Committee is astonished at the extent of these flawed past practices. Given the enormity of these errors, the Committee struggles to place confidence in current business practices and risk methodologies.
- 3.73 The Committee is of the view that the whole point of insurance is the capacity for a company to carefully assess the cost of the risk that they underwrite and then to calculate premiums accordingly. If companies have failed so completely in assessing the risk in the past, then it is difficult to have faith in their capacity to accurately calculate the current risk that is supposedly driving premium increases.
- 3.74 The Committee heard anecdotal evidence about the disparity in premiums prices quoted from different companies, including evidence suggesting that insurance companies were able to drastically reduce their quoted rates for premiums when challenged over prices. In some instances, policy premiums were reported to be reduced by between \$30 000 and \$50 000 with no change in other policy conditions or excess levels.
- 3.75 This suggests either a lack of sound methodology being applied to initial risk assessments, or that price points have been heavily inflated above the cost of the assessed risk (and hence the capacity to provide huge deductions).
- 3.76 The Committee presents no view as to how or why these reductions are possible and did not attempt to gather evidence on this given the urgency of this inquiry. While the Committee is thankful that some strata title holders were able to benefit from these reductions, the Committee expresses its grave concerns regarding these business practices and its subsequent concern for those who did not challenge the first quoted premium and who may not have secured reductions.
- 3.77 The Committee considers that suggestions of either price inflation or a lack of methodology adds weight to the urgent need for a review of risk pricing by APRA.

Recommendation 2

- 3.78 **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.

Market involvement and competition

- 3.79 Evidence was given that over the last five years there has been a decline in the number of insurance companies providing strata title insurance in the north Queensland area.
- 3.80 The Owners Corporation Network (OCN) notes that ‘there are currently only four core strata insurance providers’ in north Queensland and that other insurers ‘have withdrawn from the market due to insufficient premium base.’³⁰
- 3.81 The exit from the market of many insurers has forced some Body Corporates to change insurance companies, and others have been unable to seek alternative quotes for insurance cover and have been forced to accept the prices set by the one or two insurers remaining in the market.

30 OCN, *submission 388*, p. 5.

- 3.82 This, in itself, is not evidence of any price fixing or price inflation. However, there is certainly an absence of evidence of robust market competition.
- 3.83 Successive Australian governments have been committed for several years now to a free market approach to general insurance. While regulating the industry and ensuring oversight of financial practices, governments have not intervened in setting premium pricing or assessing risk.
- 3.84 In other types of insurance and in other localities there are a number of insurers providing a competitive range of residential home, contents, vehicle and other forms of insurance. Given the lack of evidence received regarding strata title insurance outside of the Queensland area, the Committee assumes that a robust strata title insurance market exists elsewhere with premiums that are considered affordable by unit holders.
- 3.85 When a free market fails to operate effectively and service public need, it is for governments to investigate the existence and cause of distorting factors. In this instance, a lack of robust market competition is particularly troubling given the mandatory requirement for strata title insurance and recent excessive premium increases.
- 3.86 While strata title insurance is mandatory in all states and territories, the issue of rising premiums and lack of competition seems confined to the north Queensland market. Clearly insurance companies are choosing to have a presence where risk profiles are considered lower. This is creating regional inequities with robust markets operating in some areas, and excessive premiums with limited or no insurance choices in others.
- 3.87 There is currently no obligation for an insurance company that provides certain insurance cover in one region, to offer this cover to all areas of Australia. Consequently, while legislation requires residential strata title insurance (and so ensures that there is a demand created for residential strata title insurance), there is no requirement for insurance companies to offer residential strata title insurance. Therefore, there is no regulatory requirement that ensures the supply of affordable insurance in all areas of Australia.
- 3.88 Many witnesses claim there is a failure in the strata title insurance market in north Queensland. Several assert that this lack of competition is creating monopolistic conditions in the marketplace and contributing to price increases.
- 3.89 For example, Mr Matthew Blackmore, an owner-resident of an apartment in Cairns, expresses his frustration that only one insurer was prepared to

quote for his strata title complex, and they were forced to accept the dramatic premium increases dictated by this insurer:

There is unquestionably market failure for body corporate insurance in northern Australia as evidenced by the fact that only one insurance company was willing to quote for our building. I made numerous attempts to identify other insurers, as did our current insurance broker. The legislative requirement for bodies corporate to take out building and other related insurance has created a monopoly of sorts, where one insurer is able to command premium increases of around 400% in 2 years.³¹

- 3.90 Similarly Mr Beath argues that a market failure exists for tropical strata insurance. He notes that:

this is evident in the failure of increased prices to attract entrants. In fact insurers have withdrawn from the market as prices have been increasing.³²

- 3.91 The Committee heard evidence from insurance brokers who also suggest the north Queensland situation was indicative of a market failure. For example, Mr Pavey said that 'there has been a market failure in north Queensland'.³³

- 3.92 Similarly, Mr Dallas Booth CEO of the National Insurance Brokers Associated (NIBA) conceded that 'there is market capacity, but it clearly is limited and the market is struggling at the present time'.³⁴ Mr Booth added that 'I cannot deny that it is getting very close to market failure'.³⁵

- 3.93 SCA outlines how prices had increased with the withdrawal of other insurers from the market:

The quantum leap in prices in 2010 and 2011 was clearly associated with a collapse in competitive tension in the tropical insurance market. Some insurers withdrew altogether while others would quote for renewals and not new business.³⁶

31 Mr Matthew Blackmore, *submission 377*, p. 2.

32 Mr Mark Beath, *submission 298*, p.1.

33 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 26.

34 Mr Dallas Booth, *Committee Hansard*, Thursday 16 February 2012, p. 1.

35 Mr Dallas Booth, *Committee Hansard*, Thursday 16 February 2012, p. 7.

36 SCA, *submission 354*, p. 5

- 3.94 SCA notes this has enabled the remaining companies to select business and the consequence is that some older buildings struggle to secure the insurance coverage required of them by law:

By late 2011 there was effectively only one major insurer taking new business other than on a highly selective basis. Even then, this insurer drew the line at some of the risks seen to be at the higher end of the spectrum, such as buildings on resort islands and older (pre-1980s) buildings which may not meet current cyclone standards. These have been effectively uninsurable.³⁷

- 3.95 Other evidence suggests that limits placed on available cover are a serious issue and give weight to the notion of market failure. Several submissions and witnesses referred to seeking quotes from companies and being refused cover. For example:

- A strata complex was refused cover because the company only insures 'up to \$5 million and they do not have a catastrophe allowance.'³⁸
- Anecdotal evidence of one Standard Format Plan registered as a community titled scheme under the BCCM Act that was unable to secure cover for the whole property because the buildings were made of timber and were holiday let. The owners were forced to make their own insurance arrangements, however the common property was uninsurable.

- 3.96 Several witnesses also express their concern that Body Corporates are no longer able to obtain flood insurance in north Queensland.³⁹

- 3.97 OCN argues that this situation goes beyond market failure and is a complete system failure. OCN assert that:

The aim of strata title insurance is to provide comprehensive protection against risks to which the Owners Corporation is exposed. A successful market operation in the area implies that choices by well informed consumers, that is, executive committees, result in effective protection for strata plans at the least cost.

In OCN's view this is not the case and a state of affairs exists which is best described not merely as *market failure* but as *system failure*.⁴⁰

37 SCA, *submission 354*, p. 5.

38 Viewmont Body Corporate, *submission 137*, p. 5.

39 See, for example, Body Corporate for Park Edge, *submission 174*, p. 1; Ms Denise Timanus, *submission 39*, p. 1; Mr Graham Young, *submission 409*, p. 1.

40 OCN, *submission 388*, p. 2.

- 3.98 OCN describe the lack of competition for strata insurance and how this was impacting pricing policies for strata title insurance. OCN also suggest that this is also resulting in a poor insurance product being offered:

This lack of competition adversely impacts the cost of strata insurance via inefficiencies and inflated premiums. Without an incentive to price products more keenly, the cover offered tends to be 'one size fits all' resulting in inflated premiums as well as, in many cases, underinsurance in such areas as machinery breakdown, public liability, and office bearer's cover.⁴¹

- 3.99 Mr Graham Janz, a unit owner from Cairns, calls for urgent government intervention because of 'crippling increases' in insurance premiums:

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.⁴²

- 3.100 However, Mr Pavey reacts to calls for government intervention or a government insurance company, suggesting this would only exacerbate the market failure and concentrate risk on one insurer. He argues that the ACCC needs to investigate how and why the market failure had occurred in north Queensland.⁴³

- 3.101 Mr Pavey suggests that the only viable solution to address premium increases is to increase competition in the market, which spreads the exposure:

Ultimately, if you set up a government insurance company it is going to be the only one operating in the market because everybody will insure with it. That company will eventually face the same pressures as the other insurers. When you have one insurer in the market, it has all the exposure and it will attract higher reinsurance premiums. The only solution is more insurers.⁴⁴

41 OCN, *submission 388*, p. 5.

42 Mr Graham Janz, *submission 387*, p. 7.

43 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 26.

44 Mr Raymond Pavey, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 25.

Box 3.2 Port Douglas and Cairns: a dire situation pricing out beautiful north Queensland

'It is getting ludicrous...I am really frightened that a lot of people are going to have to sell — and to sell anything in this market you have got to give it away. As a property manager, a body corporate manager and a real estate agent, it is very hard to look anyone in the eye and suggest that they should buy a strata unit as an investment at the moment. (Margaret Trimble, *Committee Hansard*, Port Douglas, 30 January, p. 9)

'...we are concerned about the unjustifiable insurance premiums that have gone up significantly. They are impacting on our owners' investments and their livelihoods.' (Sue Chapman, *Committee Hansard*, Port Douglas, 30 January, p. 9)

'We can only insure with Zurich, they are the only ones, so they can charge us five million if they like, or we do not insure—and we have to by law, I believe. We just do not have a choice.' (Valerie Reid, *Committee Hansard*, Port Douglas, 30 January, p.16.)

'If I were a cynical person I would think that the body corporate management companies around the traps are all holding hands with the insurance companies so they can jack the premiums up.' (Ian Campbell, *Committee Hansard*, Port Douglas, 30 January, p.18.)

We are very concerned, because a lot of the people who live in our complex are retirees and some are still working at a mature age to make ends meet. It has become ridiculous.' (George Spathis, *Committee Hansard*, Cairns, 30 January, p.24.)

'I am particularly concerned because I think that this beautiful part of Australia is being priced out of the ability for some people to come and live here.' (Dr. Janice Crowley, *Committee Hansard*, Cairns, 30 January, p.25.)

'Many will think that this issue is only affecting the people who live in the far north...I would like to say that this issue is affecting people Australia wide...the situation is now dire' (Linda Tuck, *Committee Hansard*, Cairns, 30 January, pp.25-26.)

'There are literally no investors coming into Cairns.' (Clint Smith, *Committee Hansard*, Cairns, 30 January, p. 28.)

'...a situation has arisen which has enabled those insurers participating in this segment of the market to gouge customers with premium increases of up to 800 per cent.' (Garry Masters, *Committee Hansard*, Cairns, 30 January, p. 29.)

'...how do you ensure people do not lose their homes and their houses due to unaffordability of insurance?...I am distressed and outraged and I feel sick at the thought of such unjustifiable increases, which have a huge effect on people's lives' (Helen Reed, *Committee Hansard*, Cairns, 30 January, pp.31-32.)

Territory Insurance Office

3.102 The Committee heard evidence that the only state-owned general insurance company in the country, the Territory Insurance Office (TIO), provides a model of best practice for servicing a strata insurance market.

3.103 SCA comments that the TIO is able to deliver a well-priced insurance product to the strata title market in the Northern Territory:

While strata insurance remains expensive relative to southern capitals, it continues to be quoted at levels well below those now on offer in north Queensland and northern WA and with no material recent changes in price levels or restrictions on coverage.

In most respects the TIO mirrors the State insurance offices that in every other instance have been privatised in recent decades. On occasions the Northern Territory Government has considered and rejected the option of a similar privatisation because of concerns about the impact on availability and affordability of insurance in the NT. Based on recent experience in strata insurance the rest of tropical Australia, it would appear these concerns were well founded.⁴⁵

3.104 Mr Mark Lever from SCA remarks that data he obtained shows that strata insurance premiums in north Queensland are two to three times the cost of premiums being charged in Darwin, despite the city being similarly exposed to cyclone risk.

3.105 Mr Lever suggests that the TIO is shielded from increasing capital-servicing and reinsurance costs by the Northern Territory government.⁴⁶

3.106 In correspondence received by the Committee, the Chief Executive, Mr Richard Harding, outright rejects claims that the TIO is immune from market forces. While acknowledging that the TIO is a statutory corporation owned by the Northern Territory government, Mr Harding stresses that the TIO is subject to standards and capital management practices comparable to those that APRA requires of other insurers in the market:

TIO must comply with a prudential standard regime that closely mirrors relevant Australian Prudential Regulation Authority

45 SCA, *submission 354*, p. 9.

46 Mr Mark Lever, *Committee Hansard*, Monday, 30 January 2012, Port Douglas, p. 4.

(APRA) prudential standards, including its capital management practices.⁴⁷

- 3.107 Mr Harding also states that the TIO experiences the same market conditions as other insurers, including recent pressures of reinsurance and exposure to risk. These factors dictate its premium pricing:

In addition to TIO being subject to the above prudential requirements it also experiences reinsurance capacity constraints and expenses equivalent to other insurers in the industry. TIO's pricing is a factor of claims history, reinsurance costs, and the exposure and nature of the risk, and the application of a commercial return on capital which is the same approach as other commercial insurers.

- 3.108 Mr Harding explains that the differences in premium pricing results from regional differences, and how these impact on attritional and natural peril costs. Pricing differences between the Northern Territory and north Queensland cannot be attributed to any shielding of the TIO from market conditions or by more favourable operating conditions. Mr Harding emphasises that:

TIO's mandate is to operate in the Northern Territory insurance market on a fully commercial basis, like for like with other insurers.⁴⁸

Australian Reinsurance Pool Corporation

- 3.109 Some submitters raise the establishment of the Australian Reinsurance Pool Corporation (ARPC) as an analogous situation of the existence of an insurance market failure, and subsequent remedial action taken by the Australian Government.
- 3.110 Prior to the September 11 2001 terrorist attacks in the United States, Australian insurance companies were able to reinsure their insured risk in the event of a terrorist attack. However, following the terrorist attacks, global reinsurance companies withdrew from the market.
- 3.111 In the absence of reinsurance, Australian insurers could not provide insurance for terrorism risk.
- 3.112 In 2002 the Australian Treasury commissioned a review into the availability of terrorism insurance in Australia. This review found that

47 Mr Richard Harding, Committee Correspondence, 10 February 2012.

48 Mr Richard Harding, Committee Correspondence, 10 February 2012.

there was no terrorism-related cover available for commercial property and business interruption.

- 3.113 As a result of this review, in 2003 the Australian Government intervened in the market to establish a scheme for replacement terrorism insurance coverage (namely, the ARPC). The ARPC was intended as a stop-gap measure to correct an immediate market failure that had serious implications for the Australian economy.
- 3.114 The viability of the ARPC is required to be reviewed every three years by Treasury. The latest review was conducted in 2009 and found that the ARPC was still necessary because it is unlikely that the private sector can provide terrorism insurance in the near future. Moreover, the availability of insurance and reinsurance was further depleted by the Global Financial Crisis in 2008.⁴⁹
- 3.115 The review highlighted the fundamental need for private sector involvement, recommending that the Australian Government withdraw from the market once private insurers can offer terrorism insurance on reasonable terms.
- 3.116 Mr Whelan describes the intervention of the Australian Government to address market failure and establish the ARPC:

The terrorism pool was established due to actual market failure. After the 9-11 events in America, the availability of insurance for terrorist attacks evaporated globally, so there was no available cover. To replace that available cover in the marketplace, the government intervened and created the pool, which is funded to a large extent by a levy charged against insurance policyholders on certain types of property. The pool has grown and it has a stipulated requirement to build its reserves and its reinsurance capability to a certain level to cope with the potential of a major terrorist attack against Australia. All of that is in place.⁵⁰

- 3.117 While the ARPC was established to provide terrorism reinsurance for commercial buildings, a number of strata title complexes comprise a mix of commercial and residential occupancy. Depending on the composition, some are eligible for ARPC reinsurance coverage, while others must seek terrorism insurance through commercial markets.

49 The Treasury, *Terrorism Insurance Act Review*, October 2009.

50 Mr Robert Whelan, ICA, *Committee Hansard*, Monday, 30 January 2012, Cairns, p. 7.

- 3.118 In correspondence received by the Committee, the CEO of the ARPC, Mr David Matcham explains that:

Residential buildings are generally covered for terrorism risk in commercial reinsurance arrangements however the general rule is that residential buildings with more than 20% of commercial use and buildings valued in excess of \$50M are excluded.

...

The ARPC scheme provides insurers with a contract of reinsurance covering terrorism risk for commercial buildings. Where buildings are mixed use (commercial and residential), cover is available from ARPC if 50% or more of the building is turned over to commercial use.⁵¹

- 3.119 Mr Matcham notes the gaps available in cover for mixed commercial and residential strata title complexes. He indicates that this had been considered in the 2009 review, although the conclusion was that the current ARPC guidelines should remain unchanged. Mr Matcham advises that a further review is being conducted to examine the gaps in available cover.⁵²

- 3.120 OCN argues that the gaps in available cover for terrorism reinsurance are a 'glaring failure in the residential strata arena':

There are now many buildings in major Australian cities which have been converted from commercial to residential use. It is an anomaly that these residential (or predominantly residential) buildings do not qualify for participation in the government's terrorism coverage scheme. The building site, exposure and risks remain essentially the same as the former commercial building.⁵³

- 3.121 OCN goes on to add that the market failure in this area is significant with potentially serious consequences:

Meaningful terrorism insurance is not available through local insurers following the withdrawal of Affiliated FM, a US based company, from the market. It can be separately purchased through Lloyds but the cost is prohibitive. If it is accepted that strata insurance should provide comprehensive cover for risk to which the Owner's Corporations (OCs) may be exposed, then lack of

51 Mr David Matcham, Committee Correspondence, 24 February 2012.

52 Mr David Matcham, Committee Correspondence, 24 February 2012.

53 OCN, *submission 388*, p. 5.

terrorism coverage renders such policies in effect not fit-for-purpose.⁵⁴

- 3.122 In addition to concerns regarding the gaps in cover for some strata title complexes, the Committee heard calls for an expansion of the ARPC to provide general reinsurance for insured residential strata title risk.

Committee Comment

- 3.123 Poor pricing practices leading to market readjustments, and increased risk exposure of strata title complexes, were cited as key reasons for the recent dramatic increases in premium prices. Evidence of poor market conditions leading to little or no competition was also cited as a reason for the dramatic increases in premium prices.
- 3.124 The Committee agrees that the current strata title insurance market in north Queensland is characterised by monopolistic conditions and market failure. The Committee does not conclude from this that anticompetitive, monopolistic or collusive behaviour is or has taken place in the market.
- 3.125 However, it is clearly not a robust market that encourages efficiencies or competitive pricing. In addition, the concentration of insurers in this market obviously focuses their exposure to risk, exacerbating high costs and the lack of choice or competition.
- 3.126 The Committee recognises that the TIO is able to provide strata title insurance to service the Northern Territory market at a lower cost than private insurers in north Queensland as a consequence of market characteristics. 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.
- 3.127 Several submitters told the Committee how they had approached the ACCC to investigate the affordability of strata title insurance in the area. The Committee viewed some of the responses received by those submitters from the ACCC and noted that the agency has been reluctant to do so.⁵⁵

54 OCN, *submission 388*, p. 5.

55 See, for example, Mr Andrew Hayes, *submission 329A*; Mr Edward Dews, *Committee Hansard*, Wednesday 1 February 2012, Townsville, p. 22; Whitsunday Ratepayers Association, *submission 112A*.

- 3.128 The Committee considers that the responses from the ACCC were unhelpful, almost formulaic letters, which added to the frustration and stress of individuals facing the fear of ever-increasing insurance premiums.
- 3.129 The Committee recognises that the ACCC cannot make rulings about whether strata title insurance premiums are accurately set, or if prices are inflated or have been historically set too low. The Committee acknowledges that those writing to the ACCC may not have grasped the exact jurisdiction of the ACCC. Accordingly, when those writing to the ACCC requested that it investigate the price increases, the response of the ACCC (that they were not able to assist) was technically correct.
- 3.130 However, as a statutory authority with a public service duty, the Committee considers the tone of some of the responses to be inappropriate – namely some responses were bureaucratic, unhelpful and dismissive.
- 3.131 The Committee admonishes the ACCC for this type of response and for not seeking to raise the issue with other more appropriate agencies, or to refer it to the Minister for his information and action.
- 3.132 While not able to investigate the price setting of strata title insurance premiums, the ACCC has the authority to investigate the cost drivers, market conditions and relative profitability of the strata insurance market.
- 3.133 The Committee is aware that the ACCC conducted extensive reviews into the general insurance industry following shifts in the market and premium increases as a consequence of the September 11 terrorist attacks and the collapse of HIH.
- 3.134 The Committee is of the view that a similar review of the strata insurance market is warranted, given the magnitude of premium increases in recent years. The Committee notes that insurers offered to provide to the Committee confidential information on their market profitability and relative costings.
- 3.135 The Committee thanks insurers for their willingness to make available this sensitive information and trusts they will extend the same cooperation to any investigation conducted by the ACCC.

Recommendation 3

- 3.136 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.

Recommendation 4

- 3.137 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.

- 3.138 The Committee did not receive evidence quantifying the terrorism risk to residential strata title buildings and how this may impact premium prices.
- 3.139 However, the Committee expresses some concern that residential strata title buildings are excluded from being reinsured by the ARPC. The Committee queries whether the current proportions of residential/commercial use of a building that qualify/disqualify it for reinsurance under the ARPC remain appropriate given the growth of strata title complexes, particularly in coastal holiday and metropolitan areas.
- 3.140 Given that strata buildings in some locations may face similar levels of terrorism risk as commercial buildings, the Committee is of the view that a reassessment is required. The Committee is aware that any expansion of the reinsurance pool to cover terrorism reinsurance for residential strata title or general insurance risk has serious implications for the Commonwealth.

- 3.141 Further, the ICA has indicated that the average reinsurance component of insurance premiums is around six percent. Given that this inquiry was instigated because of reports of premium increases in the order of hundreds of percentage points, the Committee is not convinced that terrorism reinsurance represents the most significant component of the problem.
- 3.142 However, the Committee feels that any measures that may limit premium increases warrant further investigation with an analysis of any possible reductions that may be applied to premium prices.

Recommendation 5

- 3.143 **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.