BUSINESS NSW

INSURANCE AT THE SPEED OF BUSINESS

Getting businesses the coverage they need

November 2023

Foreword

Small businesses are the engine room of our economy, yet they are spluttering under the pressure of runaway insurance premiums and shrinking coverage. Meanwhile, financial institutions are struggling with an increasingly tough balance between risk, shareholders and their customers.

Aside from a cost and coverage crisis, NSW businesses also require a smoother customer service experience and an expedited claims management process. Add to this an uncompetitive tax regime, insurance has fast become one of the business community's biggest bugbears. Half of all businesses in the tourism and hospitality sectors are either being denied insurance or can't afford enough of it. Business NSW research has revealed a shocking 63% 'uninsurability gap' in the tourism sector for public liability coverage — that means there's a difference of 63% between the number of businesses who are fully covered and the expected industry benchmark for coverage. In hospitality, that gap is 48%, while in transport it's 33%. And that's bad news for everyone. It leaves businesses vulnerable and consumers at risk.

However, this report also points to an opportunity — for insurers, the wider financial services sector, and governments — to innovate and develop solutions that enable business to go through the challenges the next decades will pose.

Australia's brutal decade of fires, floods, COVID and mouse plagues have further increased Australian and NSW risk profiles. Climate change has made this more apparent, as have some government procurement policies and private sector practices.

Tapping local expertise and knowledge is part of the answer. Australia's financial services and fintech sectors have a strong track record of innovating to respond to emerging challenges. That spirit of innovation needs to be harnessed once more, by those best placed to bring the most effective mitigation, resilience and recovery. Improving international insurers' and reinsurers' understanding of the Australian operating environment should also lead to improved cost outcomes.

There is a role for governments too, in ensuring that tax arrangements are fit for purpose, that procurement policies do not impose onerous insurance requirements, and that small businesses are involved when decisions about the future of insurance policy are being made. Business NSW welcomes the NSW Government's recently announced changes to procurement for contracts under $250,000 and their intention to reform the Emergency Services Levy. But more needs to be done. We need to come together to address these insurance challenges. Without doing so, both NSW and Australia will become a less desirable places to do business and will see our global competitiveness decline.

Dan Hunter

Dan Hunter
CEO, Business NSW

Executive Summary

Australian businesses are facing increasing pressure from rising insurance costs. Insurance has taken the top spot in Business NSW's survey of leading causes for concern in 9 out of 11 quarters, since being added to our list of survey options in 2019. Businesses in NSW consider insurance to be a more severe driver of cost pressure than energy, tax, rent and wages.[1] Insurance is a business cost that has risen considerably in recent years, putting pressure on the competitiveness and viability of Australian businesses, especially small businesses.

While insurance premiums are rising across the board, for a subset of businesses undertaking specific types of activity or located in flood and bushfire-prone locations, insurance is either not commercially available, or only available at such prohibitively high prices that the business is in effect uninsurable. These businesses, which range from critical activities underpinning economically vital sectors such as construction, to those which typify Australiana such as camping and caravanning sites and outdoor recreation centres, face choices about whether to continue operating.

Many enterprises are experiencing escalating insurance premiums and diminishing product availability. Competition in insurance is deteriorating. This is especially evident in the foundational business insurance classes of professional indemnity (PI), public liability (PL) and asset insurance. Premiums in some classes are escalating by about 30% per year, and that is where businesses can still access insurance at all.

Standard insurance products are not capable of operating 'at the speed of business'. Current models with slow decision-making and rigid payout structures are failing to meet contemporary small business needs. Businesses receiving insurance payouts are often obliged to build back as before the insured incident occurred, in some cases exposing them to the same vulnerabilities that left them susceptible to floods or bushfires in the first place. Businesses need insurance products that deliver the speed and flexibility to enable them to operate in the way that meets their circumstances.

Long-term solutions cannot by themselves address the acute crisis in insurance affordability and access. Government and the insurance industry are discussing measures to address the long-term issues with business insurance affordability and availability. Most of the solutions proposed by the insurance sector would take many years before they translate into relief for NSW businesses, even if the work commenced today. The insurance sector has also not committed to reducing premiums if these solutions were implemented, nor specified how much they expect premiums would drop. Businesses need solutions that can be implemented on a timetable meaningful to their operations — they need solutions that take effect in months, not decades.

Government — and ultimately taxpayers — are bearing increased exposure to the gaps left by commercial coverage. Trends in the commercial insurance market, combined with the increased incidence of natural disasters, are likely to impose ever-greater risk on the NSW Treasury as the effective ‘insurer of last resort’ as more parts of the economy become uninsurable.

Unreasonably high insurance is a barrier to business, especially small business. It also serves to transfer risks to the taxpayer as, when businesses and individuals go uninsured, government is often obliged to step in to fill the gap.

Local Australian and NSW risk profiles have been moving further away from global reinsurers’ risk appetites for covers for decades. Climate change has made this more apparent in recent years, as have some government procurement policies and private sector practices.

Tapping local expertise and knowledge is part of the answer. Covers and funds, managed by those best placed to bring the most effective mitigation, resilience and recovery, should be brought to bear on a fast-rising mountain of uninsured risk in regions.

Many businesses lack understanding of insurance pricing. Businesses typically purchase liability and indemnity insurance at rates 150-300 times the average national claim, meaning many of them are paying high premiums they will not benefit from. This can stem from excessive requirements included in government tenders and procurement processes. However, it is also more commonly a case of the business itself or its insurance broker viewing maximal insurance coverage as being ‘best practice’, regardless of the cost or fit to a particular business’ circumstances.

Small business needs a clearer voice in the discussion. It cannot be left to the insurance industry and governments alone to stitch up a set of solutions. The needs of business customers must be represented in working groups aimed at resolving these problems.

The solutions proposed in this report intend to enhance insurance affordability and availability for NSW businesses, for them to remain viable and productive. They are:

Recommendation 1

Market audit

ASIC to audit the insurance market model to ensure brokers give at least two quotes and adhere to a minimum standard in explaining the pros and cons of the options.

Recommendation 2

Procurement alignment

NSW Government to audit procurement policy across agencies to confirm that insurance required by businesses is aligned and fit for purpose. As an example, $20 million PI and PL is currently required by most NSW vendors but may be excessive for some contracts. Guidance should align to the relevant maximum insurable event.

Recommendation 3

Insurance education

The NSW Government and Federal Government to co-fund a support and training program for business to uplift the level of education around risk management. Such a program would be similar to the currently funded energy education and selection support tools such as Energy Made Easy.

Recommendation 4

Reduce insurance taxes

Insurance taxes are higher in NSW than any other Australian jurisdiction. The NSW Government should immediately remove the Emergency Services Levy (ESL) and stamp duty tax from insurance premiums to make insurance more affordable for business and reduce risk to the business economy from operating without cover.

Recommendation 5

Include small business in the HIP

Include business and consumer representation in the funded Hazard Insurance Partnership (HIP) project to ensure that there is clear linkage between inputs (investment, policy development, etc) and outputs (premium reduction, affordability, coverage, resilience, etc). Ensure the premium reduction can be achieved in under three years. Prioritise HIP recommendations based on a benefit realisation model including criteria such as investment required, regulatory impact, measurable benefits to business, premium reduction.

Recommendation 6

Test the market for alternative products

Create market segment-specific workshops to determine customer and supplier interest/support for alternative products in the following three categories:

- Professional indemnification for specialised construction services.
- Public liability for NSW tourism activity-based businesses.
- Geographic solutions for bushfire/flood prone locations that cannot get traditional cover.

NSW Government to run an insurance innovation market testing procurement, where it will fund up to three proposed innovative product offerings that will achieve at least two of the following objectives:

- Reduce the government liability as insurer of last resort.
- Demonstrably reduce premiums.
- Offer alternative coverage where no coverage is offered (or is unaffordable to most of the market).

Recommendation 7

Develop alternative products to provide cover 'at the speed of business'

Establish a focused business/government project team to develop products based on alternative product features such as characterised by Discretionary Mutual Funds (DMF) and Parametric insurance to engage with industry. Develop an impact assessment of whether these alternative products provide adequate alternative cover for specific market segments under strain. Draft strawman Product Disclosure Statements (PDS) to allow for further interrogation of the business model. Work with industry to explore government policies to enable DMFs to form and flourish.

Recommendation 8

Learn from other markets

NSW Government to fund a study into coverage gaps in the NSW business market to ensure that the State's business economy is competitive. This would include a comparison to other markets and an assessment of the hurdles to overcome in NSW. Insurances such as product liability, transport, business continuity, workers compensation, public liability and professional indemnification could be included in the study. An example would be comparing the New Zealand PL market for activity-based businesses.

Recommendation 9

Create a culture of insurance innovation

Create a permanent insurance working group across the Australian Federal Government, States and Territories where innovations, market testing and policy alignment can be actioned. Focus on product innovation and premium reduction.

Introduction

The collective impact of natural disasters, the COVID-19 pandemic, geopolitical instabilities, litigation frequency, market capacity, disrupted supply chains and shortages of workers have battered businesses over the past few years. Adding to these strains is the rising cost of insurance premiums across all business sectors, and for some sectors the inability to secure insurance at all.

Insurance costs have consistently been raised by Business NSW members as a rising cost concern[2] and in November 2023 again reached the top position in our quarterly Business Conditions Survey (ahead of energy costs, taxes, wages, and loan repayments). We have examined what is driving this concern, and which business sectors and insurance products are most acutely affected. Building on these insights, this report explores the policy responses available to industry and government. We were keen to extend previous work and better understand the market appetite for alternative insurance products that already exist but are not widely used in NSW. We have assessed these options based on affordability, availability, suitability, and using our knowledge of international markets for insurance products and services.

The recommendations in this report are based on our findings from an analysis of survey responses gathered from Business NSW members and other NSW businesses supplemented by publicly available data.

In this study we have focused on the three major “foundation” insurance building blocks for business:[3]

- Public liability
- Professional indemnification
- Asset coverage (property, equipment, stock, fleet, material)

Any insurance discussion starts with an immediate focus on affordability and availability of coverage. While these remain important in this study, as well as the work of many other bodies, another lens through which to view the problem has emerged — the suitability of products for modern small business.[4]

We surveyed the features of less well-known products because we are concerned that common existing products do not adequately “work at the speed of business”. These concerns were echoed in a recent Insurance Council of Australia report, which described community feedback received by the insurance sector: *“The most consistent feedback from community forums was the desire for more frequent and clearer communication from insurers about the claims process, timeframes and the progress of their claims. In addition, customers expressed their desire for one claim manager throughout the process to avoid the need to tell their story to several claims managers”*[5]

We support and echo the contributions from the Australian Small Business and Family Enterprise Ombudsman (ASBFEO)[6] and the NSW Small Business Commissioner[7], who have made significant recommendations. We also recognise the ongoing work of the Insurance Council of Australia (ICA) to relieve some structural burdens on the insurance sector.

Tort reform, removal of excessive taxes and levies, procurement alignment, resilient infrastructure, and promotion of insurance alternatives can ease the unsustainable burden insurance has become for many businesses, particularly small business.

However, many of these proposed solutions will take years, if not decades, to implement. As a result, Business NSW is also calling for more urgent action requiring government, the insurance market and businesses to make investments in policy, preventative strategies, product development, strategies and innovations, and better educated buyers to restore a viable insurance market for small businesses and lead to a more resilient NSW economy. Unless these insurance challenges are addressed, NSW will become a less desirable place to do business and will see its global competitiveness decline.

Why business needs to be able to place risk elsewhere

Financial stability

Insurance helps stabilise the financial situation of individuals, families, and organisations. It accomplishes this task by indemnifying those who suffer loss or harm. Without insurance, individuals and families could become financially destitute and forced to seek assistance from relatives, friends, or the government. Businesses that incur significant uninsured losses may suffer major financial losses or even fail. Besides the loss in value of the owners' stake in the business due to an uninsured loss, the firm's future contribution to the economy is lost. Employees lose jobs, suppliers lose business, customers forgo the opportunity to buy from the firm, and government loses tax revenues. The stability provided by insurance encourages individuals and firms to create wealth with the assurance that their resources can be protected.

Facilitation of trade and commerce

Many products and services are produced and sold only if adequate insurance is available. Insurance coverage is a condition for engaging in some activities. Because of the high risk of new business failure, lenders often make funds available only if tangible assets and the entrepreneurs' lives are adequately insured. Entrepreneurs are more likely to create and expand their business ventures if they can secure adequate insurance protection. Insurance underpins much of the world's trade, commerce, and entrepreneurial activity. It is in these ways that insurance serves as "a lubricant of commerce." This fact is unsurprising. Modern economies are built on specialisation and its inherent productivity improvements. As commercial and business activity have become ever-more specialised, financial services sectors have responded by developing ever-more specialised offers. Without a wide insurance product choice and constant service and pricing innovations, insurance inadequacies could stifle both trade and commerce.

The role of brokers, insurers, reinsurers and others have evolved to create an environment in which businesses should be able to reduce the consequences of certain risks, and in doing so enable the business to grow, employ staff, and take advantage of opportunities. Despite changes in technology, communication and purchasing channels, the fundamentals and operation of today's business insurance product would be instantly recognisable by insurers from the time of Federation.

Less Competition, Rising Costs

The average Business NSW member is able to purchase professional indemnity, public liability and cover for business assets at a price accommodated within the business budget. Nevertheless, it would be a challenge to find a business that views the purchase of insurance as anything other than a grudge expense, an unwelcome but necessary business risk management activity.

Insurance has become one of the top two issues businesses identify when asked about cost drivers. This is a sentiment consistent with research that shows nearly three-quarters of small business owners are dissatisfied with, or are not loyal to, their insurance provider.[8] The Reserve Bank, in its November inflation update in its Statement on Monetary Policy, highlights that *"Insurance premiums have continued to increase significantly, reflecting higher expected claims (due to the effects of high inflation and weather events) and a reassessment of risk more broadly."*[9]

Only 19% of small business owners switch providers each year.[10] This suggests there could be significant rewards for insurers who are able to better meet the needs of small business owners. While it might require adopting entirely new business models, the potential gains are significant.

Furthermore, when specific segments are reviewed there are signs of a crisis of uninsurability emerging across the economy. The rate of annual premium rise in PI is highest in construction and professional

Recommendation 1

Market audit

ASIC to audit the insurance market model to ensure brokers give at least two quotes and adhere to a minimum standard in explaining the pros and cons of the options.

Figure 1: Percentage annual change in premiums since 2011, public liability and professional indemnity, selected sectors

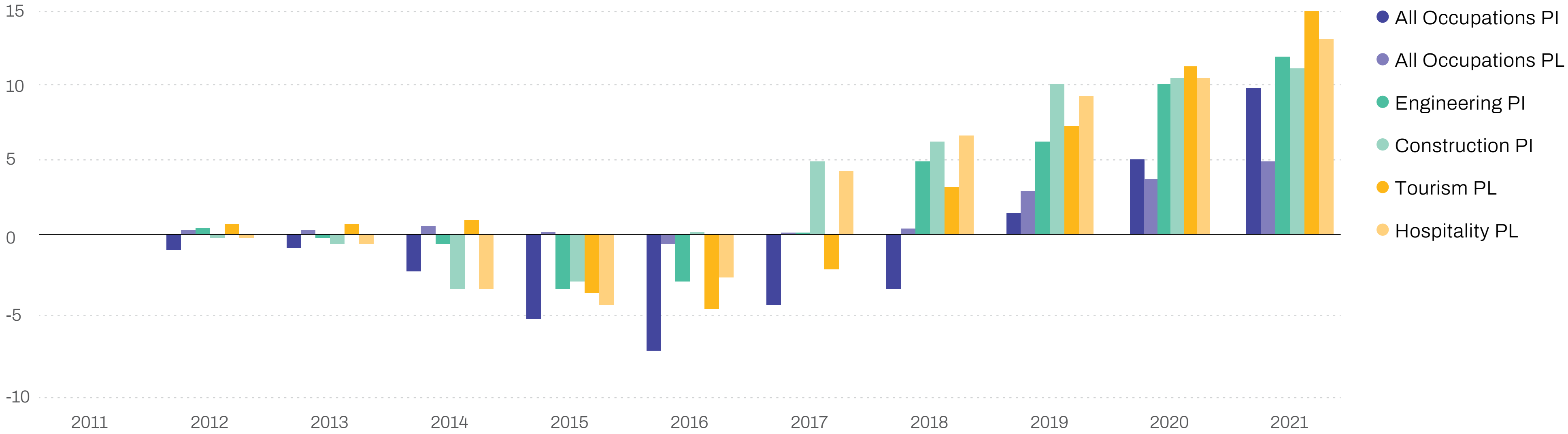
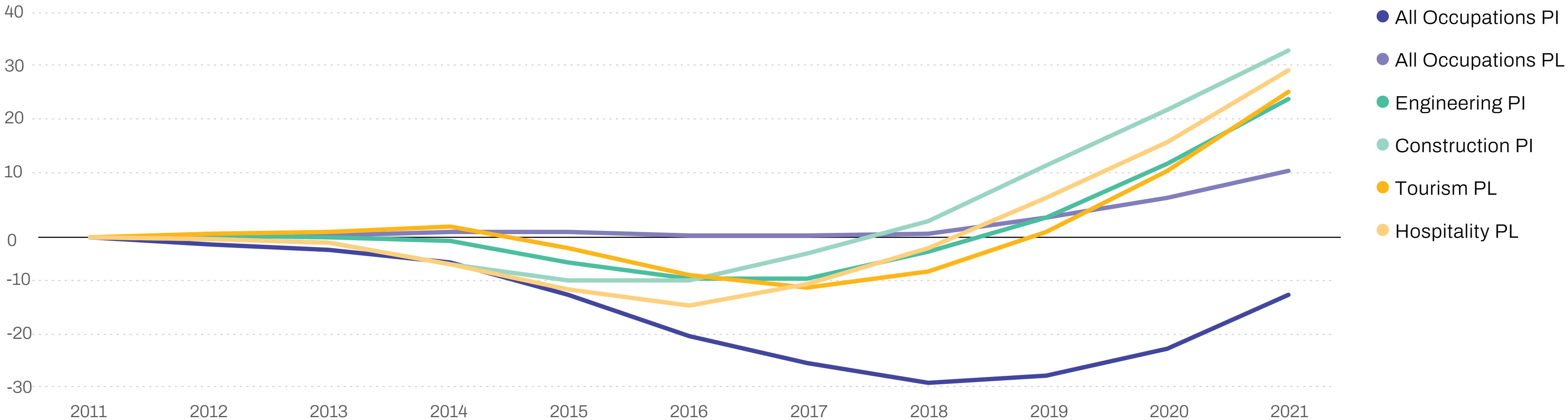


Figure 2: Cumulative percentage annual change in premiums since 2011, public liability and professional indemnity, selected sectors



Source: APRA NPCD Level 2 Data Sectors by Premium Indexed from 2011.

services (engineering). The rate of increase in PL is highest in tourism and hospitality classes, led by adventure and activity based businesses (Figures 1 and 2).

A further driver of rising costs for business insurance is that many businesses are drawn to over-insure their business, thanks to a combination of advice from their insurance brokers and inappropriate requirements from regulations at a state and national level.

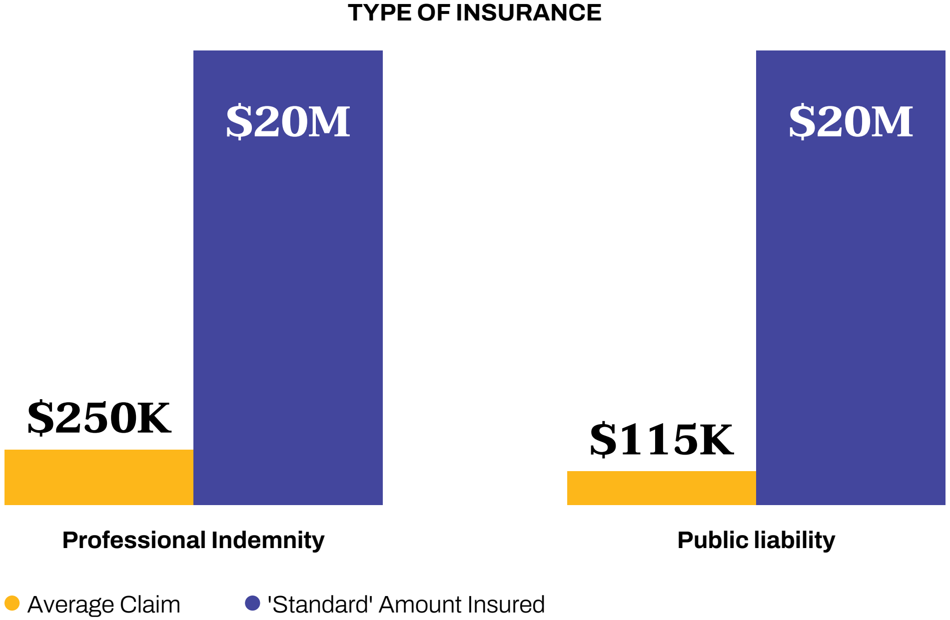
Most of respondents (80%) to our survey purchased $20 million or more of Professional Indemnity or Public Liability cover. The primary reason given for making a purchase of this amount was that it was "good practice" to do so, followed by receiving advice that this amount was appropriate. Based on APRA NPCD statistics the mean Professional Indemnity claim is $250,000 annually, and for Public Liability it is $115,000 (Figures 3 and 4).

The discrepancy between average amounts insured in the tens of millions of dollars, and the average actual amounts claimed, in the low hundreds of thousands of dollars, indicates that most businesses are buying excessive amounts of insurance. It suggests that they are doing so on the basis of intuitions about good practice or government requirements, rather than an informed assessment of their business's needs. In an economy where businesses are prominently flagging concerns about the cost of insurance, an easy remedy would be to improve policies and processes to make sure businesses are buying insurance commensurate to their needs.

Government procurement and regulatory requirements also drive businesses towards large, and often excessive amounts of coverage. It is a common stipulation of procurement processes that the applicant business have large ($10 or $20 million) in coverage, regardless of the nature of the project being procured. Governments (federal, state and local) should take greater steps to ensure that procurement eligibility requirements are tailored to the nature of the work being performed, and that high insurance requirements are not used when they are not needed.

Figure 3: Reason for the amount of liability cover

Figure 4: Average claim compared to 'standard' amount insured, public liability and professional indemnity



Source: Business NSW Survey Results 2023; NPCD Level 2 Data Sector Specific GCP by Claims average 2019-2021.

Recommendation 2

Procurement alignment

NSW Government to audit procurement policy across agencies to confirm that insurance required by businesses is aligned and fit for purpose. As an example, $20 million PI and PL is currently required by most NSW vendors but may be excessive for some contracts. Guidance should align to the relevant maximum insurable event.

Recommendation 3

Insurance education

The NSW Government and Federal Government to co-fund a support and training program for business to uplift the level of education around risk management. Such a program would be similar to the currently funded energy education and selection support tools such as Energy Made Easy.

Businesses often struggle with the probability calculations underpinning insurance, which also contributes to a marketplace in which customers often feel as if they should acquire far higher coverage amounts than they are likely to need. Respondents were asked to calculate an estimate of the insurance premium in a simplified model where there is a 5% chance of a $100,000 claim for damages from a flood event. The answer is 5% of $100,000 or $5,000. Less than 5% of respondents were able to correctly answer the question.

The overwhelming number of incorrect answers points to a difficulty or mismatch with expectations regarding a policyholder's financial literacy. Transparency of pricing should enable a policyholder to correlate the premium charged with the level of risk predicted. A rudimentary understanding of how risk is monetised by an insurer is therefore necessary, unless this information is presented clearly, to conclude if a premium being charged represents value — and is therefore 'affordable'.

Nevertheless, with most businesses sourcing insurance via a broker, or choosing an insurance product not on the basis of first principles analysis but via comparison of offers in the marketplace, better knowledge cannot solve the problem by itself. If a business learns that all the offers available to them are overpriced based on the arithmetic described above, what choice do they have?

Insurance providers and brokers should strive for much greater transparency of both existing and novel products, with probability-based examples given to potential customers to aid comprehension of the appropriateness of the product on offer.

"As part of a smaller market segment that provides specialist geotechnical consultancy, it is becoming increasingly difficult to deliver services as a sole trader, due to lack of competitive insurance providers and the litigious nature of the building industry. Furthermore, the insurance industry has blunt tools for assessing risk that blankets all risks into a high premium category. As PI premiums have quadrupled in the last 3 years, and reach 10% of operating budget, it will become increasingly difficult to pass these costs on to customers. We have evolving GIS technology that can assist in the risk assessment process, but the market has no clear path to reward innovation"

Phillip Davies
Geo Reports

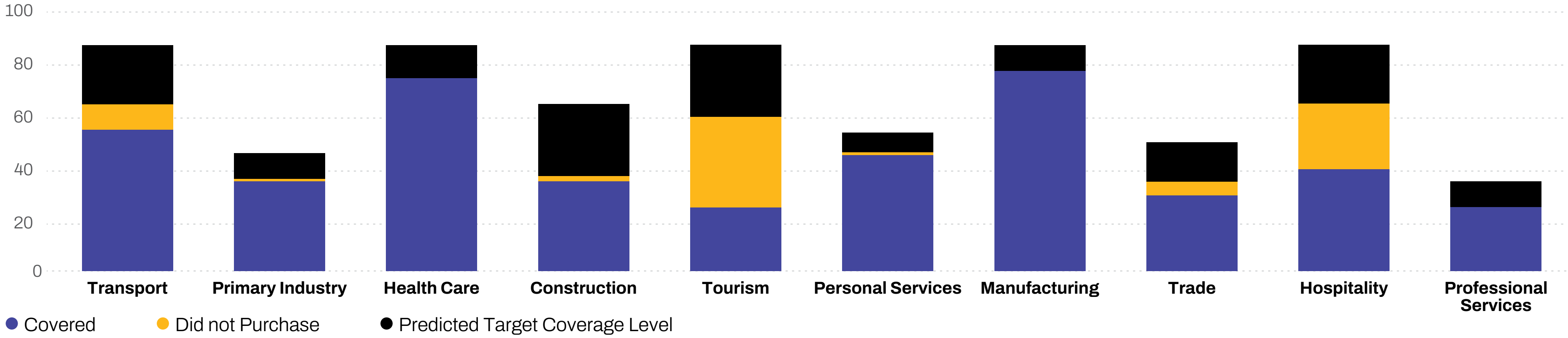
Sectors Facing Uninsurability

Estimating the number of 'uninsurable' businesses is a challenge involving agreement on a number of key terms, an exercise never successfully undertaken by industry and government in the past. However, the Business NSW survey has indicated non-insurance in certain business sectors, albeit without being able to attribute the reason for the non-coverage. Uninsurability occurs where insurers decline to offer cover to specific businesses, or offer combinations of premiums, deductibles and exclusions that businesses are not willing, or are not able to accept. This means that even cases where insurance is notionally available may be considered practically uninsurable if it is offered at a prohibitive price point, or requires the buyer to accept exclusions or deductables that make the product not viable.

Sectors facing the threat of uninsurability vary widely in their role in the economy, the type of insurance which is no longer available, and the consequences of going uninsured on business owners and customers.

The outdoor recreation sector was the focus of work led by the ASFBEO, along with its peak body AALARA (Australian Amusement Leisure & Recreation Association). It has faced a severe deterioration in access to public liability insurance (Figure 5), and for many sites asset insurance. The chart depicts the differential between the expected level of insurance for each sector based on industry benchmarks (black) compared to the actual level of insurance observed by Business NSW in its survey

Figure 5: Public Liability Coverage by Sector, compared to Predicted Target Coverage Level



Source: Business NSW Insurance Survey, benchmarked against Australian Prudential Regulation Authority, NPCD Level 2 Data.

(blue). The yellow bars indicate businesses who considered purchasing coverage but ultimately chose not to, contributing to the overall level of uninsurability. In the tourism sector we observe a 63% ‘uninsurability gap’ (i.e. there is a difference of 63% of businesses between those who are currently covered and the expected industry benchmark for coverage). In hospitality the uninsurability gap is 48%, and for transport businesses 33%.

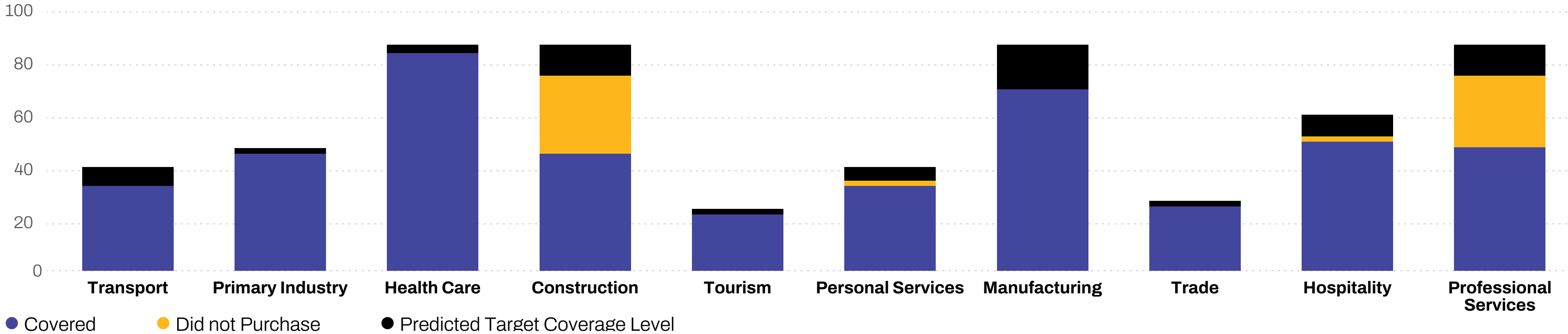
The ASFBEO’s report concluded that, *“a hardening global insurance market has meant that many small and family businesses in the amusement, leisure and recreation sector cannot get the essential insurance coverage they need to operate their business. With only one insurer willing to provide coverage to these businesses, insurance premiums have skyrocketed — often by more than 200% — and many businesses have been refused coverage outright. Others have stranded assets, with just some of their equipment securing insurance coverage. These business face imminent closure if they cannot get insurance”.*[11]

Building surveyors and other consultants associated with construction and engineering have also faced an insurability crisis, in their case in relation to Professional Indemnity insurance (see Figure 6). The professional indemnity uninsurability gap we observe is 42% for construction businesses and 39% for professional services businesses.

Not only have premiums skyrocketed and product availability decreased in the wake of the Opal Tower and Mascot Towers scandals, these businesses are also faced with requirements to remain insured for 7 years following the completion of an item of work, which can place burdens even after retirement or the sale of the business and exit from the sector.

Businesses in regional NSW of all types face increasing challenges in asset coverage if they are located in flood or bushfire risk areas. As threats from natural disasters grow due to the effects of climate change, insurability pressures on regional businesses will increase. These pressures on premium costs are exacerbated by the inflexible payout model which largely requires ‘building back as before’. Businesses

Figure 6: Professional Indemnity Coverage by Sector, compared to Predicted Target Coverage Level



Source: Business NSW Insurance Survey, benchmarked against Australian Prudential Regulation Authority, NPCD Level 2 Data that have faced a natural disaster and received a payout are commonly obligated to put themselves back in harm's way, rather than being given the flexibility to decide for themselves and their business what the most appropriate and resilient way to rebuild would be. The ICA recognises this consideration in its latest Insurance Catastrophe Resilience report: *"Customers, particularly those who had been impacted by flood more than once, were keen for greater choice or control around the rebuild process, with particular interest in building back 'like for right' rather than 'like for like' to better protect their property in the future."*[12]

Many businesses in critical market segments are facing the following realities:

- The business is uninsurable and cannot obtain an offer of insurance.
- Insurance premiums offered are unaffordable.
- Insurance coverage offered excludes critical risks, such as flood or bushfire.
- The insurance product does not reward business risk prevention practices, meaning the business has no meaningful ability to lower the premiums it faces.
- The claims process is slow and impedes business recovery.
- The claims process is inflexible, and 'payouts' come in a form no longer suited to the business.

Approximately 20% of businesses have indicated that they do not hold a policy for certain risks where it can be inferred from the business type that the risk exists, and coverage would normally be expected to be held (for example, asset coverage, PI or PL). This result is not inconsistent with the insurance industry's own estimate of 13% non-insurance in the sector.[13]

Some of the reasons for a business not taking up adequate insurance go beyond affordability and availability. The results of a survey conducted by QBE, one of the largest commercial insurers in the region, revealed that many small businesses have a low level of understanding about the need, role and operation of liability insurance covers:[14]

62%
are unlikely to have the right insurance.

60%
admitted to having little understanding of liability cover.

52%
were uncertain about different types of insurance.

52%
were not concerned about liability claims being lodged against them.

"

Without government intervention to cap liabilities, we are increasingly exposed to ambit claims and the reluctance of the insurance industry to provide adequate cover at a reasonable price. As a business focused on safety we work hard to ensure our rides are safe, however the government must ensure that its policies do not make it impossible for the insurance industry to support us"

Matt George
Jamberoo

Key Statistics

Key observations based on the BNSW Insurance survey results (n=745) and publicly available data:[15]

Non-insurance:

- One fifth of respondents do not insure business assets or liabilities.
- The same proportion reported not being offered flood insurance.
- Of those who were offered flood insurance, 14% declined due to cost.
- Certain high-risk businesses report not being able to secure asset insurance at rates less than 10% of the asset value and with deductibles of 2-5%, if at all.

Professional indemnity:

- Average national annual premium increase for all sectors is 12.5%.[16]
- Average of 1.9% of PI policyholders nationally make a claim on their policy.[17]
- Average of 3% of Business NSW survey respondents made a PI claim annually.[18]
- Respondents in professional services and construction had average premium increases of 29%.
- Professional indemnity for engineers and building certifiers is increasingly unavailable, and shrinking in coverage, faster than all other classes, confirming studies undertaken for the Building Ministers Forum.[19]
- 80% of businesses surveyed hold $20 million or more PI coverage, 80 times the average claim.
  - 45% indicated the reason for purchase was ‘good practice’.
  - 25% purchased this amount following professional advice.
  - 10% purchased this amount due to license or contract requirements.
- Average national claim value for PI claims is $250,000.[20]
- 69% of respondents made a purchase through a broker.
- 66% of respondents obtained two quotes or less before purchasing.

Public liability:

- Average annual premium increase, all sectors 8%.[21]
- Average of 1.1% of PL policyholders nationally make a claim on their policy.[22]
- Average of 2.3% of survey respondents made a PL claim annually.[23]
- Respondents in tourism, activity experiencing average premium increase of 30%.
- Activity based businesses increasingly unable to find cover.[24]
- 65% of businesses surveyed hold $20 million or more PL coverage, 173 times the average claim.
  - 45% indicated the reason for purchase was 'good practice'.
  - 25% purchased this amount following professional advice.
  - 30% purchased this amount due to license or contract requirements.
- Average claim value for PL claims is $115,000.[25]
- 70% of respondents made a purchase through a broker.
- 69% of respondents obtained two quotes or less before purchasing.

Risk literacy:

90% of business respondents were unable to approximate a premium, given the probability of an event and cost of damage.

Priority needs in business insurance:

Pinpoint underwriting:

- Pricing according to risks measured at business level, not industry level.
- Transparency of premium at business-level, allowing a detailed understanding of dollar premium allocation to specific risks.
- Options for low sums-insured, not default amounts.

Rapid claim outcomes:

- 65% prefer cash settlement, paid within seven days, with the business empowered to organise its own repairs using its own choice of trades and suppliers.

Mitigation incentives:

The majority of businesses believe that business-level risk reduction efforts should be recognised with premium reductions reflecting the mitigation effort.

"While insurance cover for businesses and residents in flood areas in NSW has been in the news of late, NSW businesses including tourism assets operating near bushfire risk are facing the very real prospect of, or already are, operating without adequate property cover. The onflow risk that commercial banking services may be withdrawn or not extended has major consequences for businesses to operate and grow. The government and industry must cover these current gaps to ensure the long-term viability of business operations near bushfire zones business trying to navigate back to health post-COVID."

Anthea Hammon
Managing Director, Scenic World

Policy Responses

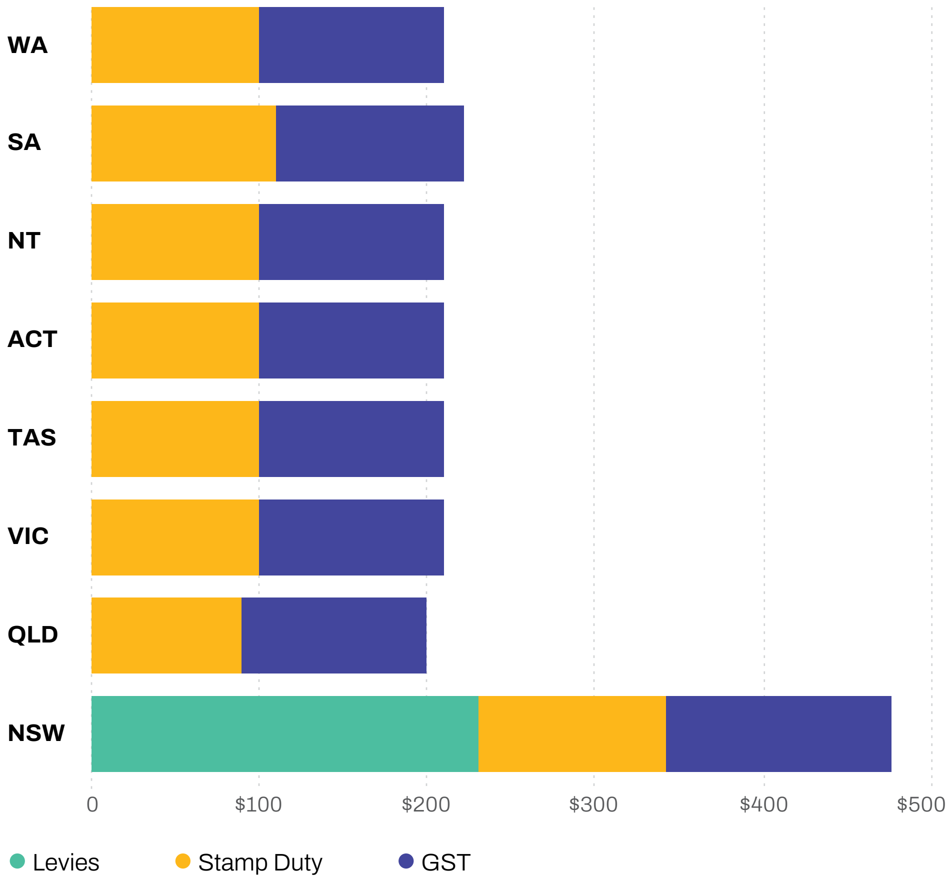
The Business NSW survey emphasises what has already been identified by specific business sectors: Insurance coverage is increasingly unavailable, and where it is available it has become unaffordable.

Business NSW is a strong supporter of the long-term policy objectives being pursued by the insurance industry and government.

Taxes and duties on insurance products are an acute issue in NSW compared to other states that enacted reform more than a decade ago. Those reforms reduced the cost of business insurance. NSW has come close to reform in the past, but ultimately has failed to take the step to reduce what is a significant cost to businesses. Insurance taxes remain higher in NSW than any other state or territory (Figure 7).

Risk reduction activity and measures that shift the cost of claims from insurers to taxpayers will assist in the longer term to lower premiums. What is clear is that many of the recommendations will take years to eventuate. New infrastructure takes time and resourcing. The approach of building up infrastructure to address flood risk, in particular, has been highly contentious in NSW in recent years. Master planning townships away from high-risk areas will take decades to realise.

Figure 7: Government Revenue per $1000 premium for business



Source: State Revenue Agencies Stamp Duty Rate; Chubb NSW Insurance Levy rate (lowest of four published)

Recommendation 4

Reduce insurance taxes

Insurance taxes are higher in NSW than any other Australian jurisdiction. The NSW Government should immediately remove the Emergency Services Levy (ESL) and stamp duty tax from insurance premiums to make insurance more affordable for business and reduce risk to the business economy from operating without cover.

Such slow-moving reforms offer cold comfort to businesses facing insurance premium rises, or uninsurability, that will lead to them ceasing to operate long before any improvements are realised. Government also stands to lose out, as the status quo implies ongoing risk transfer to the government balance-sheet and ultimately the taxpayers of NSW.

Emergency Services Levy

For years Business NSW has been calling for the removal of the Emergency Services Levy (ESL) and stamp duty tax from insurance premiums through numerous submissions and public appearances.[26] Removing these costs will make insurance more affordable for business and reduce the chances of business operating without cover. BNSW is encouraged by the announcement on 16th of November 2023 that the NSW Government will seek to undertake reforms of the ESL, creating a state-wide contribution for funding emergency services in NSW. This will bring NSW to be in line with every other mainland state. BNSW will work with the Government and members to ensure that the reformed system is designed equitably.

Taxing insurance makes it less affordable. With governments concerned about their role as the effective insurer of last resort, tax policies that reduce businesses' propensity to take up insurance coverage are deeply counterproductive.

Last resort

Without changes, governments' positions as the insurers of last resort will continue to grow. There are a number of reasons to be concerned about this development. It places an additional burden on taxpayers which will ultimately be borne, at least in part, by taxes on businesses. It raises serious questions about fairness. Taxpayers in safer parts of Australia may begin to question why they are subsidising insurance for those in riskier places. It can act as an implicit subsidy, having the perverse effect of making people more likely to live and conduct business in riskier locations and activities than they otherwise would have done, while failing to incentivise activities that reduce risk exposure. Finally, it is not as if government-led services are renowned for their speed of operation or customer service focus, which may end up replicating the challenges businesses already encounter with a slow-moving and stubborn insurance sector behind a government nameplate.

Governments' status as the inevitable insurers of last resort can focus their attention, particularly when it comes to preparing resilient infrastructure and aligning decisions in spheres such as land use planning with outcomes that reduce exposure. Lawmakers also control civil liability. Where insurance costs are driven significantly by torts, such as the examples cited in this report of public liability and professional indemnity costs, legislators have a handbrake they could pull if they desired. Tort reform is a complex topic, and there is not space to address it fully in this report, but it will need to be part of a rounded conversation about the future of insurance costs.

However, there is an important distinction between reducing the costs associated with insurable risks, and reducing the risks themselves. Interventions which simply conceal the true nature of risk — and the cost associated with it — from those who bear it are unlikely to prove sustainable.

Governments have the ability to direct vital long-term reforms — and some sensible ones have been proposed including by the insurance sector. But business requires more immediate options for risk sharing, preferably options that include features not currently or commonly available in the Australian business insurance market. A remodelled insurance product could deliver the key features prioritised by small business and alleviate the pressure being placed on the public purse.

The insurance industry has recommended a set of solutions in its contributions to government inquiries, identifying the external factors that force premiums increasingly higher, and advocating consistently for government-led solutions. The common themes advanced have been:

1. Increase resilience of the built environment through mitigation and building codes.
2. Improve building standards and practices to reduce liabilities borne by the insurance sector.
3. Remove taxation and duties on insurance products.
4. Intervention in key insurance markets to transfer losses to the government balance sheet.
5. Protect policyholders from unregulated foreign insurers in Australia.

These themes remain sensible and supportable; however, they will be slow to take effect. There has been little to no analysis of the quantifiable reduction in insurance premiums that these initiatives will achieve, and they will have little effect on small business whose futures will be decided in upcoming weeks and months, not years. With no evidence that premium reductions will eventuate, and increased availability of product expected only after 5 – 10 years, they are likely in practice to maintain the market status quo rather than driving serious improvement for small business. **NSW businesses need more immediate solutions**.

State governments and the Commonwealth have announced funding for a range of measures to improve insurability, including the Hazards Insurance Partnership (HIP) managed by the National Emergency Management Agency, the creation of a national dataset on insurance issues, mitigation solutions repository and scoping out key opportunities for public-private partnerships. Largely missing from this work, though, is significant outreach and engagement with the small business sectors facing the most acute insurance challenges. We urge both federal and state governments to engage with business groups that represent small businesses to develop targeted national responses for specific market segments that are in dire need of action. These include activity-based tourism operators, businesses operating in flood prone areas, and professional services related to construction, to name a few.

Recommendation 5

Include small business in the HIP

Include business and consumer representation in the funded Hazard Insurance Partnership (HIP) project to ensure that there is clear linkage between inputs (investment, policy development, etc) and outputs (premium reduction, affordability, coverage, resilience, etc). Ensure the premium reduction can be achieved in under three years. Prioritise HIP recommendations based on a benefit realisation model including criteria such as investment required, regulatory impact, measurable benefits to business, and premium reduction.

"The insurance market was already tight. The new legislation has made the situation dire as the remaining insurers are likely to leave the industry... This trend will likely make our market unviable, increase difficulty to attract staff, increase personal liability and create potential industry fallout as the risks of doing business become too great. Small businesses like ours are getting squeezed between consumer protection legislation, insurance industry appetite for risk, bad building practices and a litigious/confrontational mindset of government and contractors."

Chris Salz
Apex Diagnostics

A Market Solution?

Respondents to the Business NSW insurance survey were asked to select their most wanted characteristics from an insurance product. The features of insurance products most requested by respondents were:

01

Cash settlement. Nearly two-thirds of respondents would prefer to manage their own recovery with funding made available from their alternative risk cover.

02

Seven-day completion. Measured from verification of claim to payment.

03

Trigger Based Payment. Simple third-party verified trigger-based payment of claim for weather events.

04

Transparency of costs / fees.

05

Individual pricing. Provider assesses individual risks of applicant, rather than applying an industry or location based average premium.

06

Strict entry requirements for new members. Exclusion of poor risks.

07

Educational support to lower risks, reduce claims, reduce future risk product costs.

Alternative insurance product types

Discretionary Mutual Funds (DMF)

The concept of the DMF dates back to some of the earliest established insurance markets in the UK in the 17th Century.

Discretionary Mutual Funds (also known as Discretionary Risk Mutuals, DRMs) are actively managed mutual funds, which offer discretionary cover to a group of businesses, usually with similar circumstances.

Discretionary cover describes insurance-like products involving no contractual obligation by the provider to meet the costs if a risk eventuates. At its discretion, the provider will consider meeting such costs. DMFs provide alternative means of risk management, sometimes applied to risks for which commercial insurance may not be available or affordable.

With the management of a DMF usually comprised of its members, it still has an incentive to pay out for reasonable claims despite its discretionary nature. However, it also has features that regular insurance lacks, such as the ability to incentivise members who have taken 'best practice' actions to reduce their risk exposure. The sense of solidarity and mutual obligation created by being part of a like-minded community is as significant — arguably more so — to the effectiveness of the DMF model as the raw economics of its premium-payout ratios. For this reason the most effective DMFs draw membership from a wide enough pool to have diversified risks, but a narrow enough pool that membership nurtures prudent conduct.[27]

DMFs are not currently subject to the full range of financial prudential regulation that applies to conventional insurance.

The Australian Small Business and Family Enterprise Ombudsman endorsed DMFs as a solution for otherwise uninsurable businesses in the amusement, leisure and recreation sector.[28] There are DMFs currently in operation in Australia serving groups from McDonald's restaurant franchisees to Virgin Australia pilots. The Business Council of Co-operatives and Mutuals (BCCM) has published a guide for mutuals on good practice for running a DMF.[29]

Examples of overseas Discretionary Mutual Funds

The Military Mutual
The Military Mutual is a British mutual society offering discretionary and non-discretionary cover services to its members, targeted to serving, veterans, families and supporters of the armed forces. The Mutual's directors have the power to approve claims that aren't normally covered if they decide that the circumstances justify them doing so.[30]

Benenden Health
Initially established to support postal workers affected by tuberculosis (TB) at the start of the 20th Century, Benenden now operates as a not-for-profit health insurer in the UK. Benenden offers a mixture of conventional insurance (travel and home insurance) and discretionary cover (all healthcare services except treatment for TB, which is insured). Benenden today has over 840,000 members.

Parametric insurance

In contrast to DMFs, where the discretionary nature of the product is the key feature, parametric insurance operates against very clearly pre-specified benchmarks (parameters) to determine when a payout is due.

In contrast to standard insurance, parametric insurance takes no account of the amount of damage incurred, and simply assesses whether the type of event insured against has occurred. This enables faster payouts (as no damage assessment needs to be carried out) and minimises disputes between insurer and insured. Allowing a business to be operational almost immediately may allow them to better recoup their losses.

However, one of the limitations of parametric insurance is the risk of the insurance coverage not matching the actual loss incurred. If damage is incurred during an event that does not reach the pre-determined trigger or threshold, or has a different cause to that specified in the parameters, the insured party would not receive a payout.

Parametric insurance however, is typically designed to complement traditional insurance models, and not to replace them[31], for policy holders aiming to reduce their risk exposure and bridge the gap between insurable and uninsurable risks.

Examples of parametric insurance

Lockton Australia

Lockton Australia launched in 2023 Australia's first parametric insurance for future pandemics, aiming to protect businesses and industries from financial crisis. As Lockton stated, *"No pandemic insurance protection being available during COVID-19 meant that the travel and tourism industry was at the mercy of government handouts, while consumers were afforded refunds and compensated."*[32] The parameter is met whenever the World Health Organization (WHO) declares a pandemic in future.

FloodFlash

FloodFlash was established in the wake of Hurricane Sandy which flooded New York City in 2012. Its founders created the product to insure the New York Metropolitan Transport Authority (MTA) on the parameter that, if water rose above a certain depth in the New York harbour, the cover would pay the MTA $200 million. FloodFlash was created to expand this business model to offer parametric flood coverage to smaller businesses in the US and UK.[33]

Pop Storm

Swiss Re created Pop Storm to provide hurricane coverage to SMEs in the USA. The parametric trigger is based on the independently reported wind speed at a point within less than half a mile of the insured's location. When the wind speed exceeds a set parameter, the customer gets a payout within 30 days. Payout funds can be used flexibly (i.e. property replacement, repair costs, business expenses, lost revenue, and other immediate economic needs). However, unlike some parametric products, in this case proof of some loss by the insured business is required.[34]

Our member and market research has concluded there is an urgent need to respond to the new realities of the insurance marketplace, and the desires of businesses outlined above, by developing:

- Alternative products (such as DMFs and parametric insurance) that can provide meaningful coverage for NSW businesses, while only requiring minimal changes in legislation.
- Product coverage that can move at the speed of business empowering businesses to adapt quickly to new realities based on immediate cash settlement rather than a protracted claims process.
- Acceleration of education around risk mitigation and public liability both within government procurement but also in the broader business community.
- A review of capped insurance schemes that limit exposure for insurers while being internationally competitive.
- Promotion of premium reductions explicitly tied to preventative best practise and/or government investment.
- Transparency of product to ensure complete visibility between premiums paid and coverage received.
- A low cost, minimum sum-insured, indemnity product that provides liability and indemnity for 20 times the national average claim value. Businesses that wish to hold more can make a purchase from traditional market participants.

Recommendation 6

Test the market for alternative products

Create market segment-specific workshops to determine customer and supplier interest/support for alternative products in the following three categories:

- Professional indemnification for specialised construction services.
- Public liability for NSW tourism activity-based businesses.
- Geographic solutions for bushfire/flood prone locations that cannot get traditional cover.

NSW Government to run an insurance innovation market testing procurement, where government will fund up to three proposed innovative product offerings that will achieve at least two of the following objectives:

- Reduce the government liability as insurer of last resort.
- Demonstrably reduce premiums.
- Offer alternative coverage where no coverage is offered (or is unaffordable to most of the market).

Recommendation 7

Develop alternative products to provide cover ‘at the speed of business’

Establish a focused business/government project team to explore expanded opportunities to use alternative product features such as Discretionary Mutual Funds (DMF) and Parametric insurance, in collaboration with industry and the mutuals sector. Develop an impact assessment of whether these alternative products provide adequate alternative cover for specific market segments under strain. Work with industry to explore government policies to enable DMFs to form and flourish.

Recommendation 8

Learn from other markets

NSW Government to fund a study into coverage gaps in the NSW business market to ensure that the State’s business economy is competitive. This would include a comparison to other markets and an assessment of the hurdles to overcome in NSW. Insurances such as product liability, transport, business continuity, workers compensation, public liability and professional indemnification could be included in the study. An example would be comparing the New Zealand PL market for activity-based businesses.

Recommendation 9

Create a culture of insurance innovation

Create a permanent insurance working group across the Australian Federal Government, States and Territories where innovations, market testing and policy alignment can be actioned. Focus on product innovation and premium reduction.

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Business NSW wishes to acknowledge the contributions to this report of Karl Sullivan. We also thank the hundreds of members who responded to our survey. This report strived to tell their stories.

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