NSW GOVERNMENT | Small Business Commissioner

Small business insurance: contemporary challenges and experiences

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Contents

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List of recommendations

Recommendation 1 – Establish an insurance coordination function

An insurance coordination function should be established within the NSW Government. The function would be responsible for:

- Working with other agencies to resolve known impediments, including those identified in this report, as well as other emerging issues.
- Assisting agencies to better understand the impact of policy decisions on the insurance market and small business.
- Determining the feasibility of approaches recommended in previous reviews into insurance as well as international approaches, including those referenced in this report (where they relate to NSW Government responsibilities).
- Reviewing NSW Government policies (such as tax, procurement, regulation and planning) to monitor and assess their impact on small business insurance outcomes.
- Acting as a conduit between the NSW Government and other tiers of government, the insurance industry and small business stakeholders on insurance-related matters.

Recommendation 2 – NSW Government leadership and advocacy

Supported by the new insurance coordination function, the NSW Government should play a proactive role in advancing the interests of small business and industry with respect to insurance. This includes:

- Targeted action with the Australian Government and other jurisdictions to ensure the suitability of national policy settings (including through national meetings of Ministers).
- Engaging with the local government sector to ensure appropriate policy settings (including procurement policies and planning).
- Seeking cooperation and collaboration with the insurance sector to improve outcomes where small business needs are not being met.

Recommendation 3 – Facilitation of insurance alternatives

Supported by the new insurance coordination function, the NSW Government should have mechanisms in place to assist industry or other stakeholders to examine measures to improve the affordability and sustainability of insurance, including insurance alternatives. These mechanisms should coordinate within government (including local government where appropriate) to consider policy changes that may be required.

Recommendation 4 – Reduce taxes and levies on insurance

The NSW Government should look to reduce taxes and levies on insurance, with revenue foregone replaced with more efficient sources.

In the absence of more comprehensive reform, small businesses should be assisted with the cost of insurance through the provision of relief from NSW Government taxes and levies on insurance.

Recommendation 5 – Expanding insurance duty exemption

The NSW Government should expand the scope of policies where there is an exemption for small business on insurance duties.

Recommendation 6 – Encouraging insurance uptake

Further investigation should be undertaken to identify particularly price sensitive segments for the purposes of targeting relief.

To identify suitable segments and cohorts for any tax relief (or alternatives), behavioural insights should be leveraged to identify particular instances where small businesses are particularly price sensitive. This could include examining areas where financial relief in the first year could encourage insurance uptake of a new type of insurance they did not previously hold or instances where small businesses tend to hold policies that leave them underinsured as a strategy to reduce their premium costs.

Recommendation 7 – Commercial property insurance database

The NSW Government should work with the insurance industry and other tiers of government to explore potential options to establish a commercial property insurance database.

Recommendation 8 – National project to ensure appropriate protections

The NSW Government should work with other jurisdictions to establish a national project to consider the appropriateness of current consumer policy settings as they relate to small business insurance.

The next Australian Consumer Survey should make specific provisions to track business and consumer experiences relating to insurance markets.

Recommendation 9 – Business support service opportunities

The NSW Government should consider what additional support services could be offered to assist small businesses when purchasing insurance. This should include consideration of training, guidance and fact sheets, and digital tools.

Recommendation 10 – National review of tort law

The NSW Government should work with other jurisdictions to initiate a national review of tort law.

Recommendation 11 – Procurement policies and guidance

The NSW Government should provide greater clarity to government buyers on what insurance requirements are appropriate and proportionate to risk. Additional guidance should be published with agencies actively encouraged to reduce insurance requirements for small business. Cultural barriers, including excessive risk aversion, should be considered.

Recommendation 12 – Prequalification insurance requirements

The NSW Government should enable small businesses to be considered as a supplier on the condition that they obtain insurance prior to commencing work.

Introduction

Insurance is essential for most small businesses which require one or more types of insurance. Small businesses will often seek insurance to mitigate litigation risk, protect assets and manage other commercial risk exposures. Small businesses may also be legislatively required to hold insurance and may be required when supplying to government or other third parties.

The NSW Small Business Commission (the Commission) has both heard and received representations from small businesses reporting increasing challenges obtaining insurance that is affordable and meets their commercial needs. These challenges have also been observed by others examining the experiences of small businesses within insurance markets. Contemporary market conditions, during which it has become relatively more difficult to obtain insurance, is described by the insurance sector as a 'hardening market'. Partly driven by changes to the competitive landscape and the availability of products, the insurance sector has also reported that price and availability have been affected by repricing of risk, reduced market options, increasing costs from natural disasters, and increasing costs for liability and indemnity claims.

The purpose of this report is to summarise the challenges and experiences of small businesses engaging in the insurance market and to identify potential opportunities to improve outcomes. The report:

- Summarises the recent experiences of small businesses engaging in insurance markets.
- Considers previous research into insurance in Australia as well as international responses.
- Provides an overview of the regulatory environment and the role of government.
- Identifies potential opportunities for the NSW Government to improve outcomes for small businesses.

Challenges relating to insurance are not unique to NSW and are experienced nationally with some factors reflecting conditions in global insurance markets. Despite this, the Commission observes opportunities for the NSW Government to improve insurance coverage and affordability for small businesses in NSW.

A key recommendation of this report is to assign and prioritise an insurance coordination function within the NSW Government. This recommendation is crucial to driving a NSW Government policy agenda with respect to small business insurance (including the recommendations of this report).

While the Commission's recommendations will not wholly address the challenges experienced by small business, they are offered as important "first step" measures to improve insurance affordability, sustainability and coverage.

About the Commission

The Commission provides strategic advice, advocacy and affordable dispute resolution services to small businesses in NSW. The Commission's role includes:

- Encouraging government agencies and larger businesses to enter productive working relationships with small businesses.
- Facilitating and encouraging the fair treatment of small businesses.
- Promoting a fair operating environment in which small businesses can flourish.

In addition, the *Small Business Commissioner Act 2013* provides that it is a function of the Commissioner to advise the Minister, either at the Commissioner's own initiative or at the request of the Minister, on any matter affecting small businesses or that is relevant to the Commissioner's objectives or functions.

Terms of reference

In March 2022, the Commissioner initiated a review to examine the contemporary challenges and experiences of NSW small businesses in obtaining suitable insurance.

Insurance was identified as an area of focus due to increasing evidence and feedback from small businesses indicating that insurance is becoming less affordable and accessible.

As part of the review, the Commission:

- Reviewed previous research into the experiences of small businesses in obtaining insurance, and summarised key issues and challenges reported by small business stakeholders.
- Identified specific challenges encountered by small businesses operating in disaster-affected locations.
- Identified opportunities for the NSW Government to improve outcomes for small businesses.

The Commission made recommendations and consulted with small businesses and other stakeholders.

Contemporary challenges in the insurance market

Australia is currently experiencing what has been described as a ‘hardening’ insurance market. Reported factors driving the ‘hardening’ market include price correction, reduced insurance options, and increasing costs associated with natural disaster insurance and liability and indemnity insurance. In 2018 the Commonwealth Productivity Commission (PC) found that general insurance markets were concentrated and that this trend had increased due to consolidation activity.[1]

For small businesses, the impact of this is that insurance is becoming increasingly unavailable or unaffordable. Key insurance products that are becoming increasing unavailable or unaffordable includes public liability, professional indemnity, natural disaster insurance, directors and officers and management liability, and property insurance.[2] While not all businesses are impacted, these challenges have profound impacts for those affected. Acute industry affordability and accessibility challenges include:

- Public liability for tourism, amusement, leisure and recreational, and some business sectors.
- Professional indemnity for financial advisors and building industry.
- Property insurance in building construction.[3]

Insurance can also be unavailable or unaffordable for small businesses in specific locations. For example, due to the likelihood of risk, flood insurance is very expensive in areas where floods occur, leading to significant underinsurance in the areas that most need it.[4]

Small businesses face additional challenges within the insurance market, including where they operate in higher risk, regional and remote locations or in smaller industry sectors. It can sometimes be difficult for underwriters to fully assess conditions in these sectors and due to the smaller size of these markets there may be only a single or small number of insurers. Small businesses also typically have lower access to resources to identify, negotiate and pay for effective insurance cover, making them more vulnerable to access or affordability changes.

A Commission survey of around 5,500 small businesses indicates that more than one in four small businesses are dissatisfied with the availability and affordability of insurance needed in their business (Chart 1 refers).

While anecdotal feedback to the Commission suggests many small businesses are experiencing acute challenges, not all small businesses are affected with around one in four businesses indicating they are satisfied with their insurance and a further two in four being neither satisfied nor dissatisfied. The focus of this report is on the experiences of the sizable minority of small businesses that report difficulties.

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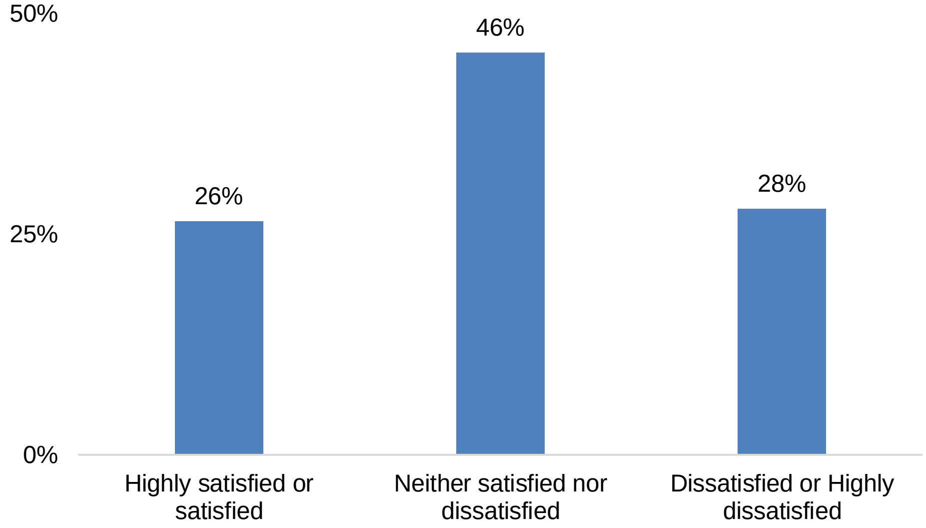
[1] PC, 2018, ‘Competition in the Australian Financial System’, p. 46.

[2] ICA, 2021, ‘Role of the Private Insurance Market’, p. 6.

[3] ICA, 2021, ‘Role of the Private Insurance Market’, p. 6.

[4] The Treasury, 2011, ‘Natural Disaster Insurance Review’, p. 22.

Chart 1 – Small business satisfaction with insurance



Source: Small Business Commission Survey (conducted in June 2021, July 2021 and March 2022)

Insurance overview

Insurance enables individuals and businesses to transfer risk to insurers, who pool and manage risks to provide protection to policy holders and achieve profits. Purchases of insurance identify risks they are required to insure, including for regulatory or market reasons, considering both the likelihood and consequence of a risk occurring. Providers of insurance assess the types of risks they are willing to underwrite, and premiums are paid based on the insurer's assessment. Insurers pool the premiums and spread risks across locations and types to provide funds for paying insurance claims. Insurers can also seek out reinsurance, which transfers part of the risk to a third party and further spreads risk.

Insurance providers

For the most part, insurance in NSW is provided by private insurance companies that weigh up the likelihood of a risk occurring, against the profitability of receiving an insurance premium. Australia's general insurance market is small. Less than 100 authorised general insurers are responsible for underwriting the majority of general insurance policies in Australia. The Australian Prudential Regulation Authority (APRA) regulates authorised general insurers to ensure insurers have an appropriate level of financial resources to pay claims.

Given the vast variety in types of risks, sectors and locations covered by insurance, authorised general insurers select those that they consider profitable and price accordingly. Risks that authorised general insurers have been unwilling to underwrite, have typically been provided by unauthorised foreign insurers (UFIs) or Lloyd's of London syndicates. UFIs typically insure risks that cannot reasonably be placed in Australia.[5] UFIs are generally only used by larger corporations, and are largely inaccessible by small businesses.[6]

Lloyd's of London is a corporate body that operates a marketplace of syndicates that underwrite insurance. Lloyd's is governed by legislation in the United Kingdom and is authorised to write insurance in Australia by the *Insurance Act 1973*.[7]

An overview of the insurance market is included in **Appendix A**.

Hardening insurance market

Australia is currently undergoing what has been described as a 'hardening' insurance market, which means insurance prices are increasing and some segments of the market are experiencing availability challenges.[8] A hardening market can be contrasted with a 'softening' market, where prices decrease and insurance products become more available.[9] The market competition between insurers partly drives the cycle between hardening and softening markets, as insurers price policies to be competitive and/or profitable in the market.[10] However, other factors have also increased the cost of insurance in Australia and impacts for small business.

Industry reporting price correction

The Insurance Council of Australia (ICA) has reported the hardening market in Australia is partly driven by insurance companies correcting past under-pricing in property, liability and indemnity insurances, which has contributed to perceived affordability challenges.[11] The ICA has suggested that commercial property insurance had been under-priced for at least a decade, before losses and increases in natural disasters caused the sector to increase prices from 2017.[12] Increases in the costs of liability and indemnity policies have also been escalated by increasing losses from class actions, court awards and claims for profession indemnity and directors and officers liability, and increasing public liability claim costs.[13]

Reduced insurance options due to the exit of Lloyd's of London syndicates

Lloyd's of London is a group of United Kingdom based syndicates, that have traditionally provided insurance for risks not insured by Australian authorised general insurers. Lloyd's of London has often provided liability insurances to small business in boutique industries that have a high-risk risk profile,[14] such as the amusement and leisure sector. Many Lloyd's of London syndicates have also

[5]Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
[6] ICA, 2021, 'Role of the Private Insurance Market', p. 19.
[7] Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
[8] ICA, 2021, 'Role of the Private Insurance Market', p. 39-40.
[9] ICA, 2021, 'Role of the Private Insurance Market', p. 40.
[10] ICA, 2021, 'Role of the Private Insurance Market', p. 40.
[11] ICA, 2021, 'Role of the Private Insurance Market', p. 41.
[12] ICA, 2021, 'Role of the Private Insurance Market', p. 41
[13] ICA, 2021, 'Role of the Private Insurance Market', p. 40.
[14] ICA, 2021, 'Role of the Private Insurance Market', p. 7.

exited the Australian insurance market due to losses, which has escalated gaps in insurance coverage for small business with many small businesses unable to find alternative coverage.

Broader factors impacting the cost of insurance

The cost and coverage of insurance is also impacted by other factors, most notably losses from natural disasters and the potential for high-cost settlements for indemnity and liability insurances. Both these factors have been considered by reviews in the past.[15]

In NSW, the value of taxes and levies on business insurance increases the cost of insurance and is frequently identified as contributing to insurance unaffordability and reducing uptake.

Natural disasters

Australia is exposed to a range of natural hazards and disasters, including storms, floods, cyclones, bushfires, and earthquakes. The occurrence of natural disasters leads to high insurance costs. A 2014 PC review found that between 1970 to 2013, the annual average insurance losses from natural disasters was approximately $480 million.[16] Over this period, there was a general trend of increasing insurance losses.[17]

The natural catastrophic events in 2020 (including the November 2019 to February 2020 bushfires) led to unprecedented claim costs of $6.53 billion. This compares with $3.13 billion in claims costs for natural catastrophes in 2021.[18] The ICA is anticipating that the March 2022 East Coast Flood events alone will result in $2.32 billion claim costs.[19]

In addition to the occurrence of natural disasters, other factors have increased the cost of claims from natural disaster events. These factors include higher population densities and the increasing value of houses and assets in natural disaster-prone areas.[20] Historical building regulations and local government planning and zoning decisions may have contributed additional cost by not appropriately mitigating risks. New building requirements and changing market conditions may mean property owners are underinsured with policies that do not cover actual rebuilding costs.

Some types of natural disasters are also more costly. Between 1970 and 2013, floods and storms accounted for 54 per cent of total insurance loses.[21] Flood risks present a specific challenge for

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[15] Including ICA, 2021, 'Role of the Private Insurance Market'; ASBFEO, 2020, 'Insurance Inquiry Report'; and Commonwealth Treasury, 2011 'Natural Disaster Insurance Review'.

[16] Productivity Commission, 2014 'Natural Disaster Funding Arrangements: Productivity Commission Inquiry Report, Volume 2', p. 279.

[17] Productivity Commission, 2014 'Natural Disaster Funding Arrangements: Productivity Commission Inquiry Report, Volume 2', p. 279.

[18] KPMG, 2022, 'General Insurance Industry Review 2022', p. 5.

[19] KPMG, 2022, 'General Insurance Industry Review 2022', p. 6

[20] Productivity Commission, 2014 'Natural Disaster Funding Arrangements: Productivity Commission Inquiry Report, Volume 2', p. 283.

[21] Productivity Commission, 2014 'Natural Disaster Funding Arrangements: Productivity Commission Inquiry Report, Volume 2', p. 279.

insurers. The Natural Disaster Insurance Review identified that floods occur in very specific locations, which makes it difficult for insurers to distribute risks across locations.[22] As floods become more common, the insurance industry is unable to provide insurance coverage, or provide insurance at a cost that is accessible. For example, Lismore is already being reported as a town that is effectively uninsurable for property damage by floods, due to coverage or affordability issues.[23] As natural disasters increase, there is a significant risk more areas or types of assets will become uninsurable or underinsured due to affordability reasons. This market gap is likely to be more acute in lower socio-economic communities and regional areas.[24]

Increasingly the industry and professional advisors are identifying that greater mitigation efforts will be required to reduce the impact of natural disasters on people and communities in the future.[25] For example, the ICA is calling for the Commonwealth Government to invest $1 billion in extreme weather resilience measure over the next five years, matched by the state and territories. The ICA anticipates this will lead to $19 billion in reduced costs for Australian governments and households by 2050.[26]

Increasing costs, or risks of cost for indemnity and liability claims

The cost, or risk of costs for types of indemnity insurance and Directors and Officers (D&O) liability claims has increased, driving up the cost or availability of insurance. The ICA estimates the cost of insurance policies for public liability has increased by 20 to 30 per cent and professional indemnity and D&O liability has increased by 100 per cent to 150 per cent since about 2017.[27]

The ICA identifies long term under-pricing has been a factor in increasing D&O insurance, as has increasing number of class actions, and the number and size of settlements.[28] In addition to price increases, policies can now include significant deductibles and restricted policy conditions.[29] Some types of liability insurance have also been traditionally under-priced according to the ICA, and there has also been an increase in litigation that has resulted in increases in the amount and frequency of claims, resulting in increasing costs of policies.[30]

The type of activity undertaken by small businesses can also expose them to a higher level of risk, for example, if they operate in adventure tourism or recreation activities.[31] Insurance companies

[22] The Treasury, 2011, ‘Natural Disaster Insurance Review’, p. 22-23.
[23] Rhiana Whitson, 5 March 2022, ‘Underinsurance “crisis” grows as climate change worsens floods, fires and extreme weather, ABC news, available at: https://www.abc.net.au/news/2022-03-05/brt-flood-insurance-story-lismore-nsw-climate-change-extreme-wet/100881434.
[24]KPMG, 2022, ‘General Insurance Industry Review 2022’, p. 17.
[25] KPMG, 2022, ‘General Insurance Industry Review 2022’, p. 17.
[26] ICA, 2022, ‘Building a more Resilient Australia’, p. 06.
[27] ICA, 2021, ‘Role of the Private Insurance Market’, p. 41.
[28] ICA, 2021, ‘Role of the Private Insurance Market’, p. 41.
[29] ICA, 2021, ‘Role of the Private Insurance Market’, p. 42.
[30] ICA, 2021, ‘Role of the Private Insurance Market’, p. 41.
[31] ICA, 2021, ‘Role of the Private Insurance Market’, p. 45.

have been increasingly reluctant to provide public liability coverage or coverage at a cost that is accessible for these types of businesses.[32]

Lloyd syndicates, that traditionally provided liability insurances to small businesses in specific sectors, including in adventure tourism or recreation activities, have left the Australian market due to losses. This has escalated coverage gaps, particularly when authorised general insurers have also decided to limit their exposure to the same risks.[33]

Insurance taxes and levies

Taxes on insurance are frequently cited by insurance industry representatives as an impediment to insurance uptake. It has been estimated that insurance duties add around 10 per cent to the price of most types of insurance and that the Emergency Services Levy (ESL) adds an estimated 30 to 35 per cent to commercial premiums.[34] The ICA has estimated that in NSW the Emergency Services Levy, GST and stamp duty could be as high as up to 70 per cent of the premium costs for some business insurances.[35] These taxes and levies significantly increase the cost of insurance and may discourage small businesses from seeking out appropriate insurance coverage.

Small business experiences

Small businesses experience a range of barriers and challenges when assessing insurance needs, identifying and accessing relevant policies, paying annual premiums, and making claims. Like the broader market, the affordability and availability of insurance, driven by the ‘hardening’ market is a persistent challenge, especially for small business that are obligated to have insurance to operate.

However small businesses also experience barriers and challenges that are specific to small business. These challenges include a lack of knowledge of the insurance sector, access to cash flow and other resources to manage the cost of insurance, a lack of fit-for-purpose products, and reliance on third parties, such as insurance brokers to access insurance. These factors can make it more difficult for small businesses to manage a ‘hardening’ insurance market.

Assessing insurance needs

Small businesses are required to identify the insurance products they need to operate. Insurance products can be required by legislation, for registration or to participate in government procurement, or be needed to mitigate risks that are likely to occur or will be too costly if they did occur. Typically, employee compensation, public liability, product liability and professional liability are viewed as compulsory for business operations. Natural disaster and business interruption insurance, along with a range of other insurance types are considered based on risk.

As the availability of insurance decreases and cost of insurance increases, small business owners reconsider which insurance products are mandatory for operation and which are highly desirable for managing risks. Stakeholder feedback indicates that small business owners are increasingly only

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[32] ASBFEO, 2020, ‘Insurance Inquiry Report’, p. 21.
[33] ICA, 2021, ‘Role of the Private Insurance’, p. 41.
[34] NSW Review of Federal Financial Relations Final Report, p.68.
[35] ICA, 2019, ‘The impact of government duties on household insurance’, p. 5.

seeking mandatory insurance products, as they can no longer afford optional cover, such as natural disaster insurance.[36] This has the potential to lead to underinsurance, which can have detrimental effects for business operations if a risk occurs.

As the cost of mandatory insurance products increases, sole-traders and smaller businesses may reassess their business viability. Stakeholder have reported that construction liability has increased by 10-30 per cent, and 50 per cent-100 per cent or higher for clients with prior claims.[37] Increases have also occurred in the finance industries.[38] In these industries, bigger businesses that can better afford or access insurance, may absorb smaller businesses, creating a less competitive market.

The insurance requirements for government prequalified schemes and government contracts can also be cost prohibitive for small business owners.[39]

Identifying and accessing products

After assessing their insurance needs, small business owners are required to identify and access the insurance products that best meet their needs.

The process of selecting annual products can be time consuming and confusing for small business owners, as there are limited ways to compare products. Insurance providers are also only required to give two weeks' notice of policy coverage changes or cost increases, which often does not provide small business owners with sufficient time to research alternative options or respond to reduced coverage.

There can be a mismatch between the needs of small business and the products available to meet those needs. This can exacerbate underinsurance or small businesses paying additional costs for coverage they do not require. Due to the complexity of insurance policy contracts, small businesses may not be aware of gaps in their coverage. For example, natural disaster insurance typically includes direct bushfire and cyclone coverage in standard policies but may not include flood damage or indirect damage.

For mandatory insurance types, such as workers compensation, it can be difficult for small business owners to understand their legal requirements. Policy settings in workers compensation are also challenging for small business owners, as it is based on a range of factors including employee size, claims performance and return to work rates.[40]

As business insurance is complex, many small businesses choose to draw on the services of an insurance broker or agent. However, the expertise and networks of insurance brokers can vary, leading to some small businesses having access to better quality insurance products. As brokers are usually paid through fees and commissions from insurance companies there is the potential for

[36] ICA, 2021, 'Role of the Private Insurance Market', p. 61.
[37] Insurance News, 24 June 2020, 'PI Pain Sets to Worsen as Insurers Harden Risk Appetite', available at: https://www.insurancenews.com.au/daily/pi-pain-set-to-worsen-as-insurers-harden-risk-appetite
[38] ASBFEO, 2020, 'Insurance Inquiry Report', p. 22.
[39] Survey for Small Business Tendering Support Program
[40] Insights from BII interview. Information on policy settings for workers compensation is available on icare.

real or perceived conflicts of interests, or lack of accountability.[41] Notwithstanding these potential or perceived conflicts, it is the view of the Commission that insurance brokers can play an important role in the insurance market and are often the best source of advice for small businesses experiencing insurance challenges.

Accessibility challenges can become critical, and some small businesses may find insurance products are not available to them. A reduced number of insurers in the Australian market has reduced the number of products in the market. This has had acute effects for some regional and rural businesses, specific industries and for some specific types of insurance.

Paying annual premiums

Small businesses do not always have the cash flow or resources to pay for an annual expense upfront. Small businesses who tender for government work may be required to pay for specific insurance cover before tendering for work, essentially paying for insurance cover for work they may not receive. Insurance premium funding, where the cost of insurance is split across the year can assist with cash flow issues but may increase the cost of insurance.[42] A Deloitte survey of Small and Medium Enterprises across 14 countries found that Australian SMEs highly valued premium payment options, such as monthly or semi-annually, compared to those in other countries.[43]

Small businesses may seek out financing to support paying for insurance, such as loans. However, small businesses may also experience barriers to accessing this finance, such as not owning property to provide as security against loans.[44] [45]

Making claims

The General Insurance Code of Practice specifies that insurance decisions must be made within 4 months of receiving a claim, unless it falls into an exemption category. Exemption categories include Extraordinary Catastrophe, which has an extended timeframe of 12 months.[46] These timeframes can be challenging for small businesses, who may be reliant on their claim to restore their operations or financial position. The Commission observes if insurance claims are not resolved within a month, many small businesses would face serious financial harm or disruption.

Depending on the nature of the claim, policyholders are likely to be asked to prove the loss has occurred and that it occurred by an insured event. The insurer may conduct due diligence and may seek to verify whether the damage occurred by an uninsured event. Legal complexities can lead to small businesses feeling uncertain that they will be able to make an insurance claim should they need it, or that they will receive the amount in a timeframe that meets their needs.[47]

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[41] ASBFEO, 2020, 'Insurance Inquiry Report', p. 11

[42] ICA, 2021, 'Role of the Private Insurance Market', p. 61

[43] Deloitte, 2022, 'The future of small business insurance – What do customers want?' p. 12.

[44] Small businesses without properties can have additional barriers to access debt finance to manage cashflow

[45] Productivity Commission, 2021, SME Lending Transformation, available at: www.pc.gov.au

[46] Insurance Council of Australia, 2020, General Insurance Code of Practice, p. 28.

[47] ASBFEO, 2020, 'Insurance Inquiry Report', p. 39-40.

When unexpected disasters or interruptions occur, governments may provide support for small businesses that do not have insurance. Disaster Recovery Funding Arrangements provide financial support for small businesses affected by natural disasters such as floods. They do not typically provide financial support to small businesses that can make an insurance claim, but may provide financial support for equivalent losses to small businesses without insurance.

Over time, acute affordability and availability challenges in some areas may lead to an increasing reliance and expectation that government will act as a default insurer. For example, increasing insurance costs in Lismore led small businesses to forgo property insurance for natural disasters, resulting in significant uninsured damage in 2017 and 2022.[48] Given uninsured damage has broader economic and social impact of this damage, government steps in to provide assistance, and in effect plays the role of insurance.

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[48] See Peter Hannam, 2 March 2022, 'Lismore Businesses that Couldn't Afford Insurance Premiums Face Huge Flood Damage Bill', The Guardian, available at: https://www.theguardian.com/business/2022/mar/02/lismore-businesses-that-couldnt-afford-insurance-premiums-face-huge-flood-damage-bills; Jane Hansen, 9 April 2017, 'Lismore Floods: Business Owners Without Insurance Hit Hardest, Could be Forced to Close Forever', The Daily Telegraph, available at: https://www.dailytelegraph.com.au/news/nsw/lismore-floods-business-owners-without-insurance-hit-hardest-could-be-forced-to-close-forever/news-story/51a52a4f328436cb3790defd2ce8280d.

The role of government and the regulatory environment

To identify potential policy solutions of government actions, it is essential to understand the role of government within insurance markets. All levels of government regulate or influence the insurance market in a variety of ways. These mechanisms include, but are not necessarily limited to:

- Regulatory obligations affecting the conduct of insurers operating in the market.
- Direct intervention through government established insurance or reinsurance schemes.
- Obligations on entities that affect the types of insurance they must hold, such as when supplying to government or complying with a regulatory obligation.
- Establishing the legal context and norms for compensation and liability claims.
- Collection of taxes and other levies on insurers or insurance premiums.

Some of these interventions may have the effect of impacting the availability of affordable insurance products for small business and there is merit in considering whether current policy settings are optimised. Other interventions may exacerbate availability and affordability challenges warranting further review.

The regulatory framework

Insurance is predominantly regulated by Commonwealth regulators. The Australian Prudential Regulation Authority (APRA) is responsible for authorising insurance companies, ensuring insurance companies have an appropriate level of financial resources to pay claims, and regulating the general insurance industry's stability. APRA's purpose is set out in the *Australian Prudential Regulation Authority Act 1998*.

The Australian Securities and Investments Commission (ASIC) is responsible for regulating market conduct to protect consumers in accordance with obligations set out in the *Corporations Act 2001* and the *Insurance Contracts Act 1984*. ASIC's role is to ensure insurers and insurance brokers provide fair, honest and efficient insurance; employ qualified staff; and use advertisement to inform, rather than misled consumers. ASIC also requires insurers to provide proper product disclosure statements to consumers, report to ASIC and handle complaints properly.[49]

The unfair contract regime in the *Australian Securities and Investments Commission Act 2001 (Cth)* applies to standard contracts for general insurance products, excluding medical indemnity, for small businesses. In November 2020, the eligibility criteria for small businesses was expanded to include businesses with less than 100 employees or annual turnover threshold of less than $10 million.[50]

In NSW, the State Insurance Regulatory Authority (SIRA) monitors and enforces NSW's insurance and compensation legislation. This includes regulating and overseeing workers compensation, motor accidents compulsory third party (CTP) and home building insurance, that are operated

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[49] ASIC, 2021, 'Insurance', available at: https://asic.gov.au/for-consumers/insurance/#asic

[50] Meeting of Ministers for Consumer Affairs, 2020, Meeting 12, available at: https://consumer.gov.au/consumer-affairs-forum/communiques/meeting-12-0

through icare. SIRA was established under part three of the *State Insurance and Care Governance Act 2015*.[51]

Government established insurance

In some segments, Australian governments have established public financial corporations to offer various insurance products. In NSW icare operates and provides services for the NSW Government's insurance and care schemes. These insurance and care schemes include (but are not limited to) workers compensation, coverage for state assets and personal injury relating from motor vehicle accidents.

Government established insurance generally operate as commercial entities, however can assist to fill gaps that are not readily fulfilled by private insurance markets. They may also be established to meet a public interest that might not be met by private insurers.

Governments also operate insurance-like schemes which reduce risks and provide a safety net to the community, but in a manner that is different to traditional insurance. Examples include Medicare, the National Disability Insurance Scheme and support payments made available through Centrelink. These schemes or programs may have the effect of crowding out insurance solutions that might otherwise exist but could not be relied on to meet public policy objectives such as universal coverage.

Reinsurance

The Australian Reinsurance Pool Corporation manages the terrorism reinsurance scheme, and from July 2022 will manage the reinsurance pool for cyclone and related flood damage. The reinsurance pool for cyclone and related flood damage pool will provide reinsurance for insurers who provide household, strata and small business insurance. The pool will be available Australia wide, however will target cyclone and cyclone related damage, which is mainly in northern Australia.[52] Stakeholders have sought for this facility to be expanded so that it is capable of supporting insurance coverage against other weather events that frequently occur in other locations such as flooding in northern NSW.[53]

The reinsurance pool for cyclones and related flood damage is backed by an annually reinstated $10 billion Government guarantee. This guarantee will provide for any shortfalls in reserves, and it

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[51] State Insurance Regulatory Authority, About Us, available at: https://www.sira.nsw.gov.au/corporate-information/about-us.
State Insurance Regulatory Authority, Regulation and Fraud, available at: https://www.sira.nsw.gov.au/fraud-and-regulation.
[52]Australian Reinsurance Pool Corporation, 2022, 'The Cyclone Pool', available at: https://arpc.gov.au/the-cyclone-pool/.
[53] For example, see: https://www.theguardian.com/australia-news/2022/mar/09/more-politicians-back-expanding-australias-cyclone-reinsurance-scheme-to-cover-fires-and-floods.

will be increased should a single cyclone event exceed the $10 billion guarantee. The pool aims to be cost-neutral to Government over the long term.[54]

Obligations that affect the type of insurance businesses must acquire

Government procurement requirements and obligations for regulated entities also affect the types of insurance businesses, including small business, must acquire.

Supplying to government

The Australian Government, NSW Government and local governments also influence insurance behaviours and practices through procurement requirements. The NSW Government Small and Medium Enterprise and Regional Procurement Policy (SME Policy) specifies that small and medium enterprises should only be required to hold the minimum levels of public liability and professional indemnity insurances to participate in procurement.[55] However, stakeholder feedback suggests NSW agencies continue to request $20 million public liability coverage as a prerequisite, even in circumstances where it does not align with the size of work or is disproportionate to risk.

In some cases, businesses are required to have certain types of insurance at the tendering stage. While businesses without these insurance types would generally be prepared to obtain compliant policies upon securing work, they are reluctant to purchase when it is uncertain whether they will be successful. The Commission notes that under Commonwealth procurement rules, buyers are to refrain from directing potential suppliers to take out insurance before a contract is actually awarded.[56]

Obligations on regulated entities

Businesses typically require a range of government licences, permits and approvals to operate. These licences, permits and approvals can be required by the Australian Government, the NSW Government or local governments.[57] Depending on the industry, these licences, permits and/or approvals can include requirements to have insurance, usually to protect customers and consumers.

For example, the 'Building and Development Certifiers Regulation 2020' specifies that certifies require a professional indemnity insurance policy that complies with the regulation. Compliance includes minimum coverage requirements.[58]

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[54] Australian Reinsurance Pool Corporation, 2022, 'The Cyclone Pool', available at: https://arpc.gov.au/the-cyclone-pool/.

[55] NSW Government, 2021, 'Small and Medium Enterprise and Regional Procurement Policy', available at: https://buy.nsw.gov.au/policy-library/policies/sme-and-regional-procurement-policy

[56] Commonwealth Procurement Rule 8.4(b).

[57] Australian Business Licence and Information Service, About, available at: https://ablis.business.gov.au/about

[58] NSW Legislation, 2020, 'Building and Development Certifiers Regulation 2020'.

The legal context and norms for compensation and liability claims.

Governments play an important role in establishing the legal environment within which entities can make a claim for compensation in the event they suffer detriment. Legislation can establish procedures for compensation and can affect the factors a court must consider when awarding compensation. Disputes are settled within this context and so the legal environment affecting voluntary agreements that parties are prepared to make. Government facilitated compensation schemes can establish norms around what amounts of compensation are appropriate.

In their totality, these factors can influence the cost of insurance as insurers price insurance premiums in accordance with their assessment of potential future claims.

Land use planning

The locations businesses operate in is determined by land-use planning and regulation, that is controlled by the NSW Government and local governments.[59] Land-use planning and regulation affects the environmental risks that businesses and communities are exposed to, and therefore required to seek insurance to cover. Land planning and regulation can have long term impacts, as environmental risks may only be experienced many years after a planning decision, or environmental risks and their consequences may increase over time.[60]

Some businesses are now finding they operate in locations where natural disaster insurance is not available, or is only available at an unaffordable price, due to high likelihood of natural disasters.

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[59] Royal Commission into National Natural Disaster Arrangements, 2020, 'Royal Commission into National Natural Disaster Arrangements Report', p. 400.
[60] Royal Commission into National Natural Disaster Arrangements, 2020, 'Royal Commission into National Natural Disaster Arrangements Report', p. 401.

Insights from previous research and international experiences

Previous research has considered the availability and affordability of insurance with recommendations intended to mitigate identified challenges. These solutions include holistic system reform and specific mechanisms that address an acute industry or accessibility challenge.

Factors affecting natural disaster insurance and liability insurance have been considered at a policy level by the Australian Treasury and Productivity Commission respectively, and international jurisdictions have implemented solutions for similar problems to what are experienced in Australia.

Key recommendations from previous research

Many previously recommended policy solutions are yet to be implemented and have the potential to improve insurance outcomes for small businesses. Responsibility for implementing these solutions can include various tiers of government, and other players such as the insurance sector itself.

There is merit in revisiting these recommendations to identify whether specific proposals, or appropriate alternatives, are a suitable response to contemporary challenges. Key reviews and their recommendations are summarised below.

Holistic system reform

A number of reviews have considered reforms from a whole of system perspective, including recommendations to improve how the insurance sector engages with small business.

ASBFEO identified 15 recommendations in the 'Insurance Inquiry Report'. These recommendations focused on improving regulation and codes of conducts to better protect small businesses, ensuring access to critical insurance through government led systems reform, and improving the insurance industry's transparency and accountability to its customers.[61]

The ICA strategic review identified 13 recommendations that focused on improving collaboration and communication within the insurance sector, improving transparency and communication to buyers of insurance, improving risk mitigation, proposing the use of group insurance schemes, the phasing out of State and Territory stamp duties and charges, and a review of business interruption insurance.

For the most part, ASBFEO and ICA recommendations are yet to be adopted and/or implemented.

[61] ASBFEO, 2020, 'Insurance Inquiry Report', p. 6-9.

Government-sponsored reinsurance

Government-sponsored reinsurance has been proposed as a mechanism to ensure the functioning of insurance markets in medium and high-risk flood locations. The Natural Disaster Insurance Review Panel identified that improving the coverage of flood insurance requires an integrated solution which addresses the availability and affordability of flood coverage. To enable affordable flood insurance, discounted insurance premiums were needed in medium and high-risk flood areas.[62]

A government-sponsored reinsurance facility for flood damage was proposed to deliver this discount. This approach maximises the extent of premium discounts available from a government funding source, as the funding is only used when claims are made, compared to every year as a premium subsidy. A premium subsidy is also more likely to be required to be paid at market price.[63]

Discretionary Mutual Funds

Discretionary Mutual Funds (DMFs) may be a mechanism to address immediate insurance needs of small businesses. DMFs have recently been considered as a potential solution to insurance challenges experienced in the amusement, leisure, and recreational sectors.[64] Small businesses in these sectors had reported significant challenges obtaining coverage.

DMFs are an insurance alternative that support businesses in mitigating risk but do not provide equivalent entitlements as what is provided by an insurance product. A DMF policy may offer discretionary cover that may involve an obligation on the DMF to consider meeting a claim while reserving discretion as to whether it will pay the claim. DMFs may be a suitable solution in circumstances where risks are considered ‘hard to place’, and insurance products are not readily available.

International examples for addressing insurance challenges

Contemporary challenges affecting small businesses in Australia have also been experienced in international insurance markets. Other jurisdictions have implemented solutions to manage costs associated with liability insurance and natural disaster insurance.

Catastrophe bonds

Catastrophe bonds emerged in 1990s in response to costly natural disasters, including Hurricane Andrew that caused extensive damage in Florida and the Gulf coast and led to some insurers going out of business. Catastrophe bonds transfer the risk of a natural disaster occurring from insurance to investors. Catastrophe bonds usually last three to five years and provide coverage if the damage from a natural disaster reaches a particular threshold. If the damage does not occur in the years of the bond, the money is returned to investors, plus interest.[65]

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[62] The Treasury, 2011, ‘Natural Disaster Insurance Review’, p. 3.
[63] The Treasury, 2011, ‘Natural Disaster Insurance Review’, p. 55.
[64] ASBFEO, 2021, ‘The Show Must Go On’.
[65] World Economic Forum, Explainer: How catastrophe bonds help manage the risk of climate change.

Catastrophe bonds are attractive to insurers as the bonds have clear triggers for payment and have longer timeframes for protection than reinsurance policies. For investors, catastrophe bonds have the potential for a high return on investment if a natural disaster does not occur.[66] Catastrophe bonds are used by insurers, government and development agencies. In 2021:

- American insurer USAA raised $300 million to cover a range of natural disaster risks, including US tropical cyclones, earthquakes, and severe thunderstorms.
- The Los Angeles Department of Water and Power raised $30 million to provide protection from losses from Californian wildfires.
- The World Bank priced a bond to provide up to $185 million protection to the Jamaican government against loses from named storms during the three Atlantic tropic cyclone season to December 2023.[67]

Catastrophe bonds could be part of a broader suite of measures to provide funding solutions where insurance markets are incomplete.

Resilience bonds

Resilience bonds, a variation of catastrophe bonds, aim to incentivise resilience projects to reduce the extent of damage caused by natural disaster. Resilience bonds link insurance premiums to resilience projects to monetise avoided losses from natural disasters.[68] Resilience Bonds use financial modelling to estimate two scenarios of loss following a natural disaster. The first is a business-as-usual scenario, and the second is a scenario were resilient infrastructure or solutions are implemented. The difference between the two scenarios is captured and used to fund the resilience project. Resilience bonds usually incorporate a range of players, including government, insures, utility providers and other players that may experience significant loss from a natural disaster.[69]

Resilience bonds are a relatively new insurance concept and are less established than catastrophic bonds in the market. The District of Columbia Water and Sewer Authority implemented an environment impact bond in 2016 for the construction of green infrastructure to manage stormwater run-off and reduce sewer overflows, that has similarities to resilience bonds. The bond pays investors based on the amount of runoff reduced.[70]

Resilience bonds could be utilised to provide funding solutions for community or government investments to reduce underlying risks (which may improve insurance market conditions).

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[66] World Economic Forum, Explainer: How catastrophe bonds help manage the risk of climate change.
[67] Ibid.
[68] Shalini Vaijhala and James Rhodes, 2018, ‘Resilience Bonds: a Business-Model for Resilient Infrastructure’, The Journal of Field Action Science Report.
[69] Ibid.
[70] Mercy Corps, ‘Financing Flood Resilience: An Option to Avert Displacement’.

Opportunities to improve outcomes for small business

This report focuses on potential opportunities for the NSW Government to improve outcomes for small business. The Commission observes that there is no single solution or class of solutions that can resolve all of the challenges identified in this report. Further, many key policy levers are not within the remit of the NSW Government while others may require an industry-led approach. Despite these limitations, the Commission has identified a range of potential opportunities that could be further explored to improve the experiences of small businesses.

Policy coordination and leadership

There is a potential opportunity for the NSW Government to examine whether current administrative arrangements are appropriate to identifying and responding to emerging insurance challenges.

Insurance coordination function

Reflecting the multiple touchpoints and policy areas impacting insurance, there is no single agency within the NSW Government that has overarching responsibility for small business insurance, or insurance more generally.

An implication of this is that accountability and expertise is dispersed. No specific agency has clear responsibility or sufficient focus for ensuring the NSW Government is contributing to favourable outcomes. Similarly, while some specific areas of government have deep insurance expertise, other agencies may be unable to maintain the technical capabilities needed to identify and respond to emerging challenges.

These factors have the potential to constrain the ability of the NSW Government to identify an appropriate policy agenda and exercise leadership on what is a national issue requiring engagement across multiple tiers of government and a wide range of industry participants.

The Commission proposes the establishment of a new insurance coordination function within the NSW Government to assist agencies and develop appropriate responses to contemporary and emerging small business insurance issues. The purpose of an insurance coordination function would be to provide oversight over the broader market for insurance, as it relates to NSW Government responsibilities, while providing appropriate technical capability and expertise to help agencies identify appropriate responses.

Implementation options include assigning the function to an existing agency that would subsequently build or leverage existing technical capability and expertise. An alternative model would be to establish an Insurance Coordination Office that is independent of any existing agency.

Recommendation 1 – Establish an insurance coordination function

An insurance coordination function should be established within the NSW Government. The function would be responsible for:

- Working with other agencies to resolve known impediments, including those identified in this report, as well as other emerging issues.
- Assisting agencies to better understand the impact of policy decisions on the insurance market and small business.
- Determining the feasibility of approaches recommended in previous reviews into insurance as well as international approaches, including those referenced in this report (where they relate to NSW Government responsibilities).
- Reviewing NSW Government policies (such as tax, procurement, regulation and planning) to monitor and assess their impact on small business insurance outcomes.
- Acting as a conduit between the NSW Government and other tiers of government, the insurance industry and small business stakeholders on insurance-related matters.

National leadership

As earlier noted, there are a range of players who influence or have a role in managing the conditions of a ‘hardening’ insurance market and addressing the insurance barriers and challenges specific to small business. These include the Australian Government, state and territory governments, local government as well as the insurance sector itself.

The Commission observes an opportunity for the NSW Government to take on an advocacy role in circumstances where opportunities to improve outcomes are outside its direct remit. Insurance is a crucial business enabler and NSW businesses and our economy is impacted by national policy settings. It is therefore appropriate for the NSW Government to advance the interests and assume a national leadership role.

Challenges relating to insurance are often complex and proposed solutions may not always be appropriate. For this reason an insurance coordination function is essential to supporting the NSW Government as a national leader on small business insurance.

Recommendation 2 – NSW Government leadership and advocacy

Supported by the new insurance coordination function, the NSW Government should play a proactive role in advancing the interests of small business and industry with respect to insurance. This includes:

- Targeted action with the Australian Government and other jurisdictions to ensure the suitability of national policy settings (including through national meetings of Ministers).
- Engaging with the local government sector to ensure appropriate policy settings (including procurement policies and planning).
- Seeking cooperation and collaboration with the insurance sector to improve outcomes where small business needs are not being met.

Insurance alternatives

Insurance alternatives such as DMFs are an imperfect substitute for insurance, but may be an appropriate alternative where insurance markets are unable to meet the needs of a sector or activity. That is, insurance alternatives can be viewed as a safety net to cover gaps in circumstances where insurance markets do not cover risks of a certain kind.

The NSW Government may not have a specific role in respect to the establishment of insurance alternatives such as DMFs. However, NSW Government policies may require amendment to allow proposed insurance alternatives to be a viable solution. For example, regulatory settings that compel small businesses to hold insurance may need to be broadened to accept an insurance alternative. In these circumstances a range of factors are relevant, including consideration of the ability of businesses to obtain insurance and any impacts on broader policy objectives. The Commission proposes the insurance coordination function assist to facilitate industry or other stakeholder proposals to examine measures to improve the affordability and sustainability of insurance, including insurance alternatives.

Recommendation 3 – Facilitation of insurance alternatives

Supported by the new insurance coordination function, the NSW Government should have mechanisms in place to assist industry or other stakeholders to examine measures to improve the affordability and sustainability of insurance, including insurance alternatives. These mechanisms should coordinate within government (including local government where appropriate) to consider policy changes that may be required.

Insurance costs

While they may be unable to fully offset reported cost concerns, the NSW Government has policy levers to contribute downward pressure on insurance costs.

Taxes on insurance

Providing relief from insurance taxes and levies is a direct way the NSW Government could assist small businesses with the costs of insurance.

As previously noted, insurance duties are estimated to add around 10 per cent to the price of most types of insurance, and the Emergency Services Levy (ESL) a further 30 to 35 per cent to commercial premiums,[71] with the ICA estimating that taxes on insurance could be as high as 70 per cent in some cases.[72]

Eligible small businesses are exempt from NSW insurance duties for some policies. These policies include commercial vehicle insurance, commercial aviation insurance, occupational indemnity insurance, and product and public liability insurance. Small businesses must be a CGT small business with a turnover of under $2 million. Announced in the 2017-18 NSW Budget, the small business exemptions were estimated to be worth just under $100 million by 2020-21, with remaining insurance duties, at the time, estimated to contribute around $1 billion to state revenue.

Despite the small business exemption available in some circumstances, many small businesses continue to pay significant taxes on their insurance premiums. The 2022-23 NSW Budget estimates that $1.4bn in insurance duty and $1.2bn in emergency services levy contributions will be collected in 2022-23. These taxes and levies contribute cost pressures and have the effect of discouraging uptake of insurance. Insurance taxes and levies are frequently cited as being among the most economically inefficient taxes, exhibiting high welfare costs.[73]

The NSW Review of Federal Financial Relations recommended:

> *"All specific taxes on insurance products, including the Emergency Services Levy in New South Wales, should be abolished and replaced by more efficient and broad tax bases, to improve the affordability and uptake of insurance."*
>
> NSW Review of Federal Financial Relations Final Report, p.74.

A key consideration is the need to replace revenue foregone with an alternative revenue source. Under revenue neutral reform proposals, small businesses may encounter new taxes (such as a new levy on their council rates) offsetting any reduction in the cost of insurance. There may also be distributional considerations with some businesses better or worse off depending on their circumstances. While replacing taxes on insurance with alternatives can be well-justified on efficiency grounds (including the potential for small businesses to underinsure), reform proposals need to be assessed in their totality.

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[71] NSW Treasury, 2021, 'NSW Review of Federal Financial Relations Final Report', p. 68.
[72] ICA, 2019, 'The impact of government duties on household insurance', p. 5.
[73] NSW Treasury, 2021, 'NSW Review of Federal Financial Relations Final Report', p. 33.

In the absence of more comprehensive reform, the Commission's view is that consideration of tax relief is necessary. While the financial cost of abolishing taxes on insurance without an alternative revenue source may mean it is unattractive from a budget management perspective, this should not preclude consideration of whether any partial relief can be provided. Insurance duties and the ESL are forecast to grow by 5.7 per cent and 5.6 per cent per annum, on average, between 2021-22 to 2025-26 (compared to 2.8 per cent for total taxation revenue).[74] This means that over this period, the NSW tax mix is expected to become more reliant on insurance taxes than in 2021-22, contributing additional cost challenges for small business.

Recommendation 4 – Reduce taxes and levies on insurance

The NSW Government should look to reduce taxes and levies on insurance, with revenue foregone replaced with more efficient sources.

In the absence of more comprehensive reform, small businesses should be assisted with the cost of insurance through the provision of relief from NSW Government taxes and levies on insurance.

A further potential opportunity to reduce the impact of insurance duties on small business is to expand the current exemption for small business. This could be achieved by broadening the scope of policies where the exemption applies or increasing the turnover threshold.

Recommendation 5 – Expanding insurance duty exemption

The NSW Government should expand the scope of policies where there is an exemption for small business on insurance duties.

Targeting relief to groups that are underinsured

Policy measures that may reduce underinsurance should be prioritised. Underinsurance produces inefficient outcomes and potentially disastrous consequences for small business. It also exposes governments to financial risk as they may be expected by the community to provide financial support in times of crisis or act as a default insurer.

The Commission has recommended the provision of relief from taxes and levies on insurance in the absence of more comprehensive reform. As part of this, some further investigation is warranted to identify where relief and support should be targeted.

Taxes on insurance, at the margin, discourage uptake of insurance and may contribute to underinsurance. However, reducing taxes on insurance would provide broad-based relief, including to groups where cost may not be a dominant factor in determining the amount of insurance they purchase.

For some types of insurance demand may be relatively inelastic (non-responsive to changes in price) because it is considered essential irrespective of its cost. For other types of insurance, and for

[74] 2022-23 NSW Budget.

some small business cohorts, decisions about how much insurance to purchase may be highly dependent on price. For example, business interruption insurance may not be regarded as essential, and a business may choose not to purchase if it is perceived as too costly. For many types of insurance small businesses can choose varying levels of coverage and may be underinsured even if they have a policy.

To identify suitable cohorts for any tax expenditures, further investigation to identify particularly price sensitive segments may be warranted. Once the needs of these cohorts are identified, it may be more practical to deliver relief through alternative delivery vehicles, such as direct support through rebates or vouchers paid directly to small businesses. Alternative delivery vehicles may have the benefit of leveraging behavioural insights to produce lasting behaviour changes.

Recommendation 6 – Encouraging insurance uptake

Further investigation should be undertaken to identify particularly price sensitive segments for the purposes of targeting relief.

To identify suitable segments and cohorts for any tax relief (or alternatives), behavioural insights should be leveraged to identify particular instances where small businesses are particularly price sensitive. This could include examining areas where financial relief in the first year could encourage insurance uptake of a new type of insurance they did not previously hold or instances where small businesses tend to hold policies that leave them underinsured as a strategy to reduce their premium costs.

Data and insights

Improved data collection and management could be leveraged to deliver insights and support the functions of the NSW Government

Property claims and policy database

Insurance databases have the potential to assist insurers, governments and community stakeholders to better understand conditions in the insurance market. The National Claims and Policies Database established by APRA provides an example of where this approach has been utilised to assist greater visibility over trends relating to public liability and professional indemnity policies and claims.

The Commission observes an opportunity to deliver improved insights through the establishment of a commercial property insurance database. A commercial property insurance database would maintain data on insurance policies held against industrial or commercial zoned property. A database of this kind could assist in the identification of insurance trends relating to cost and availability and provide insights about geographic areas where insurance may be increasingly difficult to obtain. It could also be used to support compliance activities, such as in the administration of grants offered to businesses in the event of a natural disaster (which generally require for business losses to be uninsured).

Recommendation 7 – Commercial property insurance database

The NSW Government should work with the insurance industry and other tiers of government to explore potential options to establish a commercial property insurance database.

Improvements to the user experience

Apart from affordability and availability considerations, there is also an opportunity to improve the experiences of small businesses who hold policies and seek to exercise their contractual rights.

Continuous improvement of consumer policy frameworks

ASBFEO's insurance inquiry considered a range of factors affecting the experiences of small businesses who engage with insurance products. These include terms and conditions, making claims, payment times and terms, and barriers to switching. It further considers the potential for a consumer data right (CDR) to assist businesses to access products and services that meet their needs.

While small businesses may be regarded as consumers under the Australian Consumer Law (ACL) (depending on the circumstances), insurance products are not generally within the scope of the ACL and are instead regulated by the *Insurance Contracts Act 1984* (IC Act).

NSW Government engagement with other jurisdictions on consumer law issues is underpinned by the Intergovernmental Agreement for the Australian Consumer Law (IGA). Under that agreement, jurisdictions acknowledge that collaboration and coordinated action is core to effectively protect and empower consumers, foster effective competition and enable the confident participation of consumers in markets by promoting fair trading. These arrangements have previously underpinned broader consideration of consumer law issues outside the scope of the ACL itself. For example, the 2017 Australian Consumer Law Review considered the merits of extending unfair contract term protections to the IC Act.[75]

The Commission observes an opportunity for jurisdictions to work together, through a national project, to review and progress suitable actions that can be taken to ensure appropriate protections for small businesses when they engage in insurance markets. This could include collecting deeper insights on insurance through the Australian Consumer Survey which was last conducted in 2016.

[75] Australian Government (2017), Australian Consumer Law Review, Final Report, p. 53.

Recommendation 8 – National project to ensure appropriate protections

The NSW Government should work with other jurisdictions to establish a national project to consider the appropriateness of current consumer policy settings as they relate to small business insurance.

The next Australian Consumer Survey should make specific provisions to track business and consumer experiences relating to insurance markets.

Business support services

There is an opportunity for the NSW Government to assist small business navigate insurance markets. This potentially includes the provision of training, guidance and fact sheets as well as digital tools. The NSW Government has also developed online tools and platforms that can help small businesses and consumers with common challenges encountered when engaging in complex markets. This includes the NSW Government's FuelCheck app and the Energy Made Easy service.

The NSW Government delivers training and assistance to small businesses through Business Connect, Service NSW for Business and various online and digital services. The Commission also supports small businesses with guidance on common issues, including insurance.[76] Services of this nature are predominantly delivered by agencies within the Department of Customer Service.

The Commission proposes the Department of Customer Service, with the assistance of the insurance coordination function (Recommendation 1), be tasked to consider what additional support services could be delivered to assist small businesses. The Commission notes the important role of insurance brokers in assisting small businesses to obtain suitable insurance that meets their commercial needs. Support services relating to insurance should be designed in a manner that is complementary to the services provided by insurance brokers.

Recommendation 9 – Business support service opportunities

The NSW Government should consider what additional support services could be offered to assist small businesses when purchasing insurance. This should include consideration of training, guidance and fact sheets, and digital tools.

[76] For example, the Commission has prepared a guide *Insurance claims for small business* which assists small businesses making insurance claims.

Tort law reform

Previous reviews into the affordability and availability of insurance have considered the potential for tort law reform to improve outcomes.

National review of tort law reform

Tort law reform has previously been pursued in response to concerns about the affordability of public liability and professional indemnity insurance. Reform of this nature have the potential to reduce litigated claims and court awarded compensation payments.

It is beyond the scope of this report to consider the merits of tort law reform as a potential solution to contemporary affordability and availability challenges. While policy changes of this nature have the potential to reduce the cost of insurance premiums, careful consideration is required to assess the impact on those seeking compensation.

The Commission therefore supports proposals to lead a national review of tort law to examine whether there is an opportunity to reduce impacts on small business insurance costs.

Recommendation 10 – National review of tort law

The NSW Government should work with other jurisdictions to initiate a national review of tort law.

Supplying to government

The NSW Government can improve outcomes for small business by ensuring procurement policies and requirements are proportionate to risk and appropriately implemented across government.

Proportionate insurance requirements

Survey research by the Commission indicates that 25 per cent suppliers to government said the insurance requirements for prequalification schemes were unexpected or unreasonable (mainly professional indemnity).

The SME Policy recognises that excessive insurance requirements are burdensome and expensive for small businesses, and agencies must ensure that the minimum possible levels of public liability and professional indemnity insurance having regard to the risk of the engagement. However, the SME Policy does not provide detailed guidance on how agencies should determine appropriate insurance requirements.

Agencies are encouraged to consult with their risk managers to determine insurance requirements. However, stakeholder feedback suggests agencies are perceived as highly risk averse, particularly when compared to equivalent buyers from the private sector.

Insurance guidance for buyers and clusters was last updated in 2012 and is no longer available for buyers. The absence of any current guidance and tools to assist them in calculating the right type and levels of insurance may be contributing to buyers opting to apply high or maximum $20 million limits in a ‘one size fits all’ approach. Some agencies do have access to insurance experts and these can negotiate lower amounts on a case-by-case basis where appropriate.

Recommendation 11 – Procurement policies and guidance

The NSW Government should provide greater clarity to government buyers on what insurance requirements are appropriate and proportionate to risk. Additional guidance should be published with agencies actively encouraged to reduce insurance requirements for small business. Cultural barriers, including excessive risk aversion, should be considered.

Pre-qualification

There is the potential for small businesses to be excluded from supplying to government if they are required to have insurance, of a kind they would not ordinarily hold, as a pre-condition for being considered for government work.

The Commission proposes that NSW Government pre-qualification scheme requirements be reviewed and, where appropriate, amended to enable businesses to be considered on the condition that they obtain insurance before commencing work.

Recommendation 12 – Prequalification insurance requirements

The NSW Government should enable small businesses to be considered as a supplier on the condition that they obtain insurance prior to commencing work.

Appendix A – Overview of the insurance market

Insurance market

The purpose of insurance is to transfer of risk. Small businesses identify business risks, providers of insurance assess the types of risks and locations they are willing to underwrite, and users of insurance pay a premium based on that assessment.

Sellers of insurance pool and spread types of risks, to mitigate the impact of paying claims if the insured event occurs. Buyers of insurance manage the cost of insurance by adjusting the risks they insure and the terms of conditions of their policy.[77]

Small business and insurance

The insurance products commonly accessed by small business includes workers compensation, professional indemnity, public liability, property insurance against natural disasters, business interruption and directors and officers insurance.

These insurance products are summarised below:

Insurance	Definition	Requirement	Market provider
Workers compensation	Workers compensation protects small businesses should an employee experience a work related injury or illness.	**Compulsory**, if small business has employees	Public (Public Financial Corporation) icare is the nominal insurer in NSW (except for coal), and private insurance agencies are contracted to manage claims on its behalf.
Professional indemnity	Professional indemnity insurance protects small businesses from claims of alleged negligence or breach of duty, that arise from an act, error or omission during the delivery of professional advice or service.	**Compulsory or proxy compulsory for relevant industries** due to legislation, government procurement policies or risk of litigation for small businesses that provide advice or services for a fee	Private

[77] Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 388.

Public liability	Public liability insurance covers small businesses from third party death or injury that should arise from negligence.	**Compulsory or proxy compulsory for relevant industries** due to legislation, government procurement policies or risk of litigation for relevant industries	Private
Property insurance against natural disasters	Property insurance provides small businesses with protection against natural disasters such as cyclone, bushfire and floods. Policies usually include cyclone and bushfire protection, however floods are an optional extra.	**Optional based on business risks**	Private
Business interruption insurance	Business interruption insurance is an optional insurance that protects small businesses from financial losses occurring from physical damage, lack of access to premises, government closure and infectious diseases.	**Optional based on business risks**	Private
Directors and officers insurance	Protects small businesses against loses that might arise from a manager or a director using illegal or unethical management practices.	**Optional based on business risk**	Private

Direct market participants

Four types of insurance market participants underwrite (or sell) general insurance in NSW. These insurers are authorised general insurers, unauthorised foreign insurers (UFIs), Lloyd's of London and government.[78]

- Authorised general insurers are regulated by the Australia Prudential Regulation Authority (APRA), which ensures insurers have an appropriate level of financial resources to pay claims. The number of general insurers have decreased to less than 100 in 2017, from 171 in 1999.[79]
- UFIs are foreign domiciled insurers that are not regulated by APRA. UFIs insure atypical risks, high-value insureds, and other risks that cannot reasonably be placed in Australia.[80] UFIs account for 3 per cent of the general insurance business[81], and are typically only used by larger corporations, and are largely inaccessible for small businesses.[82]
- Lloyd's of London is a corporate body that operates a marketplace of syndicates that underwrite insurance. Lloyd's is governed by United Kingdom legislation and is authorised to write insurance in Australia by the *Insurance Act 1973*.[83] However, in recent years many Lloyd's syndicates have exited the Australian market due to losses.[84]
- The NSW Government provides workers compensation insurance through icare.[85] icare is regulated by SIRA.

Reinsurance

Insurers need to manage their risks, to ensure payouts can occur and profits maintained. One method of transferring risk is by purchasing reinsurance. Reinsurance is typically provided by large global reinsurers that can diversify their risks across countries. Reinsurers can also seek reinsurance, which is referred to as retrocession.[86]

In Australia, APRA regulates reinsurers as authorised general insurers and Lloyd's of London syndicates can also provide reinsurance.[87] The Australian Government has developed re-insurance for specific risks, which cannot be specifically addressed by the private insurance market. The Australian Reinsurance Pool Corporation manages a $14 billion terrorism reinsurance scheme that was developed in response to September 11. From 1 July 2022, the Australian Reinsurance Pool Corporation will also manage a $10 billion reinsurance pool for cyclone and related flood damage.

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78 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
79 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 390.
80 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
81 Figure in 2017, quoted in, Productivity Commission, 2018, 'Competition in the Australian Financial System',
82 ICA, 2021, 'Role of the Private Insurance Market', p. 19.
83 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
84 ICA, 2021, 'Role of the Private Insurance Market', p. 7.
85 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 393.
86 Productivity Commission, 2018, 'Competition in the Australian Financial System', p. 388.
87 Productivity Commission, 2018, 'Competition in the Australian Financial System' p. 389, p. 392.

Small business accessing insurance

Small business can access insurance directly, or through an intermediary such as a broker or an agent. Given the complexity of business insurance, many small businesses choose to draw on the services of an insurance broker or agent. Brokers are usually paid through fees and commissions from insurance companies.