Insurance Council
of Australia

Role of the Private Insurance Market – Independent Strategic Review: Commercial Insurance

Final report

September 2021: Commissioned by the Insurance Council of Australia

About this report

This report has been commissioned by the Insurance Council of Australia as part of its review of the insurance sector's options for reforms to improve the industry's contribution to national economic recovery and growth. Its primary emphasis is concern from insurers, other stakeholders and the community about the availability and affordability of some categories of insurance cover for certain groups of customers. This paper deals only with commercial insurances.

The report

- The report is the sequel to a Consultation Paper prepared by Mr John Trowbridge and released on 20 May 2021. It deals extensively with issues of availability and affordability of commercial insurance. It comprises an adaptation of the consultation paper to take account of submissions received since then and of subsequent consultations with the Insurance Council.
- It includes a Foreword by Mr Andrew Hall, Executive Director and CEO of the Insurance Council of Australia and a brief summary prepared by Mr Michael Blythe regarding the importance of insurance to the Australian economy.

Submissions to the Consultation Paper are available on the ICA website.

The author

Mr Trowbridge has been commissioned as an independent consultant. The views, observations and recommendations offered in the report are his views and do not necessarily represent the views or opinions of the Insurance Council or any of its members.

Next steps

This report contains observations and a set of recommendations for the insurance industry, the business community, governments and other interested parties to consider.

Issued by the Insurance Council of Australia
20 September 2021

Role of the Private Insurance Market Independent Strategic Review: Commercial Insurance

Foreword

The Insurance Council of Australia (ICA) welcomes this independent report which considers the insurance sector's options for reforms to improve its contribution to national economic recovery and growth.

The aim of this review, which is being led by former insurance executive and regulator John Trowbridge in collaboration with leading economist Michael Blythe, is to provide a summary of potential practical solutions to problems that have been challenging sectors of the economy for some years.

This paper relates exclusively to commercial lines of insurance and primarily to SMEs (small and medium enterprises).

As risk increases, so do costs and as a result premiums rise. Availability and affordability of some categories of insurance cover for certain sectors remain a real concern. Small businesses are facing challenges in accessing the insurances, such as public liability, that they need to operate. In many of these categories, given they are pricing the risks insurers themselves are under pressure to provide a profitable product, so solutions are often difficult to determine.

A range of inquiries and reviews over the past decade have put forward various recommendations on how to address these. Increasing risk profiles have often been a long-term trend within certain sectors, while others have been created by an increasingly litigious environment.

One consistent theme in all of these reviews to Federal and State Governments yet to be heeded is the reform of State-based taxes which unfairly burden those who seek private insurance protection to the benefit of those who do not.

The ICA remains steadfastly determined to see these themes and reforms are properly embraced and implemented as a comprehensive, long-term solution.

The private insurance market performs risk transfer from those seeking insurance protection to insurers willing to bear the risks. It does so successfully across Australia but this paper enables the industry and stakeholders to examine where it can do more to manage issues of affordability or availability.

With this review on commercial insurances, a dialogue with stakeholders has started. We look forward to engaging with government, regulators, policy holders, industry groups and consumer groups to understand where we can find common agreement for actions moving forward over the short, medium and longer term.

Andrew Hall
Executive Director and CEO
Insurance Council of Australia

Executive summary

Introduction

The essence of insurance is the transfer of risk from consumers and businesses to insurers in a manner that enables these consumers and businesses to pursue their affairs in the knowledge that, if adverse events occur that are outside their control, they will receive some compensation and support that will enable them to recover financially from these events.

The private insurance market performs this risk transfer process successfully on the whole, earning in Australia in 2020 some $48bn in premiums and incurring $44bn in claims. The industry therefore delivers a valuable and substantial service to the economy but insurers are the first to recognise that the industry could also do more. Accordingly, the industry is keen to enhance its contribution to the community and the economy. That includes responding to those segments of the insurance market that are not currently seen to be delivering risk transfer effectively because of questions around **affordability** and **availability** of insurance.

An important part of the effectiveness of the risk transfer process is that consumers and businesses who are purchasing insurance, along with governments and local councils, are all playing their part by managing and mitigating those aspects of the insured risks that are within their control. The industry is therefore also keen to encourage all parts of the community and the economy through mitigating their risks where possible to optimise the economic effectiveness of insurance.

A critical step in enhancing the industry’s contribution to the economy is to deal with the known issues of affordability and availability of insurance.

The economy and the role of insurance

The Australian economy is a remarkable success story. The insurance industry plays an important part in this success and at the end of this Executive Summary is a short note that explains this success story. It also refers to the support that the insurance sector gives to the economy and outlines the role that insurance plays in reducing uncertainty, building productivity, assisting in disaster mitigation and making other contributions to the economy.

This report

This report is the sequel to a Consultation Paper released on 20 May 2021 aimed at exploring relevant segments of the commercial insurance market and identifying potential methods of resolving these market shortcomings. Various options for solutions were put forward along with associated questions for consultation purposes. This report comprises an adaptation of the consultation paper to take account of submissions received since then and of subsequent consultations with the Insurance Council.

The report culminates in a summary of the submissions received, in Section 6, and a set of 13 recommendations, in Section 7, devised to respond to the submissions in the context of 16 options for possible solutions described in the Consultation Paper and recorded in Section 5 of this report. Before nominating the 16 options and summarising the recommendations, this Executive Summary outlines the framework and the main considerations applied in arriving at the options and the recommendations.

Insurance affordability and availability

Some sectors of the economy have been hard hit by issues of affordability and availability, which have become more severe in the last two or three years, especially for:

- public liability for tourism, leisure and some other business sectors.
- professional indemnity for several professions including financial advisers and building industry professionals.
- directors & officers and management liability insurance (for SMEs and also for larger companies), compounded by the growth of successful class actions in recent years.
- property insurance for natural perils (cyclone, flood and bushfire) in some locations and for building construction.
- business interruption insurance, which has emerged during the pandemic as a form of insurance that, for many customers, we can now see is not well understood.

It is notable that the market segments referred to above and the four key topics have all been the subject of numerous reviews commissioned or conducted by governments and government agencies in recent years. There are some common themes within their recommendations but, for the most part, there has been limited subsequent action taken on these recommendations by government agencies or the insurance industry. This absence of action and progress on the recommendations is one of the catalysts for this Review.

> *There have been many insurance industry reforms in the last decade around sales models, customer information, claims practices and other matters, many driven by regulatory reforms. Arguably they have been in the nature of micro-reforms while larger issues or macro-reforms relating to affordability, availability and market failures have not been given attention.*

The Insurance Council believes solutions can be introduced by means of the insurance industry and government working more closely together and also collaborating as appropriate with industry associations, consumer groups and other interested parties in the business community and the wider community.

Four key topics

The general ideas and solutions in published reviews tend to emphasise four key topics:

- affordability
- availability
- market failure
- government intervention.

The first two are the primary symptoms, the third is an implied cause of the symptoms, or perhaps a different label for the symptoms, and the fourth is a commonly suggested source of solutions.

Market failure and criteria for government intervention

The questions of insurance affordability and availability relate to the scope and effectiveness of insurance market coverage and lead to questions about the limitations of the private insurance market. They also elicit references to market failure and to whether governments have a role in extending or improving insurance market coverage.

The term market failure should be understood as a **failure of the market** and not of the participants in that market.

> "A market failure refers to a movement away from the economically efficient outcome (that is, where mutually beneficial trades could be made). This occurs because private incentives may not perfectly align with the broader interests of society."
>
> … "Market failure guide", a 2017 publication of the NSW Government's Department of Industry,

It is frequently proposed by those affected by affordability or availability issues that governments should intervene in the private insurance market to alleviate or resolve the issues. That may not, however, be the only way forward or the best way forward.

Consideration of the economic principles associated with market failure suggest the following criteria for government intervention:

- The goal of any government intervention in private insurance markets is to deliver the greatest improvement in economic value of the market in the least distortionary manner.
- Government intervention in private insurance markets is justifiable only where and to the extent that:
  - there is clear failure by those private markets to offer appropriate cover at affordable premiums
  - the benefits of intervention outweigh the costs, and
  - non-government means are unable to resolve the market failures in an equally effective manner.

Affordability concepts

The most common idea discussed in previous reports regarding affordability is based on *socio-economic assessments* which take direct account of the customer's financial circumstances. The idea has its difficulties for personal insurances but in any event it is not applicable for businesses.

A second idea and the one explored in this paper is the idea of *comparative premium assessments.* It relates exclusively to premium levels and is presented simply as a guide to understanding affordability.

The SME insurance market

General insurance markets tend to go through cycles of being "soft" (prices falling or low relative to recent periods) and "hard" (prices rising or high relative to recent periods). At present we are in the 'hard' part of the cycle.

For SMEs, the market has changed in the last three years following a substantial tightening of capacity by Lloyd's. Historically Lloyd's syndicates have been major suppliers of liability capacity to the Australian SME market but, with many syndicates suffering losses in Australia and elsewhere, in recent years most of these syndicates have withdrawn from the Australian market.

The overall outcome has been a substantial reduction in capacity, increases in prices and, as the ASBFEO report illustrates, in some cases withdrawal of capacity altogether or else price increases that some SMEs find unaffordable.

This topic is covered at some length in Section 4 of the Report.

Recognising availability issues

Questions of availability of insurance can arise from three different sources according to the circumstances of the insurance buyer or customer. They are:

a. insurance required to meet regulatory or legislative requirements (e.g. a licence or authority to operate a certain kind of business).

b. insurance to meet the requirements of a customer or client (e.g. liability protection for the customer or client if goods or services being provided are not appropriately supplied).

c. insurance purchased voluntarily to protect the assets of persons or businesses.

The options: potential affordability and availability solutions for SMEs

There is no single or simple answer to these issues but there are numerous initiatives that can be taken by the insurance industry, in conjunction with relevant industry and professional associations, to alleviate and perhaps in due course to solve these issues.

The underlying approach being suggested in this paper for SMEs is essentially that insurers, other interested parties and experts in each market segment collaborate to devise workable risk management and insurance solutions.

There is no suggestion in this report that government intervention should be sought by insurers or by business interests before all other avenues have been thoroughly explored.

Further, in considering and evaluating options, there is a need for a balance between effective competition, insurer and insurance industry capacity and capabilities, and the public interest.

At the heart of many of the options is the proposition that the combined efforts of the interested parties, working together, can improve both availability and affordability in many areas of insurance if there is a will to do so. The interested parties are principally insurers, underwriting agencies, brokers, industry and professional associations and, in some circumstances, governments (Commonwealth, State and Territory).

The options identified are:

'Awareness' options

1. Standard documentation
2. Advice and education on risk mitigation
3. Brokers and their remuneration
4. Greater use of deductibles and coverage limits
5. Risk management and risk mitigation

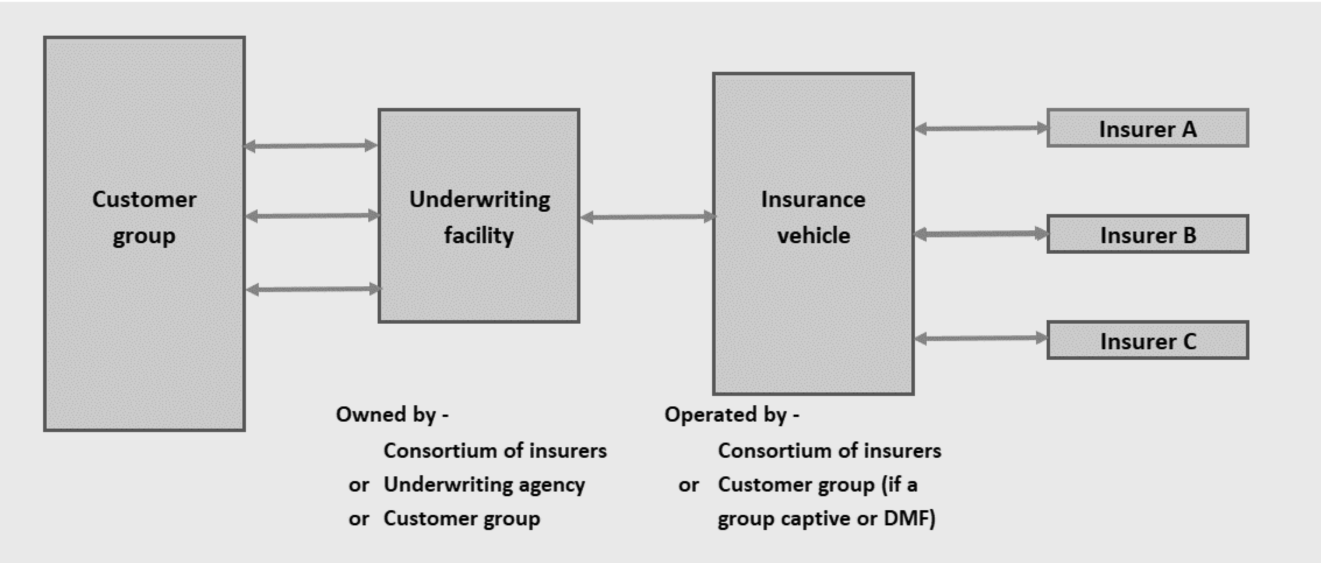
Insurance industry options

- industry is taken to include insurers, reinsurers, underwriting agencies and brokers

6. Underwriting consortia (Lloyd's style)
7. More underwriting agencies with specialist capabilities
8. Group schemes with insurers, captives and discretionary mutual funds (DMFs)
9. Industry association accreditation and standards
10. Broker specialisation
11. Supporting the public interest - the industry's **social licence**
12. The special case of natural disasters
13. The special case of business interruption insurance (BI)

Options 6, 7 and 8 are all variations on a single theme which is to bring together several insurers to pool their financial and underwriting capacity. These can be depicted as follows:

Possible alternative underwriting arrangements



Government-related options

14. Government taxes and charges
15. Collaboration with governments to reduce regulatory barriers
16. Government involvement for economic benefit.

Options 15 and 16 are variants on trying to find solutions that may require government involvement of some kind in order to meet public interest or national economic goals that the private market on its own may not be able to provide.

Submissions and recommendations

Submissions to the Consultation Paper are summarised in Section 6 and associated issues arising from them are set out in Section 7. Many elements of the submissions build on the range of options described in the Consultation Paper and reproduced in Section 5.

The submissions indicate a favourable reaction to the ICA's initiative in setting up the consultation process. The authors are clearly hoping that something positive will emerge from it. Indeed the enthusiasm with which several organisations have embraced the potential to interact directly with the Insurance Council and the insurance industry suggests that this initiative by the Insurance Council may herald a much-needed circuit breaker.

There are 13 recommendations that I have developed as a result of this consultation process. They are summarised below and described further in Section 7.

The scope of the recommendations is substantial and many of them, if adopted, will take some time to take shape and become effective. For this reason, the final recommendation is that the Insurance Council undertake a review of progress in the second half of next year.

John Trowbridge,
September 2021

Summary of recommendations

There are 13 recommendations, some but not all of which can be initiated by the ICA on its own. In some cases the primary responsibility lies with other parties, principally customer groups (industry and professional associations) and perhaps their brokers or advisers. In those cases, the ICA and/or insurers may be able to play a facilitation role.

The table below nominates the recommendations. The ticks represent the parties who can initiate and lead implementation of the recommendations. The other parties (without the ticks) will in most cases be in response mode and not initiation mode. They may be interested and may become active participants but are not expected to be in a position to lead or drive implementation.

Note that there is not a column for governments or government agencies, even though governments are important participants in several of the recommendations. The reason is that governments are expected to be in response mode. The parties interested in insurance matters that may involve governments or government agencies will usually need to persuade them to become active participants.

Outline of recommendations – ticks indicate the initiating parties

Recommendation		ICA and/or insurers	Brokers and/or advisers	Customer groups
1.	Collaboration with insurance buyers	✓	✓	✓
2.	Unusual risks, risk reductions and risk increases	✓		✓
3.	Establishing a group scheme		✓	✓
4.	Collaboration with government(s)	✓		✓
5.	Government intervention	✓		✓
6.	Pursuing industry data and statistics	✓		
7.	Standardisation of insurance documentation	✓	✓	✓
8.	Risk management and risk mitigation		✓	✓
9.	Insurer feedback to SME customers	✓		
10.	Review of business interruption insurance	✓	✓	
11.	Broker remuneration – disclosure, incentives		✓	
12.	State and Territory stamp duty and charges	✓		
13.	Progress follow up	✓		

Regarding the role and participation of underwriting agencies, in some cases they may align with and support insurers, in other cases with brokers.

The recommendations are nominated below excluding the context which supports each of them as described in Section 8.

I am recommending that -

1. Collaboration between insurers and insurance buyers

- When a group of insurance buyers, on testing the insurance market (usually through their broker), discovers a genuine affordability or availability problem –
  - Step 1: The buyer group approach the ICA to seek help with a solution
  - Step 2: The ICA respond by -
    - working with its member companies and other stakeholders to investigate the buyer group's situation for the information of both the buyer and ICA member companies and
    - making available the results of the investigation to the buyer group and also to ICA member companies, to assist their consideration of the pricing and underwriting requirements of the buyer
  - Step 3: The buyer group make a reassessment of its situation and, if appropriate, make a renewed approach to the market, with both sides armed with a more complete understanding, in an effort to find a solution for the buyer

and

- In cases where government involvement emerges as an essential component of the solution, the ICA contribute actively, in conjunction with the insurance buyers, to engagement with government in efforts to find solutions.

2. Unusual risks, risk reductions and risk increases

- In cases of unusual risks, risk reductions and risk increases when an insurance buyer or buyer group believes that the insurance market has not properly understood the situation, the buyer approach the ICA for the purpose of embarking on the same collaborative three step process as in Recommendation 1.

3. Group schemes

- Individual businesses having affordability and availability problems consider whether a group scheme with other like businesses may be in their best interests

and

- Any customer group considering a group insurance or mutual protection scheme examine carefully the available options, taking account of regulatory requirements and consulting as widely as possible with insurers and others, because the most suitable form of scheme in most cases should be selected on a 'horses for courses' basis, depending on the totality of the group's circumstances.

4. Collaboration with governments

- The ICA build closer relationships with State and Territory governments on matters of insurance with the primary goals of –
    - arranging for all potential State and Territory government initiatives that may involve insurance to include early consultation with the ICA during policy development and planning

and

    - opening up dialogue on regulatory barriers affecting insurance affordability and availability that are brought to the attention of the ICA by industry or professional associations
- in relation to the awarding of contracts for government projects, the ICA along with affected industry and professional associations advocate to each State and Territory government that, in respect of insurance requirements in contracts, the government operate according to Model Client criteria that are recognised as fair to both parties.

5. Government intervention

- The ICA investigate each situation that comes to its attention where market failure is claimed to have occurred and, if the ICA concludes that there is a case for government intervention, it collaborates with the customer group concerned to approach government for assistance with a solution.

6. Pursuing industry data and statistics

- The ICA approach APRA with a view to arranging with APRA to expand public availability of the currently unpublished NCPD data.

7. Standardisation of insurance documentation

- the ICA establish a working group on standardisation whose role is to -
    - devise and undertake a programme of work aimed at simplifying and streamlining definitions, documentation and related matters for SME insurances
    - draw on industry associations, brokers, underwriting agencies and other stakeholders and specialists as may be required
    - recognise the pitfalls of over-standardisation and the need to tailor all efforts to the specific needs of different types of insurance buyers, according to industry, profession and other relevant differences

To be successful, the working group will need carefully prepared terms of reference, sound selection of experts as members from across the spectrum of insurers and insureds and also the full support of ICA members and NIBA members.

8. Risk management and risk mitigation

- the Insurance Council support the wider insurance industry (insurers, underwriting agencies and brokers), in conjunction with interested industry and professional associations, to invest in and encourage the development of advice and education services on risk management and risk mitigation,

and

- the Insurance Council promote the adaptation of industry accreditation regimes to encompass standards regarding safety, risk management and risk resilience.

and

- the Insurance Council continue to promote, as it has done extensively to date, the importance of risk management and risk mitigation by businesses seeking insurance protection and to make available publicly the results of research studies and other information that may assist the business community to improve risk resilience.

9. Insurer feedback to SME customers

- The insurance Council and member companies establish a set of protocols, in all SME renewal situations where the Affordability Category under the Suggested Affordability Guide (see Sections 2 and 4) is Medium or higher (meaning premium increases on unchanged terms and conditions that exceed 15%), whereby the holding insurer –
  - gives at least 30 days' notice to the customer before date of renewal

and

  - provides the customer with meaningful information regarding the reasons for the increased price and/or any adverse adjustments to terms and conditions

and

  - informs the customer of any initiatives of which the insurer is aware that may mitigate the risks and generate a renewal offer that is more favourable to the customer.

10. Review of business interruption insurance

- The ICA establish a working group in conjunction with NIBA to examine the BI products currently on the market and make a set of recommendations to the insurance industry and the insuring community on the future design and operation of the BI product for different segments of the insuring community.
- In undertaking its work, the working group consider the issues associated with insuring pandemics.

11. Broker remuneration – disclosure, incentives

- The practice of insurers paying commissions to brokers continue but brokers disclose on customer quotes and invoices as part of the premium all insurer commissions and any other payments they will receive from the insurer.

12. State and Territory stamp duty and charges

- The Insurance Council continue to pursue with State and Territory governments the Productivity Commission's 2014 recommendation that "State and Territory taxes and levies on general insurance should be phased out and replaced with less distortionary taxes".

13. Follow up in 2022 second half

Noting that the scope of the above recommendations is substantial and many of them, if adopted, will take some time to take shape and become effective -

> some require only a time-limited one-off initiative while others involve some change of practice or establishment of new arrangements that can and should endure indefinitely if effective

and, because there is change involved, because there are affordability and availability problems to be overcome and because the Insurance Council, in commissioning this report, is seeking a better future dynamic across the insurance spectrum of insurers, intermediaries, insurance buyers and governments:

- In the second half of 2022, the Insurance Council undertake a review of progress on this suite of recommendations, their impact on the insurance market and their impact on the current issues of insurance affordability and availability.

The economy and the role of insurance

The Australian economy is a remarkable success story. On any comparison our economic track record is one of the best in the modern era. And economic “good times” were not so long ago seen as just “normal”. A pandemic-driven recession has clouded our view of that impressive past. But the year ahead offers hope for better times on both the health and economic fronts.

Policy makers have talked about a “bridge” to recovery. Waiting on the other side of that bridge are many of the key fundamentals that drove Australia’s exceptional economic performance.

But to capitalise on those fundamentals several things need to go right. In particular, households need to find their appetite to spend again, business needs to develop some risk appetite and policy makers need to get the settings right. Economies elsewhere face similar challenges. And a positive Australian economic story also requires an improved global backdrop.

The insurance sector also has an important role in assisting the recovery and supporting economic momentum over the medium term. Maximising that assistance and support requires dealing with the issues raised in this Report.

A well-developed insurance system is one part of Australia’s overall macro-resilience. And that resilience was one reason why the pandemic-induced downturn in the economy was less severe than expected. Those positive foundations mean that the insurance sector is also able to assist the recovery in the Australian economy. At a time of heightened economic uncertainty and low risk appetite the traditional role of insurance in transferring and diversifying risk will be as important as ever.

The insurance sector is assisting the operation of government policy. As a significant holder of interest-bearing assets, the insurance sector is helping at the margin in delivering the RBA objective of keeping interest rates at low levels. Spending on disaster mitigation, an essential component of improving insurance affordability, fits neatly with the government use of infrastructure spending as an economic stimulus tool. Provision of mortgage insurance helps the housing sector to contribute to the recovery.

The role of insurance spreads beyond conventional policy settings. Vaccine take-up, for example, is critical to the recovery and the insurance sector is playing a role in building trust for both recipients and medical professionals.

There is a long running relationship between economic activity and insurance. At its essence is the management of risk that allows businesses, individuals and governments to take those risks. The result is higher than otherwise income, productivity and living standards. This framework is available to support the Australian economy over the medium term. But there are some impediments limiting this role as discussed in this Report. These include affordability and availability in general with particular problems being experienced with professional indemnity, public liability, business interruption, and directors & officers insurance.

An effective and efficient insurance sector will also be required to deal with longer term challenges such as climate change, natural disasters and an aging population.

Michael Blythe

PART I – ESSENTIAL BACKGROUND

Section 1: Terms of reference and introduction to insurance markets

Introduction

The Insurance Council of Australia is undertaking a review of the insurance sector's options for reforms to improve its contribution to national economic recovery and growth, amid concern from insurers, stakeholders and the community about the availability and affordability of some categories of cover for certain groups of customers.

The Council wishes to encourage increased involvement of policymakers, insurance buyers and insurers in realising the full potential and overcoming the limitations of the private insurance market to facilitate economic growth. The Council aims to see the industry give greater support to the community through enhancing its services and finding solutions to the questions of insurance **affordability** and **availability**.

Insurance exists to transfer risk from consumers and businesses in a manner that enables them to pursue their affairs confident they will receive support to recover financially from any insured risks.

The private insurance market performs this risk transfer process successfully on the whole but the industry is keen to examine where it can do more to manage issues of affordability or availability. Where there are acute issues the industry needs to find ways forward so economic prosperity is not hindered or risk shifted back on to those without the capacity to manage it effectively.

It has long been the case in Australia that, for most classes of general insurance, the *private insurance market* comprises an open competitive market operating without price controls, with regulatory and legislative protections for buyers regarding policy conditions and the rights of claimants, and with prudential regulation aimed at limiting the risk of insurer insolvency and sustaining insurer ability to pay claims[1]. In general, this market functions on competitive risk-based pricing with encouragement by insurers for insurance buyers to mitigate risk where they can.

Nevertheless, a range of government enquiries and regulatory reviews over the last decade have identified a number of issues of insurance affordability and availability for some groups of consumers and businesses. Some market segments have exhibited large premium increases and even withdrawal of capacity, particularly in the last two to three years, that have created severe problems for businesses dependent on suitable insurance coverage to be able to operate.

This first part of the review relates exclusively to commercial lines of insurance and primarily to SMEs (small and medium enterprises).

1 The main exceptions to open competitive insurance markets are workers' compensation and CTP insurance, which are compulsory classes of insurance regulated by State and Territory governments.

Terms of reference

The Review was asked to:

- examine the role of the private insurance market in promoting economic recovery and growth
- identify insurance market segments and market situations where affordability and/or availability are seen to be important issues.
- explore which of those segments and situations can be ameliorated or rectified through initiatives taken by insurers, either individually or collectively.
- identify which segments and situations are not reasonably insurable in the context of community and government expectations of affordability and availability.
- identify principles and potential solutions which will overcome the insurability issues, so as to serve the community better without imposing obligations on insurers that they cannot meet or that may cause them to withdraw from the market or to fail.
- consider how best to approach scenarios where insurance protections become unaffordable or unavailable due to market limitations.
- suggest initiatives that the industry and governments might explore that would overcome market limitations and support government policymaking in the interests of the community and the economy.

As already noted, this report concentrates on commercial lines of insurance only.

Risk and Insurability

Insurance is not the only mechanism for managing risk. Risk can be mitigated by preventative action, sold into capital markets, absorbed by government or simply borne by individuals and businesses themselves. Risks are efficiently allocated in an economy when the risks are borne by the parties best placed to manage those risks at the lowest possible social cost.

Insurance is socially and economically valuable. It is an effective tool for transferring and mitigating risk. However, the expectation that insurance alone can bear all such risks is not realistic. Government can play a role and public sector solutions can be effective at addressing affordability and availability issues where principles of insurability are not satisfied, for example terrorism risk [2] and some aspects of pandemic risk.

The characteristics of insurable risk include:

- The exposure to loss must be random (in particular, not subject to adverse selection), i.e. the loss must be accidental or the result of pure chance.
- The loss must be definable and measurable.
- There should be a large number of similar risk exposures so that individual losses can be aggregated and shared.
- The premium paid for insurance must be affordable relative to the gain from risk mitigation.
- The risk of catastrophically large losses must be low.
- Risk mitigation through insurance is unlikely to be effective where:

[2] Insurance Council (prepared by Finity), *Insuring for Pandemics Study*. July 2020, P. 27.

- The loss is inevitable.
- There is insufficient past experience to assess risk.
- The proposer does not have an insurable interest (giving rise to moral hazard).
- The loss arises from 'fair wear and tear' such as rust or corrosion.
- Too many factors influence the outcome making it difficult or impossible to predict, e.g. the risk that a newly established business will fail.

These characteristics need to be kept in mind when exploring the key issues for this review of the **affordability** and **availability** of insurance.

Structure of the private market in Australia

Participants in the Australian general insurance market comprise -

Mainstream insurers

- authorised by APRA and most are Insurance Council members:
- some are full open market operators
- some are specialists (personal or commercial, LMI, medical indemnity, etc)
- most are shareholder companies but some are mutuals and some are branches of offshore insurers

Lloyd's

- authorised by APRA and a significant market participant in commercial lines

Reinsurers

- authorised by APRA
- most support insurers only but some also operate in the direct market
- can offer specialist covers not normally available in the local market
- most are international businesses with an Australian subsidiary or branch

UFIs (unauthorised foreign insurers)

- offering insurance to larger corporates who choose to seek cover offshore
- not authorised by APRA and not generally accessible by SMEs and consumers

DMFs (discretionary mutual funds)

- not authorised by APRA but allowed to operate
- mostly small and specialised, in the nature of group captives, some larger
- it is understood that there are about 100 active DMFs in Australia

Single state insurers

- some APRA authorised, some not, some are mutuals
- most support State government agencies and local councils

Underwriting agencies

- operate as agents of insurers, cf. brokers who operate as agents of insurance buyers
- authorised to accept risks on behalf of insurers
- usually specialised and insurers rely on their underwriting expertise
- there are several hundred, mainly supporting SME businesses

This list of insuring entities and insurance-like entities covers only the private market and excludes public sector compulsory workers compensation and CTP insurers.

Past reviews, inquiries and papers

There have been numerous reviews and inquiries into the availability and affordability of insurance. The Insurance Inquiry by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) and the Parliamentary Committee Inquiry into litigation funding and the regulation of the class action industry have addressed insurance questions for businesses. Most other reviews relate primarily to household property insurance although in each case some of the analysis and recommendations are relevant to commercial insurance.

The following are the most relevant inquiries held in recent years:

- Australian Small Business and Family Enterprise Ombudsman: Inquiry into Insurance (ASBFEO), December 2020.
- Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into litigation funding and the regulation of the class action industry, December 2020.
- ACCC Inquiry into Insurance in Northern Australia, December 2020 (third report – previous reports 2018 and 2019).
- Royal Commission into Natural Disaster Arrangements, October 2020.
- Australian Industry Group survey, “Business Insurance: Unaffordable or Unavailable”, October 2020.
- Productivity Commission inquiry into Natural Disaster Funding Arrangements, May 2015.
- Financial System Inquiry, December 2014.
- Natural Disaster Insurance Review, September 2011.

How do insurers operate?

The paragraphs below, quoted from a private sector insurer submission to a government inquiry, give useful information on how insurers manage their insurance risk portfolios.

Insurance underwriting and pricing

Risk rating – different premiums for high and low risk policyholders

When premiums are 'risk rated', higher risk policyholders are charged a higher premium than lower risk policyholders. Principles of fairness and equity dictate that insurers should charge policyholders a premium that reflects, and is commensurate with, their risk. For example, why should older drivers pay a higher motor premium to subsidise the poor driving skill and behaviour of some young drivers?

Commercially, an insurer has no choice in the matter. If they don't set premiums according to risk, competitors that do will be able to offer the lower risk policyholders of a community rating insurer a cheaper, more competitive premium. This would leave that insurer with both fewer customers in total and, more significantly, a larger proportion of above-average, or higher, risk customers in its premium pool. That insurer is said to be suffering from 'anti-selection' or being 'selected against'. An insurer that suffers from anti-selection because it community rates its premiums (ie cross-subsidises between its high risk and low risk customers) will retain its less profitable (or loss making), higher risk customers and lose its more profitable, lower risk customers to its risk rating competitors. The combination of these effects will negatively impact a community rating insurer's profitability.

Risk selection

Are there good and bad risks?

At first principle, low risk customers are not necessarily 'good' (ie profitable) risks and high risk customers are not necessarily 'bad' (ie unprofitable) risks. Any customer can be a 'bad' insurance risk and they become so if the premium they are charged is insufficient to cover the amount of 'risk' they bring to the insurer's premium pool. Alternatively, any customer, not matter how risky, can be a 'good' risk if they are charged a premium that reflects their risk. Indeed, some insurers specialise in providing insurance to customers that have high risks. Allianz Australia, for example, has a business unit, Allianz High Risk Solutions, that does just that.

Charging the 'right' premium to match the risk

The real science, and art, in insurance, therefore, is to charge every customer the 'correct' premium to reflect their risk. If this was possible, all customers would be 'good' risks because they would all contribute a premium commensurate with the risk they bring to the premium pool and, hence, the claim payouts they will take out of it. In doing so, they fairly contribute to the running of the insurance company and to the return on capital the insurer's shareholders deserve.

Reality bites

Unfortunately, insurers do not live in quite such a perfect world because calculating the absolutely 'correct' premium for every policyholder is an extremely difficult, if not impossible, task. Further, to the extent that an insurer misprices any policyholder, and a competitor misprices them less, that insurer is at risk of being selected against. As a result, anti-selection still occurs even when all insurers in the market use a risk rating premium setting approach.

Uniquely, insurers are required to set the price of their product before they fully know their costs (eg of future claims). There are a range of uncertainties that create difficulties for insurers in calculating the correct premium.

For instance, unforeseen events and adverse market conditions can adversely impact insurers' estimates of the future cost of claims. For example:

- the cost of imported car parts may rise due to an un-forecast fall in the value of the Australian dollar;
- a hail storm may damage tens of thousands of vehicles, totally overwhelming the supply capacity of the local smash repair industry and driving up repair costs;
- after a large-scale storm or cyclone event that causes damage to tens of thousands of houses, the cost of building services may rise as demand outstrips supply; and
- building regulations may change after an event (eg a bushfire) that increase the costs of rebuilding in the same bushfire prone location (as occurred after the 2009 Victorian Black Saturday bushfires).

To deal with uncertainty and protect themselves against the risk of anti-selection, insurers take a cautious approach to the pricing of risk. Another of the causes of this conservative approach to risk pricing is what economists refer to as 'asymmetric information'. That is, customers can sometimes know more about their risk profile than the insurer does, for example, information on their own risk behaviour (eg driving at excessive speed) or risk circumstances (eg flood risk). Insurers also suffer from 'imperfect' information. For example, poor quality and/or out-of-date government flood maps or a lack of data on how new vehicle safety technologies (eg anti-skid braking) will ultimately impact the frequency and severity of vehicle accidents and, hence, claims costs.

Selecting risks

To protect themselves against anti-selection, insurers use pricing and risk selection strategies to target 'good' (ie more likely to be profitable) risks in preference to 'poor' (ie less likely to be profitable) risks. Insurers also put in place strategies to ensure that they are not over represented in high risk areas and, as a consequence, accumulate an excessive market share of high risk customers (eg in cyclone, flood and bushfire zones, or high vehicle theft areas, or young drivers etc, etc). For example, if an insurer accumulates an excessive concentration of customers vulnerable to extreme natural events, its reinsurance costs are likely to rise relative to other insurers, causing its premiums to rise and making them less affordable and competitive compared to other insurers.

Inquiry into Australia's General Insurance Industry by the Senate Economics References Committee in 2017 – excerpt from submission by Allianz Insurance

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Section 2: Insurance markets – understanding affordability and availability

This Section explores two of the four key topics that form the basis of the analysis in this Consultation Paper. It covers affordability and availability while the next Section 3 deals with market failure and government intervention.

These four topics do not relate to any particular class of business but are intended to contribute to a framework for responding to current questions about affordability and availability.

The nominal issue is affordability and availability

- Some aspects have been on the public agenda for a decade.
- Other aspects have been emerging with growing significance recently
- Reports have been published with recommendations and general ideas on steps forward but none is far enough developed to be treated as a possible practical solution.
- Practical solutions are now needed.

The Insurance Council believes solutions can be introduced by means of the insurance industry and government working more closely together and also collaborating as appropriate with industry associations, community groups and other interested parties in the business community and the wider community.

This Review is the next step and is aimed at identifying practical solutions for commercial insurances and SME insurances in particular.

The four key topics

There are four key topics at the heart of each of the numerous reviews commissioned or conducted by governments and government agencies in recent years. They are –

- affordability
- availability
- market failure
- government intervention.

The first two are the primary symptoms, the third is an implied cause of the symptoms, or perhaps a different label for the symptoms, and the fourth is a commonly suggested source of solutions.

Risk mitigation and risk management are also a common theme emphasised in the published reviews. They have particular significance for many of the SME businesses who are experiencing affordability and availability problems at present but they are not separate topics from affordability and availability.

The insurance industry will continue to advocate to all governments and local councils that they invest more in risk mitigation and risk management support in order to limit the costs of natural disasters and of legislative structures that create economic burdens to society.

Link between relevant market segments and the four key topics

For the most part, there has been limited subsequent action taken on past recommendations by government agencies or the insurance industry. This absence of action and progress on the recommendations is one of the catalysts for this Review.

> *There have been many insurance industry reforms in the last decade around sales models, customer information, claims practices and other matters, many driven by regulatory reforms. Arguably they have been in the nature of micro-reforms while larger issues or macro-reforms relating to affordability, availability and market failures have not been given attention.*

To facilitate action on affordability measures and on other steps needed to develop practical solutions requires development of three essential solution components. They are:

- **Affordability measures:** one or more techniques for distinguishing between the unaffordable and the affordable.
- **Affordability solutions**: techniques for overcoming affordability problems.
- **Government intervention** criteria: to determine where government intervention might be warranted and where it is not warranted (recognising that solutions without government intervention are to be preferred)..

These three components need to be taken beyond where previous published reports have gone.

They then need to be applied towards potential solutions.

This paper suggests potential solutions.

Methodology for this Review

The process used to work through the consultation phase of the Review was-

a. To examine the background, meaning and substance of each of the four key topics
b. Using a, to establish an 'insurance access framework' to deal with affordability, availability, market failure and criteria for government intervention
c. For each insurance market segment where affordability and availability issues are thought to be occurring:
    - to gather relevant information to clarify the insurance issues in the sector; and
    - to evaluate these issues against the insurance access framework
d. Using the results of c, to put forward one or more potential solutions and introduce questions for consultation purposes on these potential solutions.

The 'insurance access framework'

The primary purpose of the insurance access framework is to create a means for determining affordability thresholds and for evaluating situations where government intervention might be justified to assist the resolution of affordability and availability issues.

The insurance access framework represents a basis for:

- how affordability might be understood and perhaps measured;
- how lack of availability might be recognised;
- how market failure might be understood; and
- how criteria for government intervention might be decided.

As already noted, the first two of these topics are examined in this section and the remaining two in the next section of this report.

Working through the affordability question

There are two dimensions to affordability. One is the *level* or *quantum* of annual premiums: is the premium at a level that is affordable? The other is cash flow: given the level of annual premium, which may be affordable across a period of one year, is it affordable as a single payment in advance?

The **cash flow dimension** is straightforward in principle and is covered later in this Section.

The **premium level dimension**, however, is more difficult and consumes the majority of this Section.

Affordability: the premium level dimension

There have been many reports, reviews and commentaries that refer to the affordability of insurance products, in both personal lines and commercial lines. In almost all cases, however, there is little consideration given as to how to measure or specify what is affordable and what is unaffordable. There is rarely reference to any kind of threshold or boundary or target which would separate the affordable from the unaffordable.

Usually the logic is: these prices are too high (most often a subjective statement) so we need to find steps or actions that can be taken to reduce the prices. Actions are then proposed and frequently evaluated so as to estimate potential premium reductions. They are not normally followed up, however, by any assessment or reassessment of whether the possible or expected or likely price reductions will cross a threshold or boundary between the unaffordable and the affordable.

For commercial lines, the topic has come into prominence in just the last two or three years following a series of substantial price increases in commercial markets generally and some specific problems in the SME market. As explained in Section 4, the price rises have been a combination of the 'hard' or 'hardening' market along with some reassessments of the cost of risk by insurers. Some of the price rises have exceeded 100%.

When large increases occur, some customers claim that insurance is unavailable when in fact it is available but not on terms or at a price that the customer can pay or will be prepared to pay.

Understanding affordability

An important question is: how is affordability to be understood for the SME insurance market?

> ***A practical answer to this question is a prerequisite for identifying genuine affordability problems.***

Affordability concepts

The most common idea usually discussed regarding affordability is based on *socio-economic assessments* which take direct account of a customer's financial circumstances.

The idea has its difficulties for personal insurances but in any event it is not applicable for businesses.

A second idea and the one explored in this paper is the idea of *comparative premium assessments.* It relates exclusively to premium levels. It has subjective elements, however, and its application needs to be developed beyond the ideas expressed below.

Comparative premium assessments

Affordability is largely subjective and is in the eye of the beholder: a customer may believe that there is an affordability problem while, on the other hand, the insurer may believe simply that the policy has been priced according to risk and is a fair price. In such cases it is a matter for the customer to decide whether to buy or not (in other words, on this interpretation affordability is essentially a customer or buyer problem not an insurer problem).

We can infer from this observation that affordability perceptions of insurance prices or price changes are built on expectations and that the expectations arise through a subjective combination of past history of insurance prices, comparisons with price changes for other goods and services (including inflation expectations) and perhaps also comparisons with insurance premiums payable in environments where risks are lower (for example a holiday resort with a range of sport and leisure facilities versus a hotel or motel offering accommodation only).

In summary, affordability can be seen to relate to the expectations of customers on the basis that -

- customer expectations seem generally to be based on their historical experiences, i.e. what they are accustomed to paying and perhaps also what they understand their peers in other environments to be paying
- customers usually do not have enough risk and insurance knowledge to make their own risk-based assessments of a fair price
- predictability matters to most customers, so affordability questions arise when insurance prices rise substantially from one year to the next or possibly over two or three years: we sometimes see increases in prices of 50% or more in commercial lines or even as much as 100% or 200%
- affordability does not necessarily mean ability to pay and is more complex than that:
  - if prices are too high or increase too much on renewal, insurance becomes seen as uneconomic and risking business viability (cf other overheads such as wage levels, energy, rent, interest costs)
  - when prices are high, business owners will reassess their insurance needs and may even rework their businesses in some way to alleviate the costs; either way, unexpectedly high prices can cause some dislocation of a business and sometimes even lead to business closure or failure.

A practical affordability guide?

Building on this idea of customer expectations based on the customer's own historical experience, an **affordability guide** can be suggested**.** Such a guide can be useful to distinguish between modest and severe price rises and thereby to set a basis or a foundation for prioritising initiatives aimed ultimately at solving the affordability problems. A useful starting point is to classify current premium levels on a comparative basis in order to establish affordability grades or categories.

It is important to note here that the circumstances of individual businesses vary greatly so that comparisons of prices for one business with another can be difficult to make. Although a broker can usually make some useful comparisons, the only clear reference point for most business owners regarding affordability is the customer's own past history of premiums and insurance coverage.

An affordability guide?

An affordability guide for assessing scale or severity of SME affordability questions is being suggested that uses a comparative premium assessment method.

Suggested affordability guide

Affordability grade	Affordability category	2021 increase relative to comparable 2018 premium
0	Low	< 15%
1	Medium	15% to 30%
2	High	30% to 50%
3	Very High	50% to 100%
4	Severe	100% to 200%
5	Extreme*	> 200%

** The "extreme" category can include the unavailable*

There is nothing scientific about this Affordability Guide and its grades, the three year comparison, the category boundaries or their labels. Nevertheless it illustrates different levels of 'sticker shock' and it can be useful for **individual businesses** as follows –

- Firstly to categorise the price or affordability problem that an individual business may be facing. The aim is to introduce a discipline around affordability questions by establishing a sound and accurate reference position (specified here as the 2018 actual premiums versus the properly quoted 2021 premiums on the same terms and conditions).
  - a properly quoted 2021 premium on the same terms and conditions as previously would be a genuine quotation from a broker or insurer to ensure that it is like for like and that it is more than a tentative or estimated premium

… note that customers concerned about price increases need to be precise about comparing like with like

- Secondly to establish where the real affordability pressure points are. The purpose is to guide insurers, brokers, businesses and also governments, government agencies and other interested parties as to the scale of the problem and where most attention needs to be directed to respond to affordability pressures.

NB1: This approach is not intended to serve as a market measure or estimate of changes in market prices – there are surveys and other means of making such estimates – but to home in on the specifics for individual customers.

NB2: Market comparisons are usually very approximate and not specific to individual businesses. Reliable market information on comparative prices is always difficult for surveys, brokers and insurers to obtain, for several reasons including that comparisons may not be like for like and may rely on samples that are broad indicators only of the whole market.

Once the affordability category is determined for an individual business, the next step must be to understand why the price rises have occurred or how they have arisen –

a. Are there aspects of the risks in the customer's business to which insurers are averse or more averse than previously?
b. Have there been upward movements in court awards or in claims associated with legislative change, climate risk or other matters that influence insurers in their assessments of the likely future costs of the types of claims to which the business is exposed?
c. Has the whole market changed since last renewal and, if so, why and by how much?
    - (b) and (c) may overlap
    - see further the box at the end of Section 1 on insurer underwriting and pricing, also the market explanation in Section 4.

To answer these questions, we assume here that the customer has access to a broker and that the broker is in a position to explain to the customer –

- the situation regarding the customer's risk,
- the current state of the insurance market, including which insurers are likely to be interested in the customer's business, and
- the nature of risk management and risk mitigation matters of which the customer should be aware and might undertake that would assist a coming together of customer and insurer mutual understanding.

Once these questions are answered, the direction of the answer to the broader question of affordable versus unaffordable insurance can be approached and solutions sought. This broader question is the subject of Section 5 of this report.

Affordability - the cash flow dimension

Affordability is presumed usually to relate to price but, for many businesses, it also relates to payment terms. Premiums are usually payable in full at the beginning of each 12-month policy period so that, for many buyers, the absence of ready access to more frequent payment instalments, say fortnightly or monthly, constitutes an affordability issue.

Some insurers offer premium instalments (e.g. 'pay by the month') and also some customers can gain access to premium funding through an entity that is separate from the insurer.

The question of the availability of premiums payable by instalment was covered at length in the 2020 ACCC report on insurance in northern Australia. Although the report does not mention commercial insurance.

Availability and insurance needs - how does it work?

Recognising availability issues

There are three sets of needs of insurance buyers and each one can lead to a lack of availability of insurance –

1. insurance is a condition of a licence or authority or accreditation to operate a business or offer a professional service
2. insurance is a condition of doing business for a particular customer or client
3. insurance is sought voluntarily as a matter of prudence by a business or consumer to protect an asset (tangible such as property and equipment or intangible such as business viability).

Lack of availability can emerge in all three cases:

- The first type is the most common source of availability issues because there are situations where government authorities require or decide that insurance protection is needed on terms which insurers are unwilling or unable to offer because of the nature of the risks to be covered.
- The second and third types, where there is the possibility of negotiation between insurer and customer, are generally more tractable than the first type. They can also be confounded with affordability: it is not uncommon for there to be complaints about the lack of availability when the insurance is on offer but at a price or on terms unacceptable to the customer.

The only way to uncover availability issues is by exploration of the insurance market in respect of the market sectors or individual businesses who have not been able to obtain the cover that they require.

- Insurance brokers are usually an effective source of this kind of information.

Some insurer considerations for affordability and availability

General

Insurers are heavily influenced by past experience when offering insurance cover. The past experience is a combination of:

- pricing based on statistics
- knowledge and understanding of the risks, which are a combination of the policy terms and conditions used in the past, an understanding of how future claims can arise and expectations about how future claims will be managed and settled
- awareness of a changing risk environment, e.g. a changing legal environment arising from more frequent litigation or more generous court awards or, where weather events are concerned, a belief that climate risk is increasing.

Changes in terms and conditions can be difficult to convert to changes in pricing and underwriting assessments, whether in the direction of more liberal or more restrictive policy terms and conditions. In other words, when insurers experience unexpected claims, whether by volume (e.g. storms or floods) or by size of individual claim (e.g. large court awards), they may increase premium rates and tighten policy conditions to limit their future exposure. Insurers are cautious about modifying terms and conditions in a way that creates greater exposure because of the uncertainties involved. It is not as difficult to maintain terms and conditions but to reduce prices when claims experience is favourable.

Many of today's affordability and availability problems, especially in commercial lines, are related to changing external conditions (such as increased compliance and other regulatory changes, increases in court awards or assessments of climatic conditions). These conditions can open up additional potential areas of risk to buyers and hence to exposure of insurers to new and unknown types of claims and claim settlements.

… see further in Section 5 regarding possible means of dealing with these pricing situations

Cyclone and flood

All SME policies include cyclone. Competition is limited because many insurers do not have the right resources and risk appetites for SME insurances in these higher risk areas.

The Government's Budget announcements on 11 May include participation of SMEs in a reinsurance pool for cyclone and related flood risk. This pool may in due course alleviate the affordability problems for some SMEs.

Flood cover is optional in most cases. In higher risk areas the cover is expensive and may not be available. Many businesses choose not to purchase it because of price.

Bushfire

Availability itself is good because all policies include fire. Since the 2019 bushfires, however, insurers have begun to impose extra conditions and/or price increases in rural areas for properties where bushfire risk is now seen as requiring more underwriting assessment. A common condition is a minimum distance from any surrounding bushland. While most property owners can clear bushland if they wish, some cannot because of council regulations that limit clearing or the bushland is not on their property and the owner (which may be the State government or local council or neighbour) does not allow it. Wooden construction is also seen as high risk.

Insurers see bushfire risk as a localised one where underwriting and risk management considerations predominate. The outcome for some properties may be stronger risk management requirements by insurers, higher deductibles and higher prices.

Affordability questions have therefore arisen for some commercial properties and in some cases availability may be restricted.

Business interruption

This class of insurance is valuable for many SME businesses. Like flood cover, however, it is an optional cover and many businesses do not purchase it on grounds of price. It also has technical complexities by its nature and many SMEs do not purchase it because they do not understand it well enough. Some others purchase it without having a clear understanding of what they have purchased. See further in Section 5.

Section 3: Insurance market failure and government intervention

This Section explores the second two of the four key topics that form the basis of the analysis in this Consultation Paper. They are market failure and government intervention. They complement the first two, affordability and availability, covered in the previous Section 2.

Market failure - why is it topical?

The questions of insurance **affordability** and **availability** relate to the scope and effectiveness of insurance market coverage and lead to questions about the limitations of the private insurance market. They also elicit references to **market failure** and to whether **governments** have a role in extending or improving insurance market coverage.

These questions are all related. For example, some of the reports and reviews in recent years relating to insurance affordability and availability have made references to market failure. If market failure is said to exist, it is frequently accompanied by a call for government intervention in the insurance market.

Some of the past reports have argued that there is no market failure, others have argued that there is. Either way, the conclusions on market failure have had a major bearing on whether the authors believe that there is something fundamentally wrong with insurers or the insurance market and whether there is a case for or against some government intervention to resolve the affordability and availability problems.

The term market failure is a specific term used by economists. It generally refers to market outcomes that are not economically efficient and can occur when private incentives do not align with the broader interests of society. It can also be used pejoratively, without reference to the economists' definition. In such contexts it can be used as a condemnation of the insurance industry by implying that individual insurers or insurers collectively have failed in some way to meet their responsibilities.

The term should be understood, however, as a **failure of the market** and not of the participants in that market.

Hence it is important, in examining questions of availability and affordability, to be clear on what constitutes market failure, what are its implications and in what situations government intervention in insurance markets might be justified.

Understanding insurance market failure

While the vast majority of insurance buyers appear to obtain the cover they want or need at acceptable prices, aided most of the time by the competitiveness of the market, there are exceptions. The exceptions manifest themselves through insurers declining to offer cover to some buyers or alternatively offering it to them at prices and on terms that the buyers are not willing or not able to embrace. It is these exceptions which raise the question of market failure and which are of most interest in this Review.

It might be suggested that these exceptions illustrate market failure deriving in effect from market control by an oligopolistic set of insurers, notwithstanding that the insurers do not collude with each other and so do not themselves characterise their business strategies as constituting oligopolistic behaviour.

The perspective of insurers is that they have to balance prices and product offerings with the principles of insurability. Insurers are by nature risk takers but they can only accept risks that they can adequately manage financially, recognising that there is a limit to their financial capacity and their expertise to accept risk and also noting two important features of insurance -

- the 'inverse cycle of production' that exists because insurers cannot know in advance the costs of claims that will arise from the policies they write
- the risk of adverse selection in cases where a customer knows more about the risk and the riskiness of the business than the insurer, including levels of risk of which the insurer is unaware, notwithstanding disclosure obligations.

Furthermore, insurers have the option to participate or not in each insurance market segment they choose and also to accept or decline any individual insurance proposal put to them. If this were not the case, insurers would be obliged to participate in the market on terms that are potentially unfair or unprofitable, a situation that could lead to individual insurers withdrawing altogether from the market or ultimately failing.

In summary, the outcome of market behaviour is that insurers withdraw from market segments they regard as unattractive, thereby limiting the market to a smaller number of insurers and sometimes all insurers withdraw. Of course, the nature of insurance business is that insurers, in common with most other financial services, can enter or re-enter market segments according to their business strategy and plans from time to time and can withdraw in the same way.

Conclusions: given the nature of the insurance industry, its market participants and the industry's regulatory arrangements (through APRA and ASIC) –

- irrespective of the label given to any market shortcomings, they manifest themselves in the insurance market as lack of affordability or availability in some market segments for buyers who have a desire or a need to obtain insurance protection.
- these shortcomings are essentially the consequence of the limitations of the risk appetites of individual insurers (each of which has its own limits) and their ability in a free market to decline cover or impose their own prices and terms on buyers; the complexities of insurance products themselves may also contribute.

Affordability and market failure

If insurance is seen to be unaffordable by some insurance buyers, is it the market at work or is it insurers exploiting buyers through market control when there are few insurers offering the cover? The affordability issue arises because buyers and sellers cannot meet on price but we can ask –

- is it the market at work where insurers are asking fair prices; in this case the problem is that businesses find prices uneconomic or at levels that they are not able to pay or not willing to pay

or

- is there a market control problem where insurers active in the market segment are charging 'defensive' prices, i.e. taking advantage of the limited supply to minimise their risk of claims volatility?
  - past reviews and reports on affordability have in some cases inferred that insurers are charging unfairly high prices where they can, others accept that in general they do not do so.

Availability and market failure

Lack of insurance availability for insurance buyers who need insurance coverage for business is clearly a problem for these buyers.

Insurers generally make decisions not to make cover available, either by market segment - as the result of a carefully considered strategic decision - or for individual buyers on account of an underwriting assessment. Insurers make such decisions in line with their own risk appetite, expertise, financial position and other relevant matters.

Alternatively it might be suggested that some of these decisions are made without great care and to the detriment of potential buyers, simply because insurers choose to ignore those buyers whose insurance business they do not regard as of commercial interest.

This latter interpretation is at odds with the views of insurers but, as a matter of industry reputation, it would be valuable for the industry to be made aware of such circumstances if it can be shown that they are well founded.

Resolving market failures

Market failures can be resolved by suppliers (in our case the insurers), whether working individually or together, to find a solution and sometimes in conjunction with their buyers, either individually or collectively. It may be possible but it can be difficult or even impossible, however, as collective action risks being interpreted as collusion which is of course not legal. The alternative is government action of some kind.

Where market solutions or contributions to market solutions may be possible, several options are identified in this paper (see Section 5).

Government intervention in insurance markets

What are the problems to which government intervention is a solution?

It is frequently proposed by those affected by affordability or availability issues that governments should intervene in the private insurance market to alleviate or resolve the issues. That may not, however, be the only way forward or the best way forward.

If government(s) intervene, they can do so in two quite different ways. One is to use regulatory or legislative means and the other is by some form of financial involvement.

It is often contended that if there is market failure there is a need for government intervention of some kind but -

> *"discovering a market failure can be seen as a necessary but not sufficient step to justify government intervention in markets on economic efficiency grounds. Alternative solutions to a market failure should be subject to rigorous cost-benefit analysis to ensure they deliver the greatest improvement in economic value of the market, in the least distortionary manner."*

… page.iv, Market failure guide

This logic is of great importance regarding the potential for resolving affordability and availability issues in the insurance market. That is because it makes clear that calls for government intervention, which frequently accompany complaints or concerns about access to affordable insurance, should not be entertained until all efforts to resolve the issues within the private market have been exhausted.

This position can be underlined by earlier statements made on behalf of the Commonwealth government such as –

> "…the fact that your industry won't insure certain things does not, in most cases, provide an argument for the government stepping in to do so. Yet it is the failure to appreciate this simple point that underlies most calls on the government to subsidise various forms of activity. For that reason, most such calls will be resisted.
>
> "The second thing that should be emphasised is that the best policy response to an instance of market failure depends on a range of circumstances. Rarely will the best response involve government provision, even government underwriting."

… Ken Henry, Treasury, Address to the Insurance Council of Australia Conference, 22 August 2002

and, within the terms of reference of the Natural Disaster Insurance Review in 2011, we have -

"The Review should be guided by the following principles:

a. Government intervention in private insurance markets is justifiable only where, and to the extent that there is clear failure by those private markets to offer appropriate cover at affordable premiums.
b. The appropriate mitigation of risk by individuals and governments at all levels is a key objective.
c. Individuals and businesses should be encouraged to insure themselves where practicable."

Criteria for government intervention in insurance markets

When affordability and availability problems arise, it is often tempting to suggest or to seek some form of government support to overcome the problems but, as noted above, that may not be justified.

To ascertain whether government involvement is appropriate, it is desirable to have a framework or set of criteria for such involvement that can be openly discussed and debated with governments in the context of improving the risk and insurance environment for Australian businesses and consumers.

Conclusion

Drawing on parts of the above, we can suggest the following criteria for government intervention:

- The goal of any government intervention in private insurance markets is to deliver the greatest improvement in economic value of the market in the least distortionary manner.
- Government intervention in private insurance markets is justifiable only where and to the extent that –
  - there is clear failure by those private markets to offer appropriate cover at affordable premiums
  - the benefits of intervention outweigh the costs
  - non-government means are unable to resolve the market failure or market gaps in an equally effective manner.

Section 4: The commercial insurance market

Introduction for SME business

Some SME sectors have been hard hit by issues of affordability and availability, which have become more severe in the last two or three years, especially for –

- public liability for tourism, leisure and some other business sectors
- professional indemnity for several professions including financial advisers and building industry professionals
- property insurance for natural perils (cyclone, flood and bushfire) in areas of high risk and building construction
- directors & officers' liability and management liability insurance (for SMEs and also for larger companies), compounded by the growth of successful class actions in recent years
- business interruption insurance, which has emerged during the 2019 bushfires and the pandemic as a form of insurance that we can now see is not meeting the expectations of some insurance buyers.

Under the insurance access framework (see Section 2), it can be asserted that –

> ***Affordability and availability*** are closely linked and together represent a major issue for some SMEs. Both are issues that warrant attention across the lines of business for the market segments concerned. Prices have been increasing to respond to past under-pricing by insurers and increasing claims costs (and therefore losses by insurers). Some insurers have withdrawn from some of these segments.
>
> While there are different lines of business involved in a range of different industries and professions, the underlying issues from an insurance industry perspective are broadly similar. Hence this Section treats them all together in most cases.
>
> ***Market failure and government intervention***
>
> The lack of availability on satisfactory terms for the businesses affected, which are predominantly SMEs, arguably represent market failure and are also intimately connected with affordability. As already discussed in Section 3, market failure can occur when private incentives do not align with the broader interests of society but government involvement should only be sought if there are no market solutions.

The remainder of this Section describes the market access issues for SMEs and does so for the purposes of exploring market-based solutions that do not need government intervention. The one exception is for cyclone and related flood where the Government's recent announcement of a reinsurance pool that will involve government financial support, will apply to SMEs as well as to houses and strata complexes.

Commercial insurance market participants – how they operate

The main commercial insurance market participants are:

a. Lloyd's
b. International reinsurers
c. Insurers that choose to write larger risks
d. Insurers that choose to write SME risks

Lloyd's

Lloyd's is not an insurance company but a set of individual underwriting syndicates, some corporate and some private, each of which operates as its own insurance company but the syndicates are collectively managed under the Lloyd's umbrella. Each syndicate is required to meet a range of financial, operational and other conditions that Lloyd's imposes on them. Those conditions are aimed at enabling the totality of Lloyd's as well as individual syndicates to maintain solvency and operate as viable businesses so that, like other insurance companies, they have the financial means to pay claims when they arise.

Most Lloyd's syndicates are specialists of some kind but the coverage and scale of Lloyd's operations give them collectively a diversified share of insurance markets around the world.

Within Lloyd's there are consortia of syndicates who band together to share, on a pre-agreed basis, business brought to them from selected market segments. These arrangements facilitate risk diversification for the syndicates involved and also, from the viewpoint of buyers, can simplify selection of underwriters and offer increased capacity that may be difficult or impossible to find from any one individual syndicate.

International reinsurers

The primary function of reinsurers from the perspective of direct insurers is to provide capacity that enables the insurers to accept a level of risk taking from their policyholders, whether on individual large risks, large claims or portfolios of smaller risks, to protect them against large individual claims, multiple claims from one event such as a natural disaster or a series of claims in one year that are above the insurer's risk appetite.

The reinsurers themselves achieve risk diversification on a geographic scale and over time, deriving from an international portfolio of risks and also by participating in shares of multiple local insurer portfolios.

Insurers that choose to write larger risks

Many large and high value industrial and commercial properties, manufacturing operations, etc. are beyond the capacity of any one insurer to accept, even with substantial reinsurance support, because they represent an unacceptably high level of risk concentration.

In these situations, insurance capacity is created by the risks being shared across multiple insurers through co-insurance.

Most of the capacity in Australia for larger risks is offered by international insurers headquartered in the USA and Europe who have branches or subsidiaries in Australia.

Insurers that choose to write SME risks

Most commercial insurers write both larger risks and SME risks but some specialise in one or the other. For those that write both, there will usually be a separate internal division or department for each and some have a facility to underwrite in the more complex SME and mid-market areas.

SME business is usually accepted in full by the insurer, with no risk sharing, in contrast to the larger end of the market.

Most of the insurers who write larger risks also write SME risks and local insurers, including those with large personal lines portfolios, also write SME business.

Co-insurance or risk sharing

What is co-insurance?

It is common practice for reinsurers, Lloyd's syndicates and open market insurers of larger risks to accept only a portion of the risks that they underwrite. The exposures are shared across multiple underwriters according to each one's risk appetite and usually there is a lead underwriter who sets the price and then all following underwriters subscribe their shares at the same price and terms (a "subscription market").

In hard markets, "split slips" or "split rating" are sometimes used where different insurers subscribe on different terms and prices. Where a broker selects a lead Insurer and a price is established, if the broker cannot 'fill the slip' on the lead terms then the broker can go to the market for the remaining capacity required and ask insurers at what price they would be prepared to participate on the account. This 'split rating' is an efficient market mechanism whereby all insurers can offer cover at their required price and do not have to be dictated to by the 'lead' price. It is not a frequent occurrence and normally arises only during a hard market cycle.

In this way, large risks are shared across the market and individual underwriters are able to diversify their risks. The practice is very widespread among reinsurers, among Lloyd's underwriters who often share risks with other syndicates, and among direct insurers when they are accepting large exposures such as high value industrial and commercial properties, manufacturing operations, etc.

Brokers and their co-insurance role

The essential function of brokers is to search the market on behalf of their clients to find the most suitable insurances for their clients.

In cases where the risks cannot be placed with a single underwriter (insurer or reinsurer as the case may be) and need to be spread across two or more underwriters, or where the client wishes risk diversification by using multiple insurers or reinsurers, the broker performs an essential function in 'completing the slip': the broker locates and places a part of the risk with an acknowledged lead underwriter who sets the price and other terms and conditions, as described above, and then approaches other underwriters to follow and in due course enable the broker to fill the slip to 100%.

Relevance of co-insurance to this Review

The relevance of the above explanation of commercial markets is to illustrate an important point in the context of current commercial market conditions in Australia with particular emphasis on liability classes (professional indemnity including D&O and public liability) and on SMEs.

The practices of co-insurance and of consortia of underwriters to work together to provide market capacity not otherwise available are few in the Australian market except in relation to individual large risks and reinsurance. There seem to be two main reasons for this situation -

a. most insurers wish to operate only in those market segments in which they choose to specialise and, with the exception of individual large commercial risks, they have the capacity themselves, usually with the aid of reinsurance, to hold each risk 100%: this applies to large and small insurer portfolios (e.g. a $1bn motor portfolio or a $30m portfolio of small business risks)
    - this is a competitive approach, because sharing the risk means also sharing the client relationship including client information, and generally speaking insurers don't wish to do this unless they have to for capacity reasons

b. many insurers do not find it attractive to write small portfolios of risks that are difficult to underwrite; their reasons might be limits of expertise, risk averseness and/or the need for risk diversification.

Insurers may also fear that any efforts to create consortia to expand market capacity will run foul of competition law.

Furthermore, in our free market, individual insurers do not usually see any obligation for their own companies to fill the market gaps that are unattractive to either themselves or their competitors. Also, individually they may not have line of sight of all of the gaps that cause the availability problems that are the subject of this paper.

Inferences:

1. The practices of co-insurance and underwriting consortia, if adopted for selected SME insurance market segments in Australia, have the potential to establish a framework for solutions to availability problems for those segments.

   They may also have the potential, by virtue of improved scale and risk diversification, to contribute to some amelioration of affordability problems.

2. Insurers are likely to be interested in such arrangements only if they believe collectively that the availability problems warrant a market solution that they cannot supply individually, that there is sound economic rationale for setting up such arrangements and that there are no regulatory barriers such as competition law to prevent them from doing so.

How does competition work in a co-insurance market?

It could be suggested that a co-insurance market, where risks are shared by multiple underwriters, usually at the same price and on the same terms and conditions, constitutes collusion.

It is evident, by the widespread and long term existence of co-insurance markets as practised by reinsurers, Lloyd's syndicates and direct insurers of larger risks, that regulators and legislators have observed the practice for a very long time and have not sought to constrain it.

The explanation for the practice or its justification (depending on one's perspective) can probably be attributed to the unusual nature of insurance when compared with other industries or other business enterprises. There are two features to note –

1. The business of insurance is the business of accepting risk or offering to transfer risk to the insurer from other enterprises who are seeking to avoid risk and therefore to minimise and otherwise manage their risk exposures.

- accordingly, a prudent insurer will always temper its interest in growing its business, i.e. expanding its insurance portfolio, by the need to manage carefully its exposures and apply limits to its exposures (which limits are dictated largely by available capital, reinsurance and business strategy).

and

2. Insurance is a business with an ‘inverse cycle of production’. Its primary product is the payment of claims but the costs of the product, being future claims, are not known at the time the product is sold, being when the insurance contract is entered into. Hence the importance of prudence in managing a successful insurance business
    - insurance history is littered with the misery of ambitious underwriters who thought they had a special formula and grew their books very fast, only to discover later that they were under-pricing their books all along and could not survive the later recognition of the full costs of their underwriting (HIH in the 1990s is the Australian exemplar *par excellence*).

These constraints on insurers as risk takers have an important bearing on how risk sharing through co-insurance operates:

- The broker will test the market for the lowest price compatible with the risk assessment by a respected underwriter before signing up the underwriter as lead. If the broker cannot then fill the slip, it usually means that there is inadequate capacity at that price, because not enough other underwriters believe the price is adequate (and indeed the broker will have failed the client’s brief by doing a low price deal with one underwriter that emerges as a cut price deal).
- The tension in the other direction, whereby the broker has agreed to a high price, is firstly that the broker has failed the client by not obtaining the best price and secondly a market test will fail, being that the slip will be readily over-subscribed because other underwriters will be enthusiastic to receive the high price and will likely seek higher shares than they would usually take for the risk on offer.
- The matter can be complicated by differing risk assessments by different companies given the uncertainties around natural disasters and some other exposures and the poor (unprofitable) experiences of recent years.

This process is repeated every year so that, even if on one renewal there will be a misjudgement such that the price is lower or higher than was appropriate but the broker ‘got away with it,’ there is likely to be an adjustment that occurs the following year.

The market cycle and the current state of the market

The totality of the factors described above (insurers as risk takers, the inverse cycle of production and the broking role to test and use the market competitively) can be seen to combine to generate the market cycles that we observe, noting that the process inevitably plays out imperfectly.

Underwriters grapple with the omnipresent tension between maintaining prices at levels they believe will be profitable, based on the best estimate they can make of the cost of risk, while having to cope with the prices their competitors will accept -

- The subjectivity or estimation process for the cost of risk inevitably leads to downward pressure on prices for a period (“another 5% off can’t hurt”) until there is implicit market consensus that prices have reached the bottom, after which caution sets in and prices rise for a period (“I need another 10% in case I have it wrong” or ”I need another 10% because last year my results were poor”), until price cutting eventually resumes again when underwriters begin to see good margins.

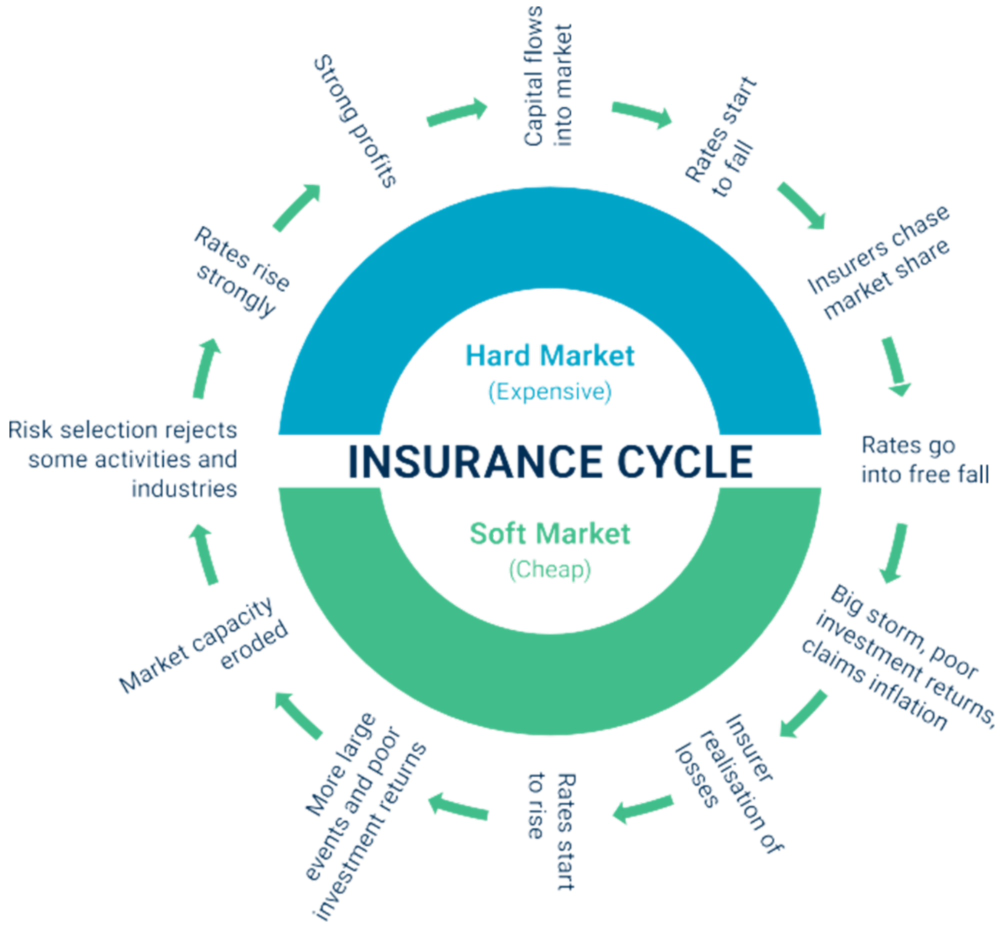
As the cycle heads down, some insurers withdraw from the market, causing a reduction in capacity which in time assists a rise in the cycle; and in a rising or hardening market new capital often arrives to increase capacity and contribute soon enough to downward pressure on prices.

This is the market cycle. To elaborate, general insurance markets tend to go through cycles of being “soft” (prices falling or low relative to recent periods) and “hard” (prices rising or high relative to recent periods). These cycles are effectively superimposed on other factors that can influence prices, for example in Australia in recent times bushfire losses; class actions, court awards and claims for professional indemnity insurance including D&O liability; and something of a “deconstruction’ of the tort reforms of the early 2000s such that public liability claims costs have also been rising in recent years.

This diminution in the effectiveness of tort reform is accompanied by the inherent volatility that exists with high risk occupations for SME liability exposures such as tourism businesses, caravan parks and other leisure ventures. It has led to a very difficult and litigious legal environment that has forced insurers into pricing for this volatility, leading to affordability issues or insurers avoiding these types of risks altogether.

The graphic below attempts to illustrate how insurance market cycles work. As of today, we seem to be at about 9 or 10 o’clock. We were at 6 o’clock in about 2017. We now have, as a result of the recent price increases, a market that could perhaps be described as rational on both sides as insurers work towards restoring profitability.

Natural disasters have played a part in property markets as well as in the under-pricing of previous years and these features are shown within the clock. It also shows a period when the markets for larger commercial risks were very favourable for corporates for a number of years.



Source: Everest Risk Group

Larger commercial insurances

In most classes of commercial insurance we are currently witnessing widespread price increases from the soft markets that existed for several years up to 2016 or 2017. Since then we have seen average aggregate price increases over the last four years variously estimated at something like 50% to 80% in commercial property, 20% to 30% in public liability and 100% to 150% in professional indemnity and D&O liability[3].

In many cases these price increases have been accompanied by increased deductibles and some policy exclusions.

These price increases are exacerbated to some extent by the withdrawal of capacity: in a hard market, some insurers reduce exposures or withdraw from the market to protect their own financial positions. When this happens, the limited remaining capacity may increase prices further to protect their own exposures.

In the larger commercial insurance market, these price increases and reduced terms have been painful for larger corporates but have generally been absorbed as part of the normal commercial swings and roundabouts that occur in insurance markets and other aspects of commercial activity.

The SME insurance market

For SMEs, the market has changed in the last three years following a substantial tightening of capacity by Lloyd's. Historically Lloyd's syndicates have been major suppliers of liability capacity to the Australian SME market but, with many syndicates suffering losses in Australia and elsewhere in public liability, professional indemnity and D&O insurance, these syndicates have withdrawn from the Australian market. Some local insurers have followed suit by also limiting their exposures or withdrawing for the same reason while others were never in these market segments.

The overall outcome has been a substantial reduction in capacity, increases in prices and, as the ASBFEO report illustrates, in some cases withdrawal of capacity altogether or else price increases that some SMEs find unaffordable.

The pricing environment

As already outlined, there have been substantial price rises in recent years in commercial property, public liability and professional indemnity insurance including directors and officers liability (D&O) insurance.

The large increases in commercial property have their origins in markets that have been unprofitable for some years. Commercial property has been under-priced for a decade or more and insurers tolerated those losses together with increased costs of natural disasters for a long time before beginning to introduce significant increases in prices and deductibles from 2017.

Increases in the liability classes arise partly though past under-pricing and partly through continuing increases in claims costs arising from increasing frequency and quantum of claims arising from various forms of litigation.

[3] Derived from Marsh market insight reports

D&O liability

The D&O market has been unprofitable for some years but the losses were not fully recognised by underwriters for quite a period and, as the numbers of class actions have increased and settlements of some of those actions have increased in number and scale, underwriters have progressively recognised the past under-pricing together with higher costs today than a few years ago, leading towards the very high increases of the last three or four years.

Further, these price increases are not the full story. For D&O cover in particular, they have been accompanied by hefty increases in deductibles and some restricted policy conditions.

This high level of price increase has disturbed many larger corporates, including insurance companies themselves because they too need to purchase D&O insurance. The trends in class actions have been seemingly inexorable in recent years, leading among other things to the December 2020 Parliamentary Committee report “Litigation funding and the regulation of the class actions industry”.

Insurers have no real choices on D&O other than to limit their own exposures. They are also finding reinsurance capacity very expensive. Not surprisingly some insurers, local and international, have withdrawn from this market causing access to D&O cover to become very limited.

In other words, the rising frequency and costs of awards against corporates, large and not so large, have been fuelled by the class-action ’movement’ that has been gathering pace in recent years, encouraged in part by the efforts of active litigation funders and a growing number of enthusiastic legal firms.

The D&O claims experience is very uncertain and the insurers involved watch very closely each case and its outcome. The actions of the courts and also of directors seeking settlements for their own protection where the company must pay the directors’ costs as well as the settlements for the plaintiffs, are not very predictable and precedents are still being set. So the future direction of this market is difficult to predict and insurers are naturally reluctant to price aggressively or extend their exposures.

Price reductions for D&O coverage (and for other classes of business including commercial property) will be dependent on claims costs stabilising or subsiding. The timing is difficult to predict but is unlikely to occur this year.

PART II – OPTIONS, OBSERVATIONS, RECOMMENDATIONS:

Section 5: The SME market and potential solutions

Introduction

The market issues for SMEs, as to both price and access to insurance cover, relate to policy terms and conditions as well as to price. There is a multiplicity of needs for public liability, professional indemnity, property protection and business interruption for businesses and professionals supplying services to consumers, to other businesses or to both. Many businesses including professional services operate as individuals, partnerships or companies and some have other business structures.

The types of insurances covered in this section relate to:

- Public liability (PL)
- Professional indemnity (PI)
- Property insurance for natural disasters (cyclone, flood, bushfires)
- Business interruption insurance (BI)

The SME market

From an insurance perspective, the SME market comprises a set of businesses which, in many cases, are not well informed about the complexities of the market as they do not have the in-house insurance expertise and resources that most larger businesses rely on to set their insurance programmes each year. Their needs may be dictated by licensing and other regulatory requirements or by client requirements in addition to prudence in managing their businesses.

Many SMEs need expert assistance to assess their insurance needs and to decide on contract terms, excesses and cover limits appropriate to their businesses. As a result, although many small businesses buy ‘package’ small business insurance directly from their insurers, there are many SMEs who rely on brokers. The broker fraternity is generally able to deal with their insurance needs but that is not necessarily so for the particular segments of the SME market that are experiencing affordability and availability issues. The reasons are fourfold:

- individual SMEs usually have little bargaining power with insurers and are heavily reliant on the broker
- the broker needs to be experienced in dealing with insurances for each business concerned, which can be quite specialised
- some brokers’ service models are not well suited to the advice needs of the SME market
- the broker needs to be fully informed about the appetite of individual insurers, directly or through underwriting agencies, that underwrite the relevant risks; generally that is not difficult but when markets are changing, as they have been in the last two or three years, that can be difficult, especially for the smaller brokers.

The evidence for current SME PL and PI affordability and availability problems

ASBFEO Insurance Inquiry – report of December 2020

The recently released Insurance Inquiry Report by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) attracted submissions from a range of different types of small and medium business enterprises. Collectively these submissions provide valuable and extensive descriptions of insurance problems of various kinds that are currently being encountered by these enterprises.

The descriptions of affordability and availability issues in these submissions are generally consistent with information on the insurance market environment as described by insurers and insurance brokers.

There are also significant questions raised about the awareness and understanding by SMEs about the insurance products and services that are being offered to them. This problem is particularly evident in the PL, PI and BI classes of insurance.

It is therefore widely accepted by the main stakeholders, being the insurance buyers, the insurers themselves and the brokers who arrange the insurances for the buyers, that the issues described in the submissions, some of which are quite detailed, need to be addressed. These issues are of course reflected in the findings of the Ombudsman.

The findings and recommendations from the ASBFEO report are reproduced at Appendix A. Some of these recommendations are included among options put forward in this Review but there are other options put forward as well.

Australian Industry Group – survey in September 2020

The Ai Group reported hearing from companies of different sizes, sectors and regions that they were facing some combination of steep premium increases and reductions in scope of coverage, or were unable to secure insurance at all. Their member poll in September 2020 and subsequent research reported the following findings:

- More than half of businesses polled reported unusual trouble seeking insurance in the last 12 months.
- Unusually high premium growth was the most frequently reported problem faced by Australian businesses seeking insurance in the last 12 months.
- A concerning number of businesses are reporting that there is a general lack of insurance options. Because of this, some businesses reported paying an extremely high price, or not obtaining insurance at all.
- Local insurance problems are being driven by global factors.
- COVID-19 has not played a major role in current insurance difficulties, but may still cause concern into the future."

Summarising the affordability and availability problems

While details of the needs vary by industry, profession and type of cover, the general issues that appear to be facing a range of industries and professions in 2021 are largely the same: the buyer has the need and in many cases the obligation to hold appropriate and adequate insurances but is having difficulty in obtaining such insurances, some on affordability grounds and others owing to lack of availability.

In some cases, the obligation of the buyer is determined externally, by licensing, other regulatory requirements or the requirements of clients, lenders or property owners. In other cases, there is not such an obligation but a need based on buyer prudence to protect against financial loss, reputation loss, business interruption or business failure in fortuitous adverse circumstances.

There are three main categories of problem to be solved –

a. The first is policy terms and conditions: to align the policy terms and conditions with buyer requirements. As obvious as this may sound, the evolving licensing and regulatory regimes to which many businesses and professionals are subject have rendered unsuitable in some respects the policy coverages offered in the past or on offer now. In other words, some of the availability problems relate not to prices or insurers' willingness to offer cover but to the cover itself being unsuitable for the customer. There are also evolving business needs in some industries and professions with advancing technology, new business models and changing business practices.
b. The second is the question of affordability including financial scope of cover, i.e. price, deductibles and cover limits.
c. The third is availability: the insurance requirements of some buyers cannot currently be met at all, i.e. there are no insurers willing to offer the cover being sought.

The first category, policy terms and conditions, is only indirectly about affordability and availability. Inclusions and exclusions to standard policies can obviously cause increases or reductions in premiums and in some cases exclusions insisted upon by an insurer may render a policy unsuitable for the buyer and therefore effectively making the cover unavailable.

For some larger businesses, these three categories of problems also exist but may be soluble using avenues not usually available to SMEs, for example one or more of bespoke tailoring of the policy conditions, direct negotiation with one or more insurers or reinsurers if the buyer has substantial buying power, operating a captive insurer, risk sharing with an insurer or some self-insurance (equivalent to acceptance of a high deductible).

It is notable that some of the SME insurance problems arise from the risky nature of the businesses involved and the underwriting problems they thus create for insurers. This is especially so for leisure-oriented businesses. We live in a world where some individuals and families choose to participate in risky or dangerous activities and some business enterprises are established to accommodate these interests. The potential for serious injuries to children is a major concern for insurers. Evidently insurers need to take great care in accepting risk transfer in these circumstances as they seek to assess the quality of risk management and determine the insurance offers they can make to such businesses.

There is no suggestion in this Section or elsewhere in this report that government intervention should be sought by insurers or by business interests before all other avenues have been thoroughly explored. That is one of the propositions put forward in Section 3 on market failure and government intervention.

Further, in considering and evaluating options, there is a need for a balance between effective competition, insurer and insurance industry capacity and capabilities, and the public interest.

Some options to alleviate lack of affordability and availability

Affordability and availability are linked to each other and, as explained elsewhere, can be caused by a number of factors. Overall, however:

- affordability is characterised by the unwillingness or inability of buyers to pay the prices asked or to accept the policy terms offered.
- availability is characterised by the unwillingness of insurers to offer the coverage sought, usually because of the potential for losses that cannot be funded from the expected premium pool or because they are otherwise outside an insurer's risk appetite (recognising also that individual insurers are free to participate or not in individual market segments according to their own business strategies, capital and financial positions, risk appetite and other considerations).

In the more substantial cases of affordability and availability issues where premiums in high risk environments are a multiple of premiums in low risk environments or insurance is not available, any measures taken of the kinds proposed below are unlikely to be complete solutions. While no doubt alleviating affordability to some extent and perhaps improving availability, they may not resolve the more severe price and availability pressures that have led to the calls for action on premiums.

The underlying question, however, is whether insurers, underwriting agencies and brokers have collectively optimised their underwriting resources in market segments where affordability or availability are problematic.

There is no 'silver bullet' for resolving these two dilemmas, with or without government intervention. There are, however, a number of options, not all mutually exclusive, that may alleviate these problems to some extent without formal regulatory or government intervention.

In other words, the purpose of the options is to identify potential techniques for contributing to solving the affordability and availability problems.

The options can be considered in the light of the "suggested affordability guide" explained in Section 2.

Suggested affordability guide

Affordability grade	Affordability category	2021 increase relative to comparable 2018 premium
0	Low	< 15%
1	Medium	15% to 30%
2	High	30% to 50%
3	Very High	50% to 100%
4	Severe	100% to 200%
5	Extreme*	> 200%

* The extreme category can include the unavailable

The first goal of the options is to make an impact on affordability for the severe and extreme categories (extreme includes unavailable). To the extent that any of these options are effective, it is likely that the other categories of affordability problems will also be alleviated.

It should be recognised that some of the options are aimed at availability in the first instance. If availability is resolved, improved affordability and greater competition may well ensue.

The second goal is to improve the quality of understanding and decision making on insurance matters by the owners of SME businesses.

At the heart of many of the options is the proposition that the combined efforts of the interested parties, working together, can improve both availability and affordability in many areas of insurance if there is a will to do so. The interested parties are principally insurers, underwriting agencies, brokers, industry and professional associations, and also governments (Commonwealth and State or Territory, depending on the circumstances).

The options identified are:

'Awareness' options

1. Standard documentation
2. Advice and education on risk mitigation
3. Brokers and their remuneration
4. Greater use of policy excesses or deductibles
5. Risk management and risk mitigation

Insurance industry options

- industry is taken to include insurers, reinsurers, underwriting agencies and brokers

6. Underwriting consortia (Lloyd's style)
7. More underwriting agencies with specialist capabilities
8. Group captives and discretionary mutual funds (DMFs)
9. Industry association accreditation and standards
10. Broker specialisation
11. Supporting the public interest - the industry's **social licence**
12. The special case of natural disasters
13. The special case of business interruption insurance (BI)

Government-related options

14. Government taxes and charges
15. Collaboration with governments to reduce regulatory barriers
16. Government involvement for economic benefit

Terminology: insurer vs underwriter

'Underwriter' can be ambiguous – may refer to an insurance company or an individual,

So we use the term 'insurer' or 'insurance company' to mean the business entity authorised by the regulator (APRA) to carry on the business of accepting and managing insurance risks (with 'carrier' and 'insurer' used interchangeably), and

'Underwriter' to mean –

- an individual person who is an employee of an insurer and has the authority to accept insurance proposals on behalf of the insurer, or
- a business entity which has the authority to accept insurance proposals on behalf of an insurer (such a business entity might be an underwriting agency owned independently of insurers or it could be an entity owned by one or more insurers.

'Awareness' options

1. Standard documentation:

Standardisation of policy definitions and wordings may assist customer understanding and insurer efficiency. There are several possible approaches to this topic as described below.

Ideas and options relating to standard documentation

a. Clearer documentation:

The insurance industry to -

- decide upon standard definitions for use across the industry

and

- list clearly all inclusions, exclusions, limitations and conditions together with standard policy checklists, i.e. same principle as Key Fact Statements now required for home and motor policies but more explanatory yet also abbreviated relative to PDSs

and

- describe risk management principles and risk mitigation initiatives open to the buyer that are specific to the buyer's industry or profession

and

- summarise the most common reasons historically as to why claims have been denied under this kind of policy.

… reference: ASBFEO Report

NB: This ASBFEO recommendation is very broad. A task-oriented response would be to identify those wordings or definitions that are problematic or creating affordability issues and to establish priorities for action accordingly.

b. **Standard policies and documentation**:

- The insurance industry and each interested industry or profession to collaborate to redesign or rework the insurance coverage so as to build standard wordings with standard definitions, standardised exclusions and standardised optional extras, all properly designed for the industry or profession concerned to be 'fit for purpose' –
  - the need is acute in some areas of PI, PL and BI.
  - as for the ASBFEO recommendation above, priorities would need to be established to identify and deal with the acute problems
- products to be kept fit for purpose in a changing world.
- any exclusions to be transparent.

… reference: adaptation from several reviews relating to natural disasters

c. Underwriting arrangements:

- Implement the preferred elements of options (a) or (b) by means of -
- the ICA issuing guidance notes for insurers specifying the details after undertaking the requisite consultation and dialogue among insurers and with relevant industry and professional associations

and

- all underwriters (insurers and underwriting agencies) being encouraged to use the new coverage or documentation.

… reference: this Review

d. Standards and Guidance Notes:

The ICA to introduce a system of mandatory standards and non-binding guidance notes along the same lines as the FSC –

> "The FSC promotes best practice for the financial services industry by setting mandatory Standards binding on FSC's Full Members as well as providing Guidance Notes to assist in operational efficiency."

A set of standards and guidance notes would effectively extend the scope of the ICA's General Insurance Code of Practice and may contribute in a valuable way to improving transparency, industry efficiency and customer understanding of insurance matters. They could, for example, embody the outcomes of any initiatives taken under options (a), (b) and (c) above.

The Code is currently directed mainly towards consumers and personal lines of insurance, although the definition of retail insurance includes small businesses.

… reference: FSC

e. No industry-wide change:

Retain current freedom of insurers and brokers to select their own wordings and adapt them to their clientele independently of the actions of other insurers or brokers

It is notable that the distribution power of large brokers and broking groups leads to brokers 'making the play' in some cases while insurers do so in other cases.

… reference: traditional approach

f. Regulatory clearance:

Recognising that some elements of options (a) to (d) above may be questioned by the ACCC on competition grounds, the ICA to explore with the ACCC any such elements with a view to clarifying the competitive issues and demonstrating where appropriate that the arrangements will yield economic benefits that either do not represent collusion or do not constitute a form of collusion that is detrimental to buyers or to competition among insurers.

See also previous Section 4 on competition and co-insurance.

… reference: collusion concerns within the insurance industry

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2. Advice and education on risk mitigation:

Greater investment and support from the wider insurance industry (insurers, underwriting agencies and brokers), in conjunction with interested industry and professional associations, to encourage and support the development of advice and education services on risk management and risk mitigation, have the potential to reduce risk and to deal with better informed insurance buyers.

3. Brokers and broker remuneration

Reductions in commissions paid to brokers or even abolition of commissions and other charges by brokers or other intermediaries are often promoted because it is assumed that these commissions and charges are unnecessarily high in relation to the services given or else create a conflict of interest for the broker and should be replaced by a fee for service payable by the client.

Without entering fully into this debate here, it is worth noting that –

- Market commissions for commercial insurances are typically in the range 10% to 30% of the underlying premium (corresponding to 9% to 23% of the customer's premium), differing usually by the class of insurance. Brokers may also earn volume bonuses or commission overrides from insurers and charge some fees in addition to commissions.

Where the market is thin (limited) through few insurers offering cover, it can be argued that the services of a broker can add more value than in other situations . That is because the customer struggles to identify the available insurance offerings, not to mention evaluating those offerings. By contrast, the broker should know the whole market and be able to give worthwhile assistance and advice to the customer.

In other words, abolition of commissions in these cases would usually mean brokers would withdraw from the market unless the client was prepared to pay a fee. Experience shows, however, that many SME customers are not willing to pay fees. In these cases the effect would be reduced access to and availability of advice along with reduced effective insurer choice for the buyer.

- Replacing commissions with fees for service would have questionable impact on total costs paid by the client because of the range of variables involved. It may lead in some cases to lower prices but not necessarily to lower total costs to the client. It also has potential downsides already alluded to: in today's environment it would almost certainly adversely affect access and availability of advice and insurer choice for some.

The ASBFEO report makes references only to "conflicted remuneration", of which it is critical, without defining the term. It is presumably a reference to ASIC's definition and is therefore a reference to commissions paid by insurers to brokers vis à vis the alternative of fee for service paid by the client. The report states that –

"For many small businesses, their broker is a key business relationship and vital to them accessing the insurance they need. However, for others the issue of conflicted remuneration has led to a belief that their broker is not operating in their best interests."

"Even if they are aware the broker is receiving a commission, they may not be aware of the amount of the commission or how the commission would differ between policies. Small businesses who engage a broker must be able to rely on the broker to act ethically, competently and professionally when representing the interests of the small business. Allowing conflicted remuneration to continue fundamentally undermines this expectation.

"Given the importance of brokers to small business' access to insurance, the conflicts involved, and the existing confusion over how brokers are paid, conflicted remuneration needs to be urgently addressed."

"Recommendation 4: Conflicted remuneration for insurance brokers should be banned with a phased transition period."

The report seems to identify "commissions" with "conflicted remuneration" while also offering clear recognition of the important role of the broker to SMEs. To the extent that broker remuneration is not transparent and that there may be conflicts associated with volume bonuses, commission overrides, profit shares, undisclosed fees that are additional to commissions and any other payments that are not fully disclosed, there is a strong case for rectification and elimination of conflicts. Full and clear disclosure of broker commissions and charges is an important starting point.

On the major topic, however, of broker remuneration by the insurer (primarily commissions) vis à vis fees for service that are paid by the client, to introduce full and explicit disclosures of broker commissions and charges would enable subsequent clearer debate on what might constitute conflicted remuneration when the ASIC review scheduled for 2022 is undertaken. That topic is beyond the scope of this Review.[4]

4. Greater use of deductibles and coverage limits

Deductibles are a well established practice for most forms of insurance. The practice assists in aligning the interests of policyholder and insurer because both parties have an interest in the claim outcomes.

Affordability can be alleviated by increasing deductibles and/or reducing limits of cover.

If insurers require high or increasing deductibles without a price reduction, or will not offer previous deductibles at all, customers are faced with a combination of a price problem and a protection problem that can be thought of as part of the affordability debate.

Insurers will frequently offer a reduced premium for a higher deductible and narrower coverage limits. The obvious consequence is that in the event of a claim the cost to the policyholder will be higher.

Affordability thresholds for a business where deductibles are being increased may be even more difficult to assess numerically than price increases where there is no change of deductible or policy coverage. Nevertheless, they can represent a de facto affordability problem if the increases in deductibles or reductions in limits are material.

Severe affordability problems can be alleviated but in most cases not solved by higher excesses because the level of excess required to bring the premium down very substantially would introduce in most cases an unacceptable level of risk to the policyholder.

5. Risk management and risk mitigation

Risk improvement is a very important topic and is a key element in any medium and longer term strategy to reduce exposure. There are limits in many cases, however, to the level of risk reduction that can be undertaken.

Risk management and mitigation are ultimately at the heart of affordable and effective insurance protection. It is a major topic on its own and may solve the problems of some businesses but in cases where affordability is severe it is not a ‘here and now’ solution to current affordability problems. Also, when risk mitigation steps are taken, the effect on insurance premiums may not occur until the effectiveness of the steps taken can be evaluated, which can take some time.

The limits on risk reduction potential can be physical (altering building, land use and infrastructure) and economic (for example legislative requirements or court awards where the risk improvement may be beyond the powers of the insured business).

6. Underwriting consortia (Lloyd’s style)

Such a consortium would be a joint venture of two or more insurers created to underwrite a specialised portfolio aimed at underwriting one or more difficult market segments.

The business could be written on a conventional co-insurance basis, with one insurer acting as lead with others following as they wish until 100% of the risk is placed – and if the lead declines,

[4] Greater and more transparent disclosure of commissions and other remuneration is a key proposal set out in the discussion paper looking at a new Code of Practice for insurance brokers in Australia. See: https://www.niba.com.au/insurance-brokers-code-of-practice/

generally the consortium as a whole would decline) or on a pre-agreed sharing basis (e.g. three or four insurers sharing equally in every risk), where a single underwriter accepts or declines the risk on behalf of the consortium.

Greater willingness of insurers to work together in underwriting consortia, on the basis that a greater spread of risk and greater concentration of expertise and experience developed through greater specialisation may enable less defensive assessments of the costs of risk and lower expenses, leading to lower prices and improved availability.

There are some current and past examples of underwriting consortia. NTI is a 50/50 venture between IAG and Suncorp in commercial vehicle insurance; marine joint ventures have been common while AAMI, now a wholly-owned subsidiary of Suncorp, was originally a consortium of some 15 or 20 insurers attempting to compete with RACV in motor insurance in Victoria in the 1970s. AAMI and some of these other ventures are often referred to as insurance pools.

A particularly interesting example is Community Care Insurance, a venture established after HIH failed in 2001 to offer public liability cover to community organisations for whom HIH had effectively cornered the market (at unsustainably low prices) until its failure. See further description in the box below.

Community Care Insurance: a valuable case study

Community Care Insurance (CCI) was established in the early 2000s following the failure of HIH Insurance. Its mandate was to offer liability insurance to community organisations, especially not-for-profit groups, so that a wide range of community activities that had ceased could be insured and thereby resume their activities.

CCI was a joint venture between QBE, NRMA, Allianz and Munich Re, who pooled their resources to supply affordable insurance to this market segment. Each of the four participants took 25% of the underwriting risk and its personnel were seconded from the three direct underwriters in the joint venture.

As well as underwriting public liability insurance, CCI engaged in educational initiatives such as holding seminars around the country on liability insurance and risk management. Although many of these community organisations had risk management plans, it became evident that their quality varied greatly and many of them were not used very effectively.

It was clear at the time that the insurers involved wished to solve a community problem and were willing to act on that goal by pooling resources in the way that they did.

At the time, CCI was essentially a monopoly and therefore needed ACCC approval. The ACCC granted it an exemption from the Trade Practices Act, allowing the four members to act together in a manner that might otherwise have been seen as collusion. The venture appeared to be very successful but in 2004, when market capacity began to improve, the ACCC saw no further need for it to operate and withdrew the exemption.

Withdrawal of the exemption had an adverse corollary: it forced the abandonment of CCI's educational initiatives that had developed valuable momentum during CCI's existence.

The general idea of an underwriting consortium in the current SME market environment is a version of the CCI model, where several insurers, perhaps 2 or 3 or 4, agree to establish a joint venture in which they all share the risks on a pre-agreed basis, perhaps equally. It would operate in one or more specialist SME segments and be staffed by underwriting personnel recruited for the purpose.

There could be more than one such consortium and indeed that may be desirable, depending on how many other participants there are in any market segment.

… see diagram below after Option 8 and also market explanation of co-insurance in Section 4.

7. More underwriting agencies with specialised capabilities:

There are many specialist underwriting agencies in Australia who accept business on behalf of insurers in cases where the insurers do not have ready access to customers or to the depth of expertise of these agencies. The agencies are reliant, however, on insurers giving them underwriting authority and capacity in situations where insurers may not have the risk appetite themselves for reasons of expertise and dedicated resources.

The primary difference between an underwriting consortium as described above and an underwriting agency is the ownership. Underwriting agencies are generally owned by their principals but in some cases are partly or wholly owned by one or more insurers.

One of the consequences of the ownership difference is the access to insurance markets. A consortium is controlled by its insurance owners and they decide together the market segments and business strategy of the consortium.

On the other hand, independent underwriting agencies generally have time-limited underwriting agreements and rely on their ability to obtain such underwriting agency agreements with one or more insurers. They have the commercial freedom and the corresponding commercial risk to move from one insurer to another from time to time and their insurers also have options regarding the terms of the underwriting authority granted.

In the current environment, in the same way that underwriting consortia might be established to offer insurance to some SME segments on a co-insurance basis, an underwriting agency could also seek to establish a co-insurance underwriting or binding authority with two or more insurers, instead of just one as is the usual situation.

8. Group schemes with insurers, group captives and discretionary mutual funds (DMFs):

Individual businesses may participate in a group scheme (effectively a 'buying group') arranged by an industry association or similar where prices, terms and conditions are agreed broadly through the scheme manager, who might be a broker or independent insurance management firm, and where the customer benefits from being part of a group of customers with like businesses.

Typically each customer would purchase or renew policies separately from other customers but the policy wordings, terms and conditions, pricing basis and underwriting requirements would be the same or similar for each customer.

Group captive insurers are special purpose insurance companies sponsored and established by an individual industry or profession – similar to underwriting consortia but owned by a customer group as sponsor instead of by the insurers.

DMFs perform a similar function to group captives but are not insurance companies. The arrangements between a DMF and its members are not contractual as with insurers but are governed by agreements that give discretion to the fund regarding benefit eligibility and payments.

For most SME market segments, it is unlikely to be an attractive idea for an industry association to create its own captive insurer or establish its own DMF but they are mentioned here for the sake of completeness.

By way of explanation -

- Group captives and DMFs are underwriting businesses themselves. A group captive is a bona fide insurer in its own right and can only operate if it is authorised by APRA. It therefore would need to meet the extensive range of capital and other requirements that APRA imposes on all insurers. There are some APRA-authorised group captives operating in workers' compensation and in the legal profession in some states.
- DMFs exist in a number of industries and have been most common in franchise operations where the franchisor works with franchisees to establish what amounts to a risk management and insurance member-based mutual for the franchisees. There are some dozens of DMFs operating in Australia today. They require similar resources to a small insurance company and will usually purchase insurance at a low retention level, often less than $1m, to provide security to the members who, through the insurer, are effectively purchasing a group insurance policy (and if the DMF were an authorised insurer itself, the insurance policy would actually be a reinsurance treaty).

Comment on Options 6, 7 and 8 - group schemes and alternative underwriting facilities

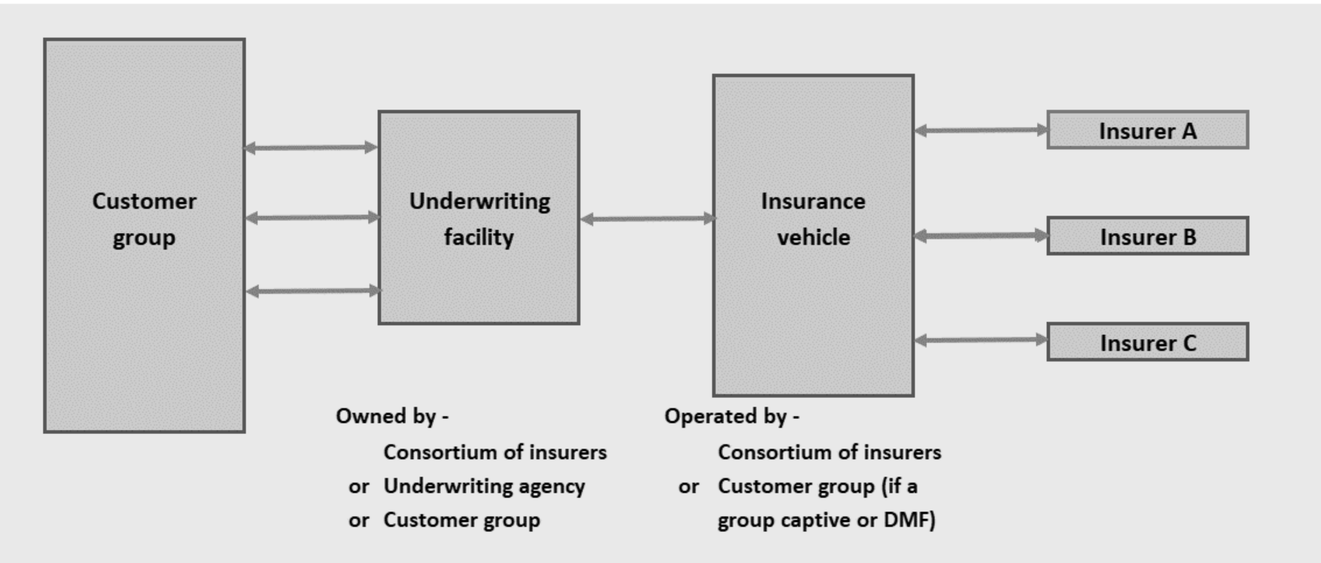
These three options are all variations on a single theme which is to bring together customer groups and one or more insurers to pool insurable risks of the group and the financial capacity of the insurers involved in a way that could break the current impasse for some SMEs who are unable to find an insurer to support them. These SMEs are businesses in industries or professions that used to be able to obtain the insurances they need but no longer can, for a range of reasons associated with the nature of the risks (on the client side), the assessment of these risks by local insurers and the limited international capacity or appetite for these risks.

From a claim volatility viewpoint, there are two kinds of underwriting situations to be dealt with. One is where most of the larger individual claims in an industry or profession are manageable for an insurer but the portfolio of the insurer is too small to enable adequate pooling of the insurer's risks.

The other is where most individual claims are readily manageable but there is the risk of rare but expensive claims that, for an individual insurer, do not justify underwriting the risk at all. This latter situation is where, for example, a child is badly injured in an amusement park or similar and the premium pool is inadequate to absorb such claims. Even though such claims can be assisted by reinsurance, an insurer may well regard the volatility and exposure as beyond its risk appetite.

The three options 6, 7 and 8 can be depicted as follows:

Possible alternative underwriting facilities



One of the benefits of underwriting facilities set up on a group basis for a particular industry group or profession is that expertise and experience among the underwriting personnel and the brokers involved can assist specialisation that benefits all parties. There is not only greater risk pooling for insurers but also greater common understanding of the risks involved and of the risk management and risk mitigation techniques that are relevant to these industries or professions.

For each of the options, reinsurance (or, in the case of DMFs, insurance) could be obtained for the insurance vehicle as a whole or alternatively ceded to the participating insurers if they wished to take their shares fully to their own accounts.

In summary, there are numerous possible ways of structuring these kinds of arrangements, both at the customer or broker end and at the insurer end. *The starting point is a willingness for insurers to consider and to assist in developing arrangements of these kinds.*

This topic is considered further in the next section because, not surprisingly, submissions have demonstrated that it has become a topic of major interest in the current hard market.

9. Industry association accreditation and standards:

This option can be thought of as a companion initiative to Options 6, 7 or8.

Many of the availability and affordability problems arise through insurers being unable to satisfy themselves that the business seeking insurance is being operated to full professional standards of safety, risk management and risk resilience.

If the business is part of an industry or profession that can develop a well operated accreditation regime requiring and monitoring minimum standards, insurance should become more accessible for those businesses that can demonstrate that they are meeting and maintaining the standards.

Insurance market specialisation is an underlying theme of each of Options 6, 7 and 8 and is also a feature of Option 9 -

- Options 6 and 7 are predominantly insurer-led initiatives
- Option 8 is essentially an insurance-oriented joint initiative of an intermediary and an industry association.
- Thus Option 9 is intended to describe an industry-led or profession-led initiative.

The essential difference from a strategic viewpoint between Options 8 and 9 relates to resource allocation:

> a group captive or a DMF needs professional insurance resources that are controlled by the customer group so that it can operate an underwriting and claims facility,

whereas

> an industry association accreditation regime requires professional resources that will concentrate on support for association members regarding safety, risk management, risk resilience and related matters without concerning itself with claims management and other insurance functions.

10. Broker specialisation:

Greater investment by interested brokers specialising in these more difficult lines of business, assuming they can be assured of greater interest and support from individual insurers, underwriting consortia or underwriting agencies, has the potential to increase market expertise in these lines of business.

Smaller specialist brokers who have limited distribution reach in geographically diverse market segments (e.g. tourism and adventure businesses) can consider opening up their customer access through local brokers and the support of broker networks.

Larger brokers with specialist expertise who have developed schemes for industry or professional groups can also consider opening up these schemes in different market segments to other brokers.

11. Supporting the public interest - the industry's social licence:

It is noted elsewhere that individual insurers are free to participate or not in individual market segments according to their own business strategies.

Accordingly, insurer participation in some segments of insurance markets can appear to be unstable, even volatile. As illustrated in the ASBFEO report and elsewhere, individual insurers can choose to exit parts of the market to the apparent detriment of the business community and in some cases the economy. Insurers do not do so lightly, however, and are disturbed when accused of acting against the public interest in situations where they cannot support financially the expectations of some critics or insurance buyers. Frequently insurers support their clients in time of need although generally have not been in a position to give greater support on an industry wide basis (and competition law restrictions often play a part).

An important question therefore is whether the insurance industry, to deliver on its social licence, is able to maintain the commercial independence and viability of insurers while simultaneously conforming with competition law and agreeing, voluntarily through the Insurance Council or otherwise, to find ways to offer market capacity when no individual insurers wish to do so.

Regarding potential amelioration, possibilities might include an extension of the underwriting consortia or specialist underwriting agency or broker ideas as at options 6, 7 and 10 above, perhaps with some industry-wide funding support and of course subject to competition issues being resolved.

12. The special case of natural disasters:

Further to Option 16 below, which relates to government involvement generally, several government and other reviews have drawn attention to the insurance problems of SMEs regarding cyclones, floods and bushfires. From both a community perspective and a business perspective, these problems are similar to those encountered in personal lines.

Regarding cyclone and related flood risk, the Government has recently announcement a reinsurance pool that will involve government financial support for SMEs as well as for houses and strata complexes.

We can infer therefore that insurance against flood damage that is not associated with cyclones and insurance against bushfire risk will not receive government financial support, at least in the foreseeable future. Hence current affordability and availability problems remain private market problems.

It is worth noting that both cyclone and bushfire cover are included as a matter of course in all commercial property insurance policies but flood is an optional extra. It is no surprise therefore that if property insurance where the cyclone risk or bushfire risk is seen to be high or severe, property owners will either purchase no insurance or comprehensive insurance. On the other hand with flood cover, only a minority of businesses purchase the cover if there is a material additional premium.

Both flood and bushfire risk are amenable to varying degrees of risk mitigation, depending on the locale of the properties to be insured, the construction of those properties and some other factors. Active efforts to mitigate risk therefore have the most potential to alleviate insurance reduce insurance affordability and availability problems for SMEs.

13. The special case of business interruption insurance (BI)

Business interruption insurance is available but purchased by only a minority of SMEs.

Originally BI policies covered only business financial losses arising from physical damage. Over time many policies have evolved to give additional cover such as prevention of access to the premises, closure by authorities and infectious diseases. Some policies cover these items as optional extras while others include them as standard in the policy.

Each one of these items can be ambiguous and therefore needs careful definition. Insurers need to be able to price what is offered, brokers need to be clear on what is covered and what is not, including the intentions of the cover, and customers need to become informed as to what they are buying. BI insurance is one of the more difficult types of insurance to define, price and convey to the customer but at the same time for many businesses it is a valuable form of cover.

The bushfires of 2019 have demonstrated that the current approach by the insurance industry (insurers and brokers) to BI insurance is not meeting the expectations of some insurance buyers. The pandemic experience in 2020 has demonstrated a different set of mismatched expectations. Aside from problems on foot that are currently before the courts, a wider question has arisen as to how well is BI insurance ‘fit for purpose’ in an advancing economy, how suitable is it in its current form for the protection of businesses in the event of physical damage or other circumstances that limit or prevent the business from operating normally.

Current experience is indicating not only that it can be difficult to determine whether a claim is payable or not. There can also be uncertainty over the quantum of a claim and whether the buyer has understood correctly and assessed properly the level of cover purchased, i.e. whether the buyer understood what cover was actually being purchased and whether it was well suited to the nature and scale of the buyer’s business.

The bushfire and pandemic experiences of the last two years demonstrate the effort that needs to be made with the BI product by all interested parties (insurers, brokers and insureds) to clarify which risks are insurable and which are not while simultaneously reducing complexity, improving understanding and avoiding unintended consequences.

14. Government taxes and charges

State governments charge stamp duty of between 9% and 11% on insurance premiums (except in the ACT where it is nil). The NSW government also charges via insurers an emergency services levy of 20% or more (it fluctuates according to Government funding needs) on business insurance policies (the levy is also collected on most retail policies). GST of 10% is also charged on all policies.

Every inquiry and review of insurance costs and affordability over the last decade has recommended the abolition of these State government charges and some have also recommended the abolition of GST. For example, a Productivity Commission report in 2014 concluded on this topic with -

> “Replacing state insurance taxes and levies with more efficient revenue sources, such as broad-based payroll or land taxes, would improve the price signal to policyholders and the effectiveness of insurance as a risk management tool and reduce the price of insurance. Taxes could be phased out over time, as is being done in the ACT. The resulting price decrease could also encourage households and businesses to take up insurance or increase their coverage. “

“RECOMMENDATION 4.8

“State and territory taxes and levies on general insurance should be phased out and replaced with less distortionary taxes.”

The effects of abolishing these charges would be limited to the current scales of government taxes and charges, in other words a reduction of the order of 10% of premiums, except in the ACT where it would be nil and NSW where the reduction would be 24% or more[5]). GST abolition would be another 9% reduction.

Abolition of these charges would presumably apply to every policyholder in the state or territory.

In relation to the more severe affordability issues, they would certainly assist affordability but on their own would not be a complete affordability solution, especially in NSW (because of its ESL).

15. Collaboration with governments to reduce regulatory barriers:

Collaboration between the Insurance Council and individual industry or professional associations in working with governments to investigate and, where warranted and possible, either

- to reduce regulatory or legislative barriers to the mitigation of risks that are adversely influencing affordability and availability

or

- to moderate, from a legislative or regulatory viewpoint, the risk exposure of individual businesses or professionals while still protecting the rights of parties injured or wronged by a business or professional to gain some form of restitution that can be funded through an insurance claim.

An example of a professional indemnity (PI) need in this category is construction industry professionals who are being called upon by State governments to obtain insurance cover on terms that insurers may be unwilling or unable to offer – see also under Option (16) below.

16. Government involvement for economic benefit

Subject to meeting the criteria for government intervention (see Section 3), insurers to investigate and work with governments where appropriate on efforts to provide government backstops in some form. These efforts would be aimed at those segments where private sector solutions are believed to be insufficient to solve affordability and availability problems that, in the eyes of government, are detracting from or inhibiting economic growth and development. See also option (15).

5 Loadings of 9% SD and 20% ESL compound to 31% , corresponding to a premium reduction of 31/131 or 24%

Comment on Options 15 and 16

These two options are variants on trying to find solutions that may require government involvement of some kind in order to meet public interest or national economic goals that the private market on its own may not be able to provide.

Note that some risks can be regarded as uninsurable as a result of government licensing or legislative requirements. They are the risks for which businesses or professions are obliged to seek insurance but where no insurer is willing to underwrite it at all or else only at unattainable prices. If it is a case where a government or the community requires insurance, a solution has to be found.

> *Case study 1:* in 2002 this occurred in the medical profession after the failure of a medical indemnity DMF followed by a recognition that for years doctors had been asked to pay premiums for protection that were too low to be sustainable. The Commonwealth government stepped in by agreeing to offer a guarantee for those parts of the risk that were deemed to be uninsurable.
>
> *Case study 2*: a more recent case relates to professional indemnity in the construction industry in New South Wales where new legislation requires construction industry professionals to have insurance for claims from the past as well is the future. In this case, it may be that a solution is one that is similar to the medical indemnity solution: insurers to underwrite most risk components but any large or exceptional cases are covered, at least in part, by what could be described as a last resort government guarantee so as to limit insurer liabilities in a way that would render the risks insurable.

Any new initiatives of this kind would presumably need to meet criteria such as those suggested in Section 3 for government intervention (which could be Commonwealth or State, depending on the circumstances).

Section 6: Responses to the consultation paper

Submissions – overall feedback

The quality of the submissions received in response to the Consultation Paper was high, the scope informative and their input very constructive. All parties seem to be searching for solutions or steps toward solutions.

The submissions also demonstrate, however, the serious nature of insurance issues being faced in some sectors within the business and professional communities.

The submissions indicate a favourable reaction to the paper and, most importantly, to the ICA's initiative in setting up the consultation process. They are clearly hoping that something positive will emerge from it. Indeed the enthusiasm with which several organisations have embraced the potential to interact directly with the insurance industry suggests that this initiative by the Insurance Council may herald a much-needed circuit breaker.

Three examples:

- ASBFEO: "We are encouraged by the industry-led options proposed in this review. This office recommends thorough exploration of all potential options to address issues of market failure and encourages collaboration of insurers, industry associations and government. We would be pleased to work with industry to develop solutions to these issues."
- Consult Australia: "Consult Australia notes the constructive relationship that has developed with the ICA over the past few months and believes that now can be the turning point to alleviate market conditions by working together to advocate for solutions."
- NIBA: "Overall, we are seeking engagement with the Insurance Council and insurers to identify mechanisms whereby good risks have ready access to adequate cover at reasonable rates, and that poor risks are identified, assessed and understood so that steps can be taken to properly manage and mitigate those risks in order to restore their attractiveness to insurers."

The submissions – direction

The submissions show that there is clear interest in working with the ICA and/or insurers but also with any other parties that can assist. Further, in some cases there is a desire to engage simultaneously with governments to deal with regulatory barriers and any other matters that are within the purview of governments.

In relation to governments, the submissions generally do not distinguish between

the different jurisdictions of State and Territory governments versus Commonwealth government. It is an important topic because most of the regulatory problems that beset insurance buyers arise from State government regulatory requirements of various kinds. Frequently they relate to licensing or other operating requirements where several State governments have a history of relying on untested and sometimes invalid assumptions that risks to businesses licensed by or contracting to a State government can be transferred to insurance companies on terms and at prices affordable to the business without consulting the insurance industry in advance.

Categorising the submissions

Submissions have been received from:

- insurance industry participants (brokers, underwriting agencies and a consultant)
- interested parties without a direct vested interest (ASBFEO, Ai Group)
- parties with a specific industry or professional interest (Engineers Australia, Consult Australia, ASIAL, SEGC and the FPA)
- case studies (CPAQ , Coonawarra Resorts, participants in the Federal Government's AusIndustry Entrepreneurs' Program, and Ski Club of Australia)
- professionals with client interests (lawyers Clyde & Co, Law Council – business law section).

Insurance industry participants (brokers, underwriting agencies and a consultant)

Key points raised across these submissions:

- Agreement with the Consultation Paper's description of the difficult state of the insurance market –
  - in the early 2000s, the public liability market was so difficult that all State governments intervened by introducing tort reform
  - some argue that another round of tort reform is now warranted.
- For most of the past 12 months, many SMEs have not been able or willing to pay the cost of an adequate insurance programme. Brokers therefore have to work with them to determine areas of the business where insurance is critically important (as opposed to highly desirable), and to at least have some form of cover for those areas of critical risk. Frequently, insurance brokers have discussed higher levels of excesses or self-insured retentions and reduced limits but have reported that even where this occurs the remaining cost of cover is still a major challenge for clients.
- Insurance premium funding adds to the cost of insurance, but it also gives the insured the option to determine the relative value of payments over time versus the impact of a single lump sum payment at the start of the policy period.
- Risk underwriting is important; it ensures the insurer understands the nature and extent of risk it is assuming both from a particular sector more broadly and from individual clients within the sector.
- There is concern that, rather than excluding poor quality risks, insurers have withdrawn from providing cover to some sectors, including cover for the better risks in that sector.
- Insurers have been making greater use of technology platforms for processing business and for underwriting the risks they are prepared to write. As this has developed over time, the ability of insurance brokers to discuss client risk propositions with underwriters has reduced and in many cases unduly limited the dialogue between broker and underwriter.
- Insurers often do not explain why cover is unavailable.
- There are numerous initiatives occurring because of the hard market around conventional and non-conventional forms of insurance and risk protection

- For sectors where insurance cover is particularly difficult, a process needs to be developed whereby the industry association for the sector and their preferred insurance broker can meet with relevant underwriters in order to understand the reservations and concerns insurers may have from an underwriting perspective.
- There is a risk that standardised wordings would lead to numerous policies not adequately meeting the needs of different insureds, would limit innovation and would reduce competitive vitality.

Interested parties without a direct vested interest (ASBFEO, Ai Group)

Key points raised across these submissions:

- Welcomes collaborative approach to identifying sector specific solutions
- Some SME sectors have reached the stage where government intervention is needed
- Support for standardised wordings, longer notice periods before renewal, explanation of premium increases and decline to renew; possible mitigation measures, what the insurer needs to accept mitigation has occurred, and information on factors which impact the insurers' risk appetite

Parties with a specific industry or professional interest (Engineers Australia, Consult Australia, ASIAL, SEGC and the FPA)

Key points raised across these submissions:

- Strong support for a formal process of sector specific stakeholder collaboration to develop and implement solutions
- Real need for better insurer/broker/underwriter understanding of the client's business and the specific risks they face
- Governments should act where problems are most acute
- Regulatory reforms need to take account of impact on insurance
- Government agencies should be Model Clients to avoid unfair or unequal contract terms between public sector clients and consultants with whom they do business
- There is good potential to explore many of the solutions identified in the Consultation Paper, especially:
  - Government action to address regulatory issues
  - Advice and education on risk mitigation
  - Risk management and mitigation.

Case studies (CPAQ, Coonawarra Resorts, participants in the Federal Government's AusIndustry Entrepreneurs' Program, the Ski Club of Australia)

Key points raised across these submissions:

- SMEs called on to pay steep increases in premiums, sometimes more than 100%, often without explanation or a blanket "not interested in taking on the risk". This comes on top of increases in other costs for small businesses and a significant loss of turnover due to COVID-19 restrictions.
- Increased insurance costs are hitting small business in sectors such as tourism and leisure activities that are key to economic recovery.
- Insurers don't seem interested in conversations about mitigation taken or taking actions into account
- There are limits to which SMEs can self-insure

- Lack of timeliness of claim payouts
- Support for statutory cap on civil liability awards
- Particular support for options relating to –
  - standard definitions of key terms
  - longer notice periods before renewals
  - insurers giving explanations of premium increases/decline to renew
  - tax reform
  - risk education programmes.

Professionals with client interests (Clyde & Co, SME section of the Law Council)

Key points raised across these submissions:

- Endorsement of analysis of market failure and need for Government action
- Earlier attention to regulatory issues in some instances could avoid severe affordability problems
- Value in exploring benefits from standardised definitions and wordings (with constructive proposals outlined)
- Support for insurers actively encouraging mitigation, including through premium discounts
- Endorsement of mandatory ICA standards
- Importance of the role of the broker
- Support for retaining broker commissions
- Support for an industry review of coverage of Business Interruption policies
- Potential solutions that may be particularly useful because of mutual benefits:
  - Advice and education
  - Risk management and mitigation
  - Industry association standards and accreditation
  - Group insurance schemes.

The full submissions from which the above summaries have been prepared are available on the Insurance Council website.

Section 7: Responding to the submissions

It is evident from the submissions that there is considerable willingness in many parts of the business community struggling with insurance problems (price, availability, terms and conditions) to take active steps to ameliorate or solve the problems and some are willing to do so independently of the established insurers.

Group schemes - current market information

There are already many interest groups or business groups who have group insurance arrangements of one kind or another, many of them in existence for a number of years. Some are with authorised insurers including Lloyd's, in some cases directly with the insurers and in other cases through underwriting agencies. Some others are with DMFs. Examples to give some flavour are –

- NIBA has a group insurance arrangement for PI cover in which insurance brokers who are NIBA members can participate
- Arrangements for numerous sports through 'Marsh Sports' using a combination of DMF support and underwriting agency support
- Local council mutuals – Marsh has several schemes, some being DMFs, some using underwriting agencies and at least one as an APRA authorised insurer (for workers compensation).

The hard market is spawning a range of initiatives from or on behalf of various customer interest groups, mostly industry or professional associations, assisted by a range of advisers and service providers.

There are currently several different service organisations promoting or assisting the development of new insurance ventures or new DMFs in their efforts to overcome the primary symptoms of a hard market, being affordability and availability. They also aim to harness the benefits of a common understanding of risk management and other risk and insurance related issues among the membership and to communicate these things to insurers or underwriting agencies, or alternatively among themselves through DMF structures.

The ASBFEO has announced publicly that it is assisting AALARA to explore a DMF in the belief by AALARA that there is no appetite in the insurance market to underwrite their members' risks, either individually or as part of a group scheme.

There are professional insurance management organisations that are not brokers or underwriting agencies but who act as managers of group schemes. While Marsh, Aon and other brokers have divisions that support mutuals and other group arrangements, there are also some independent specialist players, e.g. Picnic Labs (relatively new, perhaps also regarded as an insurtech, and with support from a Lloyd's syndicate) and Regis Mutual (a UK operation that has serviced or supported Unimutual, which is a DMF for universities and other like institutions).

In view of all of the above, it would be fair to conclude that this proliferation of initiatives contemplating non-insurance solutions to risk protection and insurance problems has arisen because of the lack of insurer interest in seeking solutions that involve insurers.

Group schemes – current and future options

In establishing a new group scheme, a group of customers might choose to have its insurance needs arranged with one of –

a. an existing individual insurer
b. a consortium of existing insurers
c. a new or existing underwriting agency
d. a new group captive insurer
e. a new DMF (discretionary mutual fund).

To elaborate -

a. an existing individual insurer is one authorised as such by APRA, either as a shareholder company or a mutual, and already operating in the insurance market
b. a consortium of existing insurers, as explained above
c. a new or existing underwriting agency –
   - from the customer's and broker's perspectives, this is similar to dealing with an individual insurer or a consortium that operates through a single underwriter
   - underwriting agencies usually use a single insurer for each line of business (even if using different insurers for different lines of business) but coinsurance arrangements can also be entered into
d. a new group captive insurer, being a new special purpose insurer authorised by APRA and operated by or on behalf of an industry group or similar
   - establishing a new group captive is usually a substantial undertaking because of the time, effort and investment required
   - two existing examples are LawCover NSW, a mutual operated by the Law Society of NSW, and StateCover, a mutual whose members are NSW government councils)
e. a DMF (discretionary mutual fund), being a quasi insurer operated by an industry group or similar on a co-operative basis and protected by an insurance contract with one or more insurers.

Of these five options, group schemes arranged according to (a), (b) and (c) are all flexible arrangements that are contractual. They can be established reasonably quickly, essentially by negotiating and setting up contracts of types for which there are many and varied precedents. They can usually also be readily expanded, modified, diminished or disbanded as might be required from time to time.

Option (d), a group captive insurer, is usually a major long-term commitment for its members and as such is unlikely to be any industry group's preferred option to combat a hard market unless there are other reasons for setting it up. It needs to be seen as a permanent arrangement because of the commitment needed from its members.

Option (e), DMFs, are currently being seen as alternatives or partial alternatives to conventional insurance in today's hard markets and are being considered by several industry groups or customer cohorts with assistance from professional advisers such as brokers or other insurance advisers. DMFs can be effective if well set up, managed and prudently funded as cooperative ventures with a suitable cohort of homogeneous members. The funding needs to be supported by insurance protection at levels low enough to maintain stability of the DMF and to maintain the loyalty of its members in times of adversity. They usually need to be seen as medium to long term ventures to justify their establishment.

NB Mutuality, mutual insurers and discretionary mutual funds:

Mutuality itself is being keenly promoted in some quarters at present and mutuality can have many benefits. Advocacy of mutuals, however, is not always accompanied by a distinction being drawn between discretionary mutual funds and mutual insurers –

- Mutual insurers as a whole have a long and proud history in providing insurance and risk protection in many situations in many countries, in both general insurance and life insurance. They are normally authorised and regulated in the same way as shareholder owned insurers.
- Discretionary mutual funds, however, are different from mutual (authorised) insurers.

For a group considering whether a DMF is a suitable structure for its needs, it is important to evaluate its discretionary nature and its financial soundness against the alternatives.

Innovation by underwriting agencies, brokers and other advisers in their dealings with customer groups on the one hand and insurers on the other are to be welcomed in this hard market. For their part, insurers can act in response mode to some of these initiatives and generally will make resources available in cases that present as interesting commercial opportunities.

In the case of DMFs, there are many difficulties, obstacles and risks but at the same time there are some very capable and professional people engaged in supporting and managing them. Also they are not entirely unregulated as ASIC imposes some conditions on them.

In summary, group schemes for business and professional cohorts are to be welcomed for several reasons, including the sharing of common interests and resources that can be brought to bear on the customer side and the greater knowledge and understanding that can thereby be made available to insurers.

Some important questions

It is evident that many businesses and professional groups struggling with insurance issues of availability and affordability respect the need of insurers to set prices, terms and conditions that are financially workable for them and, on the whole, they accept that insurers do so in good faith.

At the same time, however, there is a mystery for many insurance buyers as to how and why insurers frequently do not communicate reasons for their assessments of major price increases, changes in cover or declinature of risks. This mystery leads to an important question that has emerged implicitly through the consultation process, noting goodwill generally towards insurers but also the frustrations and business continuity problems for buyers in current market conditions –

> How do insurers, in an effort to see the industry deliver on its social licence to support the public interest, maintain their commercial independence and viability while simultaneously performing within competition law and agreeing, voluntarily through the Insurance Council or otherwise, to find ways to offer market capacity when no individual insurers wish to do so?
>
> This question arises because individual insurers are free to participate or not in market segments according to their own business strategies.
>
> In other words, how can the insuring community (buyers and their brokers on the one hand and insurers on the other) communicate more effectively with each other and take collaborative action in the interests of solving the affordability and availability questions that have arisen?

Submissions suggest that this question might be divided into three as follows –

1. How can insurers contribute to enhancing market capacity?
2. Can the scope of publicly available underwriting information be expanded?
3. Can insurers give early pricing recognition to customer risk improvement initiatives?

Responses to these questions are incorporated in the recommendations in the next Section.

The regulatory dimension

The insurance problems of some customer groups are regulatory in origin, as explained in Section 5. As several of the submissions illustrate, obligations are placed by state governments on some industry groups through legislative requirements or licensing requirements. Examples are certain engineering and construction professional groups and many parts of the leisure and tourism industries.

These problems cannot be solved by insurers and customer groups alone. They need effective engagement with relevant parts of the State governments concerned.

Underwriting information and statistics

Several submissions have drawn attention to the lack of information and feedback available to customers from insurers who decline to offer cover or who have asked for heavy price increases. As a result, a common question in submissions and externally relates to underwriting information: is there a way for insurers to offer greater transparency and more information to insurance buyers and their brokers about the costs of risk, both generally through public availability of relevant statistics and specifically through more information exchange with individual buyers?

There are some prospects for more widely available detailed insurance statistics for professional indemnity and public liability in particular. Access to such statistics can be helpful but, being long tail classes of insurance, the statistics can be readily misinterpreted. That is not a reason, however, to limit their availability.

Following the liability crisis in the early 2000s after the failure of HIH and the subsequent enactment of tort reform across the States and Territories, the Commonwealth Government asked APRA to establish the NCPD (National Claims and Policies Database). APRA began collecting data in 2005 from authorised insurers on public liability and professional indemnity insurance. Statistics from the data collection are available from APRA, which collects the data half yearly and updates the published information annually.

This database is not widely used. APRA describes the NCPD statistics that are published as being level I and level II. Level I comprises numbers of risks, gross written premiums and associated claims run-off tables, recorded by State. Level II includes additional aggregated information, also by State, covering product, industry or occupational code, indemnity limits and excesses.

While broadly helpful at insurer portfolio level, the statistics are of limited use to customers and their brokers. It is notable, however, that APRA collects rather more detailed statistics than those that are published, on both policies and claims. These statistics are subject to confidentiality and privacy considerations but if they could be made available, there is potential for insurers, customer groups and other interested parties to obtain much more granular statistics than are currently available. Further, publication and subsequent scrutiny of the statistics could lead not only to better information in the future but also to a continuing opportunity for insurers and APRA to work together towards progressive enhancement of the NCPD.

Early recognition of risk improvement

Frequently we hear that, for insurance buyers to reap the pricing benefit from risk improvements in their businesses, insurers need to observe claims and risk experience for a period of time, perhaps three years, before being ready to adjust premiums or terms and conditions to give any credit to the risk improvements.

This approach by insurers, while perhaps understandable, is one which warrants further consideration by them.

There are other cases where risk is increased as a result of legislative or regulatory changes. In these situations insurers also often seek to defer for some time the acceptance of insurance cover and the pricing under the changed conditions.

In both cases it is desirable that insurers find ways to recognise the changed risk conditions earlier, perhaps with some innovation around pricing structures, so as to support the customers who are experiencing the changed risk conditions. Hence the question that arises is -

> Can insurers give credit, in the form of reduced prices, to insurance buyers for changes that they make to risk quality at the time they make those changes?

The submissions and dialogue show interest in various aspects of the 16 options and they offer constructive input around the options. There also seems to be good understanding and acceptance of the market failure and government intervention material.

Some buyers believe that

- insurers don't understand their needs (and don't try – just decline or over-price) and
- governments don't understand their needs.

Engaging with State and Territory governments

Two types of issues have been identified in submissions regarding State and Territory governments. One relates to the imposition on businesses of insurance requirements that are difficult or impossible for businesses and their insurers to meet. The other relates to government agencies awarding contracts for government projects and their treatment of contractors bidding on those projects. There appear to be cases of governments exploiting their bargaining power to impose terms on contractors, including risks and insurance requirements, that some contractors, especially smaller ones, cannot meet economically in a tender environment.

A third possible issue regarding State and Territory governments that was not raised in submissions relates to statutory schemes (workers compensation compulsory third party motor insurance). There is dialogue and a relationship between the ICA and statutory scheme officials in each jurisdiction which do not appear to raise any particular engagement issues for insurers, the ICA or the relevant government agencies.

Government insurance requirements

Regarding the first issue (imposition of insurance requirements on businesses), the most common source of problems appears to be that State government departments or agencies, in regulating or licensing businesses in various industries, recognise that insurance is a valuable means of reducing risk for both government and business but seeks to impose insurance requirements without advance consultation with the insurance industry. Without such consultation, insurers may be asked to offer insurance cover that they are unable or unwilling to offer and/or any cover on offer may be uneconomic (i.e. seen to be unaffordable) by the businesses concerned.

A related issue is that each State's local government councils do not have uniform insurance requirements across the State, which can cause complexities for insurers and brokers that flow on to the insurance requirements of businesses.

An obvious solution to these problems is for the relevant arms of government in each jurisdiction to consult earlier or more actively with the ICA. It seems, however, that awareness of the need to do so is low. Therefore to improve the situation in future, earlier and better communication between insurers and State and Territory governments, most likely through each jurisdiction's Treasury department, is to be encouraged. Regular dialogue would be beneficial, if possible before or during policy development instead of afterwards as often seems to happen –

> The primary aim of such dialogue would be to give to the ICA and insurers early warning of State or Territory government policies or plans that may specify insurance requirements on businesses of various kinds to obtain insurance as a condition of meeting regulatory or licensing requirements.

Government contracts

Regarding the second issue (terms of government contracts), it is advocated in submissions that State and Territory governments operate according to Model Client criteria (in similar fashion to government agencies that are required to behave as Model Litigants during legal action).

> The purpose is to arrive at fair treatment on insurance requirements for contractors in "David and Goliath" situations.

Standardisation of documentation etc

Several submissions, particularly those from the ASBFEO, Clyde & Co and the SME Committee of the Business Law Section of the Law Council, were very supportive of the benefits of standardising key definitions and important terms such as exclusions, inclusions, conditions and limits. The Clyde & Co submission in particular offers valuable input on a range of details associated with this topic.

The benefits expected are greater policy understanding and certainty for small business policyholders leading to a better, faster experience at the time of underwriting and at claim time. Comparability of the policies offered by different insurers and competition among insurers may then focus more on the standard of service and the cover limits being promised for the level of premium the insurer is asking.

The arguments for and against various forms of standardisation are often made yet are not compelling either way. The reason appears to lie in the many different meanings and emphases that can attach to the idea of standardisation: is it definitions in policies, policy conditions, inclusions and exclusions? How rigid is it, how well tailored to different types of businesses and different types of insured risks? Will it stifle innovation or enhance competition and simplify the comprehension of coverage by insurance buyers?

This type of debate is hardly new. It also goes hand in hand with other topics, for example industry standards, codes of practice, legislative requirements (such as the Insurance Contracts Act and competition law), and regulatory interventions of different kinds (for example from ASIC and the Financial Services Royal commission).

These questions serve to explain some of the dilemmas that working groups attempting to make progress on various forms of standardisation encounter. They also signal the importance of being clear on the goals of standardisation and the outcomes that are sought.

Policy wordings in the market today comprise a wide range of PDSs and a degree of standardisation has come to be imposed by some of the larger broker groups (large brokers such as Marsh and Aon and large broker networks such as Steadfast and Austbrokers). Their market influence is often such that insurers can find themselves being obliged to follow the demands of brokers in situations where they are pressured to use policy wordings different from their own, complicating administration and understanding across the insurer, broker and buyer communities. Evidently there will always be differing views across the market as to the best way to design wordings.

This current mixture of bespoke wordings, insurer by insurer and broking group by broking group, illustrates the complexities for customers and exposes the level of the investments by different parties on matters which many buyers see as perplexing and unnecessary.

Overall, it is difficult to avoid the conclusion that there is a very good case for some forms of standardisation but what also must be recognised is that definitions and policy terms should be tailored specifically to different sectors and professional groups, that over-simplification or over-standardisation may well be worse than the status quo.

The scope of these different issues is well illustrated in Section 5 of this report (Option 1) which outlines some of the risks that arise in this debate on standardisation.

The above material related to the submissions is recognised and taken into account in the recommendations offered in the next Section.

Section 8: Recommendations

There are 13 recommendations, some but not all of which can be initiated by the ICA on its own. In some cases the primary responsibility lies with other parties, principally customer groups (industry and professional associations) and perhaps their brokers or advisers. In those cases, the ICA and/or insurers may be able to play a facilitation role.

The table below nominates the recommendations. The ticks represent the parties who can initiate and lead implementation of the recommendations. The other parties (without the ticks) will in most cases be in response mode and not initiation mode. They may be interested and may become active participants but are not expected to be in a position to lead or drive implementation.

Note that there is not a column for governments or government agencies, even though governments are important participants in several of the recommendations. The reason is that governments are expected to be in response mode. The parties interested in insurance matters that may involve governments or government agencies will usually need to persuade them to become active participants.

Outline of recommendations – ticks indicate the initiating parties

Recommendation		ICA and/or insurers	Brokers and/or advisers	Customer groups
1.	Collaboration with insurance buyers	✓	✓	✓
2.	Unusual risks, risk reductions and risk increases	✓		✓
3.	Establishing a group scheme		✓	✓
4.	Collaboration with government(s)	✓		✓
5.	Government intervention	✓		✓
6.	Pursuing industry data and statistics	✓		
7.	Standardisation of insurance documentation	✓	✓	✓
8.	Risk management and risk mitigation		✓	✓
9.	Insurer feedback to SME customers	✓		
10.	Review of business interruption insurance	✓	✓	
11.	Broker remuneration – disclosure, incentives		✓	
12.	State and Territory stamp duty and charges	✓		
13.	Progress follow up	✓		

Regarding the role and participation of underwriting agencies, in some cases they may align with and support insurers, in other cases with brokers.

1.Collaboration between insurers and insurance buyers

Effective collaboration warrants the involvement of insurers, brokers and industry or professional associations but there is not a straightforward insurer-led answer to how this collaboration might occur, as explained in Section 6.

To elaborate, reactions to the ICA initiative in commissioning this Review have been very positive and there is enthusiasm from many groups to engage in the future with the ICA. It is not so obvious, however, how the ICA might respond to this interest. This is essentially because -

- the ICA, as an industry association, concentrates on industry affairs but has no authority over the commercial affairs of individual insurers and
- individual insurers are sellers not buyers and cannot know the full circumstances of individual buyers.

While insurers as sellers in a free market can seek to anticipate buyers' needs in the design and distribution of their products and services, they are by nature in response mode. The ICA can facilitate interactions with buyers, including promoting effective and productive dialogue, but the buyers need to make their needs and circumstances clear to insurers.

Consequently the buyers ultimately need to engage with the sellers (one or more insurers) rather than with the ICA. Others can also contribute, e.g. brokers, underwriting agencies, consultancies.

It is therefore evident that, in general, the initiative needs to be with customers, customer groups and their advisers, rather than with insurers

At the same time, however, the ICA and its members are committed to alleviating as far as possible affordability and availability problems besetting SMEs. Hence a solution is needed to this buyer versus seller conundrum.

My conclusion is that this conundrum can be resolved most effectively by a three step process involving the buyers, the ICA and the sellers (insurers) and, accordingly:

I recommend that –

- When a group of insurance buyers, on testing the insurance market (usually through their broker), discovers a genuine affordability or availability problem –
  - Step 1: The buyer group approach the ICA to seek help with a solution
  - Step 2: The ICA respond by -
    - working with its member companies and other stakeholders to investigate the buyer group's situation for the information of both the buyer and ICA member companies and
    - making available the results of the investigation to the buyer group and also to ICA member companies, to assist their consideration of the pricing and underwriting requirements of the buyer
  - Step 3: The buyer group make a reassessment of its situation and, if appropriate, make a renewed approach to the market, with both sides armed with a more complete understanding, in an effort to find a solution for the buyer

and

- In cases where government involvement emerges as an essential component of the solution, the ICA contribute actively, in conjunction with the insurance buyers, to engagement with government in efforts to find solutions.

2. Unusual risks, risk reductions and risk increases

Some submissions claim that insurers do not make the effort required to understand properly risks that are out of the ordinary. Two examples: the SEGC, which is a unique arrangement for the stockbroking industry that is claimed to be misunderstood by insurers; and security guards who are now exposed to COVID 19 risks during crowd control.

Other submissions claim that, when the nature of the insurance risk for a particular business changes, insurers stand back such that -

- when risk improvements are made by a business, either of its own initiative or because of changed circumstances of the industry concerned, insurers frequently decline to recognise them until considerable time has passed, often three years
- similarly, if regulatory or other changes occur that increase risk, insurers will frequently decline to price and underwrite the insurances for quite some time.

An example of the former is financial planners who, in the last three years, have undergone extensive regulatory change, educational requirements and industry restructuring which, taken together, should indicate a material reduction in professional liability risk and reworking of policy conditions for many planners.

In all of these cases, insurers are seen to take a defensive underwriting approach that limits insurance affordability and availability.

This situation is not satisfactory for the insuring community but I believe it can be alleviated or resolved by collaboration as in Recommendation 1, i.e:

I recommend that –

- In cases of unusual risks, risk reductions and risk increases when an insurance buyer or buyer group believes that the insurance market has not properly understood the situation, the buyer approach the ICA for the purpose of embarking on the same collaborative three step process as in Recommendation 1.

3. Group schemes

Group schemes are an important part of the insurance ecosystem and are quite likely to become more significant in the future. They are covered at some length in the previous section and five options for dealing with them are explained.

It is not the purpose of this report to advocate for or against any of the five options for group schemes described in the previous section and their variants. It is appropriate, however, that:

I recommend that –

- Individual businesses having affordability and availability problems consider whether a group scheme with other like businesses may be in their best interests

and

- any customer group considering a group insurance or mutual protection scheme examine carefully the available options, taking account of regulatory requirements and consulting as widely as possible with insurers and others, because the most suitable form of scheme in most cases should be selected on a 'horses for courses' basis, depending on the totality of the group's circumstances.

4. Collaboration with governments

Historically the ICA has interacted frequently with the Commonwealth on a range of insurance matters, in both proactive and reactive mode depending on the circumstances. Relations with State and Territory governments, however, have generally been less comprehensive such that closer future engagement is likely to yield better outcomes for all parties (governments, insurance buyers and insurers). Hence -

I recommend that –

- the ICA build closer relationships with State and Territory governments on matters of insurance with the primary goals of –
    - arranging for all potential State and Territory government initiatives that may involve insurance to include early consultation with the ICA during policy development and planning

and

- opening up dialogue on regulatory barriers affecting insurance affordability and availability that are brought to the attention of the ICA by industry or professional associations

- in relation to the awarding of contracts for government projects, the ICA along with affected industry and professional associations advocate to each State and Territory government that, in respect of insurance requirements in contracts, the government operate according to Model Client criteria that are recognised as fair to both parties.

5. Government intervention

Government intervention on behalf of some customer groups is advocated in several submissions on the basis that market failure has already occurred and that these groups are suffering severe business disruption, in some cases business failure, through lack of the availability of insurance on terms that the buyers can accept.

At the same time, submissions have endorsed the criteria set out in Section 4 for government intervention, including the primary proposition that government intervention is justified only where a market solution cannot be found. On this basis:

I recommend that –

- the ICA investigate each situation that comes to its attention where market failure is claimed to have occurred and, if the ICA concludes that there is a case for government intervention, it collaborates with the customer group concerned to approach government for assistance with a solution.

6. Pursuing industry data and statistics

Paucity of industry-wide data, especially for public liability and professional indemnity insurance, is problematic in many situations for both insurer and insurance buyer. In the previous section, however, attention is drawn to APRA's data base, the NCPD, which contains a potential source of additional data which are currently being collected from insurers but are not published.

It would be desirable for the additional data to be made available while recognising that there would be some confidentiality and privacy considerations to be overcome to make such data accessible. Nevertheless:

I recommend that –

- The ICA approach APRA with a view to arranging with APRA to expand public availability of the currently unpublished NCPD data.

7. Standardisation of insurance documentation

The subject of standardisation of documentation, definitions and related matters is explored in both Section 5 under *Option 1* and Section 6 under *Standardisation*.

It is an important subject and, if handled well with the help of individuals who have the right mix of skills and understanding and treated as a continuing programme of work over time, could yield valuable benefits on many fronts. It could reduce dramatically the aggregate amount of time and effort invested by insurers and broking groups in designing policy wordings and interpreting claims. It should be aimed at simplifying the insurance buyer's task in understanding the insurance protections on offer against the buyer's needs. On the other hand it also carries risk because, if not carried through astutely, it could add bureaucracy, stifle innovation and create dissatisfaction in many quarters. On this basis -

I recommend that -

- the ICA establish a working group on standardisation whose role is to -
  - devise and undertake a programme of work aimed at simplifying and streamlining definitions, documentation and related matters for SME insurances
  - draw on industry associations, brokers, underwriting agencies and other stakeholders and specialists as may be required
  - recognise the pitfalls of over-standardisation and the need to tailor all efforts to the specific needs of different types of insurance buyers, according to industry, profession and other relevant differences

To be successful, the working group will need carefully prepared terms of reference, sound selection of experts as members from across the spectrum of insurers and insureds and also the full support of ICA members and NIBA members.

8. Risk management and risk mitigation

Risk management and mitigation are ultimately at the heart of affordable and effective insurance protection. It is a major topic on its own. There are three dimensions to risk management for businesses buying insurance –

- advice and education on risk management
- standards associated with risk management
- the creation and execution of risk management plans.

On these matters:

I recommend that –

- the Insurance Council support the wider insurance industry (insurers, underwriting agencies and brokers), in conjunction with interested industry and professional associations, to invest in and encourage the development of advice and education services on risk management and risk mitigation,

and

- the Insurance Council promote the adaptation of industry accreditation regimes to encompass standards regarding safety, risk management and risk resilience

and

- the insurance Council continued to promote, as it has done extensively to date, the importance of risk management and risk mitigation by businesses seeking insurance protection and to make available publicly the results of research studies and other information that assists the business community to improve risk resilience.

9. Insurer feedback to SME customers

Some submissions and some government reviews, including the ASBFEO report, have drawn attention to several issues that cause consternation and difficulties for customers who are faced on renewal with material changes in prices, terms and conditions for their policies. The main ones are –

- inadequate notice of renewal terms (14 days is the legislated minimum but where affordability is an issue, policyholders need longer)
- insufficient information (and in some cases no information) on credible and comprehensible reasons for changed terms
- lack of information on steps that the customer might take to mitigate risk that might lead to a lower premium offer or improved terms and conditions.

As a result:

I recommend that –

- The insurance Council and member companies establish a set of protocols that, in all SME renewal situations where the Affordability Category under the Suggested Affordability Guide (see Sections 2 and 4) is Medium or higher (meaning premium increases on unchanged terms and conditions that exceed 15%), whereby the holding insurer –
  - gives at least 30 days' notice to the customer before date of renewal

and

  - provides the customer with meaningful information regarding the reasons for the increased price and/or any adverse adjustments to terms and conditions

and

  - informs the customer of any initiatives of which the insurer is aware that may mitigate the risks and generate a renewal offer that is more favourable to the customer.

10. Review of business interruption insurance

The bushfire and pandemic experiences of the last two years demonstrate the effort that needs to be made with the BI product by all interested parties (insurers, brokers and insureds) to clarify which risks are insurable and which are not while simultaneously reducing complexity, improving understanding and avoiding unintended consequences. Accordingly:

I recommend that –

- The ICA establish a working group in conjunction with NIBA to examine the BI products currently on the market and make a set of recommendations to the insurance industry and the insuring community on the future design and operation of the BI product for different segments of the insuring community.
- In undertaking its work, the working group consider the issues associated with insuring pandemics.

11. Broker remuneration – disclosure, incentives

Insurance brokers are an integral part of the commercial insurance market and they provide a valuable service to business customers and insurers alike. Nevertheless debates over their remuneration are incessant – too high, too low? conflicted? commissions or fees for service?

Commissions payable by the insurer are embedded in the insurance market place and, in my opinion, for good reason. At the same time, however, there is one feature of broker remuneration that is an impediment to open debate and to greater trust of both insurance brokers and insurers. It is the fact that there is a lack of disclosure of commissions in most cases. Insurance buyers do not therefore know how much brokers are being paid for the role they play nor whether there are any incentives that might create conflicts of interest for the broker. Most brokers operate under a *general advice model* rather than a *personal advice model* and as such are not required to disclose rates of commission and other insurer payments. When asked they will generally disclose to their clients but the question is asked infrequently and generally brokers do not make voluntary disclosure. Hence on this subject:

I recommend that –

- The practice of insurers paying commissions to brokers continue but brokers disclose on all customer quotes and invoices as part of the premium all insurer commissions and any other payments they will receive from the insurer.

12. State and Territory stamp duty and charges

As noted in Section 5, every inquiry and review of insurance costs and affordability over the last decade has recommended the abolition of State and Territory government stamp duty and charges on insurance policies.

Recognising, however, that governments are unlikely to forgo the associated revenue, I quote here from a Productivity Commission report in 2014 which concluded with -

“Replacing state insurance taxes and levies with more efficient revenue sources, such as broad-based payroll or land taxes, would improve the price signal to policyholders and the effectiveness of insurance as a risk management tool and reduce the price of insurance. Taxes could be phased out over time, as is being done in the ACT. The resulting price decrease could also encourage households and businesses to take up insurance or increase their coverage. “

This argument is persuasive to many observers but governments have not heeded it. The associated recommendation is worth repeating and endorsing:

I recommend that -

- The Insurance Council continue to pursue with State and Territory governments the Productivity Commission's 2014 recommendation that "State and Territory taxes and levies on general insurance should be phased out and replaced with less distortionary taxes".

13. Follow up in 2022 second half

The scope of the above recommendations is substantial and many of them, if adopted, will take some time to take shape and become effective. Some require only a time-limited one-off initiative while others involve some change of practice or establishment of new arrangements that can and should endure indefinitely if effective.

Because there is change involved, because there are affordability and availability problems to be overcome and because the Insurance Council, in commissioning this report, is seeking a better future dynamic across the insurance spectrum of insurers, intermediaries, insurance buyers and governments:

I recommend that -

- In the second half of 2022, the Insurance Council undertake a review of progress on this suite of recommendations, their impact on the insurance market and their impact on the current issues of insurance affordability and availability.

APPENDICES

Acronyms

ACRONYM	FULL NAME
ACCC	Australian Competition and Consumer Commission
Ai Group	Australian Industry Group
AALARA	Australian Amusement Leisure and Recreation Association
ASBFEO	Australian Small Business and Family Business Ombudsman
APRA	Australian Prudential Regulatory Authority
ASIAL	Australian Security Industry Association Limited
ASIC	Australian Securities and Investments Commission
CPAQ	Caravan Parks Association of Queensland
FPA	Financial Planning Association
ICA	Insurance Council of Australia
NCPD	National Claims and Policies Database
NDIR	Natural Disaster Insurance Review
NIBA	National Insurance Brokers' Association
RCNDA	Royal Commission into Natural Disaster Arrangements
UAC	Underwriting Agencies Council

Reference publications

REFERRED TO AS	PUBLICATION
ACCC Final Report	Final Report of the Inquiry into Insurance in Northern Australia, Australian Competition and Consumer Commission, December 2020
Actuaries Institute Research Paper	Property Insurance Affordability: Challenges and Potential Solutions Research Paper, Actuaries Institute, November 2020
ASBFEO Final Report	Final report of the Inquiry into Insurance, Australian Small Business and Family Enterprise Ombudsman, December 2020
Australia Industry Group insurance survey	Business Insurance: Unaffordable or Unavailable, Australia industry Group survey, October 2020
NDIR Final Report	Final Report of the Natural Disaster Insurance Review, September 2011
RCNDA Final Report	Final Report, Royal Commission into Natural Disaster Arrangements, October 2020

ASBFEO Final Report on Insurance December 2020

Findings and recommendations

Overall finding: Small businesses find various types of insurance hard or impossible to obtain at affordable prices. This market failure is the result of a mix of regulatory, geographic and industry factors. Any response to improve the availability of insurance for small business needs to be multifaceted and focused on addressing this market failure.

Regulation

Inconsistent definitions of "small business"

Finding Relevant legislation, the Australian Financial Complaints Authority's rules and the General Insurance Code of Practice use different definitions of 'small business' and 'small business insurance products' thereby creating gaps in protections for small businesses. The Australian Financial Complaints Authority also lacks dispute resolution coverage of some categories of insurance.

Recommendation 1

The definition of "small business" as those businesses with (a) turnover of less than $10 million per annum or (b) less than 100 employees should be standardised for all insurance legislation, regulations and codes.

Recommendation 2

The Australian Financial Complaints Authority's rules should be expanded to cover all insurance products (including wholesale insurance) purchased by small businesses for claims assessed at $1 million or less.

Self-regulation has failed

Finding: The insurance industry's service and practice standards set by voluntary codes of practice

(the General Insurance Code of Practice and Insurance Brokers Code of Practice) are rarely enforced

and are not taken seriously by industry.

Recommendation 3

The General Insurance Code of Practice and the Insurance Brokers Code of Practice should be mandatory and amended as follows:

a. The Insurance Code of Practice to require:
    i. subscriber's boards to acknowledge receipt of, read and apply guidance and reports of the General Insurance Code Governance Committee; and
    ii. all staff handling small business clients to be trained specifically to assist small business; and
b. The Insurance Brokers Code of Practice be amended to require:
    i. disclosure of all fees and costs in all policy quotes provided to small businesses; and
    ii. all communication from an insurer to be provided to the relevant client within 7 calendar days of receipt by a broker.

c. c. Both Codes to provide for the Australian Financial Complaints Authority to deliver dispute resolution and enforcement, with a focus on customer-centred outcomes and including the ability to apply significant financial penalties for breaches.

Recommendation 4

Conflicted remuneration for insurance brokers should be banned with a phased transition period.

Critical insurance products

Lack of availability of public liability and professional indemnity insurance

Finding: Many small businesses report being unable to obtain public liability and professional indemnity insurances. The open-ended nature of injury claims and potential for large damages mean that insurance availability is becoming limited.

Recommendation 5

Following the approach taken in New Zealand, liability for personal injury should be subject to statutory caps.

Recommendation 6

The Federal Government, in coordination with the states and territories, should urgently progress work on a National Insurance Injury Scheme in line with the recommendations of the 2011 Productivity Commission Inquiry Report into Disability Care and Support.

Recommendation 7

Where there is only one or no insurers left in a professional indemnity market, the Federal Government should provide an insurance scheme of last resort for small business.

Lack of availability of natural disaster insurance

Finding: Businesses report being unable to obtain natural disaster insurance, or being offered

policies where the cost is prohibitive.

Recommendation 8

Expand the Australian Reinsurance Pool Corporation to provide reinsurance for all natural disasters for commercial property insurance.

Recommendation 9

Local Councils and State and Territory Governments that release new land for development, or rezone existing land for further development must undertake a suitability and natural peril assessment of all land (assessed for a 1 in 100 year risk) before commercial release and publish the results of the assessment prior to land release. Where land is released with known issues that are not disclosed to a purchaser or are otherwise not apparent, the relevant authority should carry the liability for the known issue in perpetuity.

Refusal on basis of industry, location or other generic factors

Finding: Through our consultations, businesses have reported being unable to obtain insurance based on industry (such as the mining industry), location (such as remote locations) or other generic factors. Insurance is an "essential service" for business alongside services such as electricity, gas and banking. As such, the provision of insurance should not be denied to legal businesses on arbitrary "ethical" and other bases.

Outcome A

The Australian Small Business and Family Enterprise Ombudsman will continue its work on a federal essential services regime. Insurance will form a critical component of this work that covers that essential service providers should not be able to discriminate against legal, legitimate and regulated businesses based on generic factors, such as an industry in which a business may operate or be associated.

Disclosure of coverage & fees

Insurance products are difficult to navigate

Finding: Small businesses are unaware of all commissions, fees and taxes that make up significant portions of their insurance premiums. Insurance product documentation is so complicated, opaque and difficult to navigate that small businesses purchase unsuitable policies and obtain inadequate cover.

Recommendation 10

All insurance quotes should include a clear breakdown of commissions, fees and taxes, including administrative costs and broker fees.

Recommendation 11

Insurance product documentation on creation and renewal should:

a. Set out the most common mitigations that businesses can make to premises and how they operate to reduce their premiums and ensure continued coverage;
b. Clearly list exclusions, limitations and conditions early in the documentation, together with standard policy checklists (with checkboxes) that show all inclusions and exclusions;
c. Set out the most common reasons why claims are denied under the policy, including a chart with percentages;
d. Use standard definitions, particularly covering natural perils, across all insurers operating in Australia; and
e. For products offered to Australian purchasers by foreign insurers, be written in Australian legal terminology.

Claims experience

Claims decisions are not always made promptly

Finding: Small businesses can be left in limbo while insurers assess their claim, leading to uncertainty of business survival and reduced resilience.

Recommendation 12

Decisions about claims should be shortened:

a. For general timeframes from 4 months to 3 months
b. For ‘extraordinary catastrophes’ from 12 months to 4 months.

Barriers to switching & market entry

Notification periods for renewal terms are too short

Finding: The current 14-day statutory notice period for renewal terms or the non-renewal of insurance is not long enough for small businesses to make informed decisions, change insurers and secure insurance. Small businesses would benefit from technology that allows them to more easily compare and change insurers. The expansion of the Consumer Data Right system (CDR) to insurance products for small business would facilitate this.

Recommendation 13

Require insurance companies to provide 60 calendar days’ notice for a renewal refusal, premium increases above 15%, or changes in exclusions or excesses, together with a statement providing reasons for the change and any specific modifications that a business can make to continue their insurance or reduce premiums, exclusions and excesses.

Recommendation 14

The Government should give priority to the extension of consumer data rights into the insurance market.

Insurtech has failed to gain broad-based industry traction

Finding: The insurance industry has high potential for benefits to small business by disruption through technology. However, where there is innovation, existing insurance companies commonly purchase that innovation for their self-use (for example, algorithms that are purchased for use to derisk existing insurance business). This means that innovation is lost to the broader market and market concentration is fortified.

Recommendation 15

The Australian Securities and Investments Commission should explicitly include insurtech as a category in its communications and online guidance for its innovation hub to enhance awareness of existing support mechanisms.

Outcome B

The Australian Small Business and Family Enterprise Ombudsman will include investigation of the treatment of innovation in the insurance industry in its work to eliminate unfair business practices arising out of the Ombudsman’s Access to Justice report.