Australian Property Institute Ltd. ACN 608 309 128

Submission to the Australian Small Business and Family Enterprise Ombudsman insurance inquiry

Executive summary

On behalf of a membership cohort of some 8000 Australian property professionals, the Australian Property Institute (**API**) thanks the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) for the opportunity to contribute to this inquiry into insurance.

The members represented by the API include those working in valuation, property management, facilities management, property law, property education, property development, funds and asset management, town planning, property consultancy and advisory.

We welcome the opportunity to meet with ASBFEO to provide more detailed analysis and feedback.

Insurance represents both a significant risk and cost to API members and this submission considers the impact of professional indemnity (**PI**) insurance on the ability for valuers to provide their services effectively and efficiently. Simply put, API members' experience with PI insurance is that *premiums are increasing*, more *exclusions are being added* to their policies and *fewer insurers* are operating in the Australian market, thereby significant reducing choice, availability and accessibility of PI insurance.

Whilst recognising that macro and micro market forces largely dictate capacity, price and availability globally, and the tightening of the PI market is not unique to either valuers or the Australian market, there are a number of factors that have influenced PI insurance coverage for valuers.

There is evidence that some government procurement policies, tenders and contracts have requested valuers contract out of the APIV professional standards consumer protection scheme, regulated by the Professional Standards Councils, a serious concern on many levels.

In some states, valuation work for local government rating has been exempted from requiring PI insurance – as a model procurer, government should consider more opportunities for government work to not require PI policies to enhance availability of PI insurance to those professional services that are of higher risk (e.g. valuations for mortgage purposes).

In respect of services undertaken for the banking and finance sector, valuers are exposed to claims risks in a way that other professions rarely are. Factors outside of a valuer's control can be the cause for claim, including market cycles, credit risk and decisions or shortcomings, Lenders Mortgage Insurance (**LMI**) policies and practices and economic conditions impacting property values.

In some case studies, it is clear that effectively a valuer's PI insurance could be 'underwriting' the security and lending practices, rather than actual shortfall on a valuers' professional opinion or standards, leading to unnecessarily high PI insurance requirements on members who provide valuation services to lenders.

The API recommends that government undertake a review of the banking and finance sector's procurement practices and contracts to ensure that they clearly protect and uphold the spirit of the professional standards legislation by aligning their PI insurance requirements with the valuers' respective caps and corresponding PI insurance requirements under the APIV Scheme.

Any responses, commentary or further information requests related to this submission can be directed to Nelson Savanh, General Manager Corporate Affairs at [redacted]

Terms of Reference

The following Terms of Reference were released by the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) and form the basis for this submission.

That the Australian Small Business and Family Enterprise Ombudsman inquire into and report on practices of the insurance industry impacting small business and whether insurance products are fit for the purposes of small business, with particular reference to:

1. *the availability and coverage of insurance policies provided to small businesses including:*
   - *the impact of coverage denial;*
   - *policy exclusions and how they are communicated to small businesses;*
   - *the use of definitions in policy documents that create de facto policy exclusions;*
   - *the fitness for purpose of market offerings;*
2. *other issues affecting availability and coverage including:*
   - *any impact of the current market's lack of diversity in insurance providers, underwriters and types of insurance;*
   - *insurance policy affordability and its impact on availability, including increases in price that amount to denial of coverage;*
   - *current models of government support or control in Australia and internationally that facilitate affordable access to appropriate insurance for small businesses;*
3. *the role of brokers in getting the right coverage;*
4. *the use of contract changes that have not been agreed to and their potential treatment as Unfair Contract Terms;*
5. *the timeliness of payment of insurance payouts and the effectiveness of dispute resolution frameworks for insurance disputes;*
6. *the effectiveness of relevant codes of conduct and legislation, including the adequacy of applicable penalties; and*
7. *any other relevant matters.*

The impact of insurance companies incentivising the use of preferred providers for services may be considered in a future review but will not be covered in this inquiry.

Professional Indemnity Insurance

PI insurance provides essential financial protection against potential losses arising out of acts, errors and omissions from professional services provided, across a wide variety of purposes and valuation-related services and in some historical cases, economic cycles and the financial services macro environment.

Insurers (including Lloyds of London) underwriting Australian valuers include Australian based and global (predominantly UK based) firms: Woodina Underwriting Agency, Newline Insurance, AXA XL Catlin, Liberty, JUA and CGU.

In February 2019, an Australian underwriter, Sterling, withdrew from the valuers' PI insurance market. The financial and professional liability insurance market continued to harden through 2019, with accelerated hardening occurring in 2020. Coverforce leaving the valuer market left many valuers uninsured and therefore, without strong intervention, unable to work.

In 2019, the valuation profession and the corresponding PI insurance market was impacted by major Australian economic factors, including the following:

- continued downturn of the Australian property market;
- tightening of lending restrictions;
- increased inflows to litigation funding and subsequent class actions;
- Royal Commission into banking;
- changes to the ABA Code of Banking Practice requiring valuation reports for lenders to be provided to customers of small businesses;
- ongoing issues surrounding cladding and building safety;
- other professional service providers claims; and
- withdrawal of insurers from the Australian PI insurance markets.

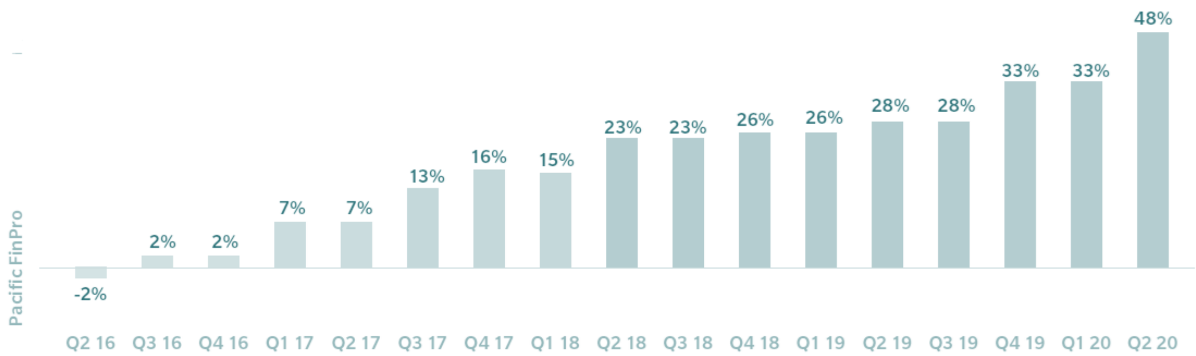
As a result, a number of member firms have expressed concerns regarding the considerable increases, without a corresponding causal connection in claims or settlements, in premium and hardship due to changes in underwriting practices, which appear to have been introduced as a result of the above macroeconomic factors.

Prior to COVID-19, the market generally was applying rate increases of about 15% and often 30-40%. The COVID-19 impact on the economy leads to uncertainty in the minds of insurers. However, insurer's PI exposure is assisted by the API's Market Uncertainty Clause in valuation reports, making it hard for a lender to argue they were not on notice of possible falls in valuation in the near future.

It is apparent that COVID-19 effects on the market are yet to be fully felt. Lloyds of London have recently released a report estimating that the total impact COVID-19 may have on the global insurance non-life industry is approximately USD 200 billion.

With appetite remaining restricted (both locally and within Lloyds) for property valuers, valuers participating in (perceived) higher risk activities such as Development Valuations, high value Mortgage Valuations, concentration of non-ADI lenders as well as other activities, face challenges in sourcing appropriate cover, thereby impacting regulatory and prudential requirements and API members operation ability.

The below chart, from the August 2020 Marsh Global Insurance Market Index, looks at quarterly increases to financial and professional liability premiums in the Pacific region. Marsh notes that in the latest quarter commercial professional indemnity increases ranged from 20% to 25% with director's and officer's coverage increases pushing up the average for the category.



API ValCover

On 8 November 2017, the API and Marsh (formerly Jardine Lloyd Thompson Pty Ltd) launched a new PI insurance facility called API ValCover. The API has licensed the use of its name to Marsh, who supports the facility through Woodina Underwriting Agency. The purpose of the partnership in creating ValCover is to create a more stable insurance environment through features such as:

- 2 reinstatements by default for any limit of choice between $1-10 million;
- loyalty discounts for renewing members after 3 and 5 years of coverage;
- a nil excess inhouse claims handling model; and
- availability of automatic run-off cover once the premium pool has grown.

API Valuers Scheme

The **APIV Scheme** is an instrument approved under the *Professional Standards Act 1994* (NSW) and regulated by the Professional Standards Councils.

The scheme binds the API to monitor and enforce members' standards, conduct and compliance obligations, thereby contributing to the improvement of professional standards of its members. Provided the participant satisfies the various requirements, including holding suitable PI insurance, the scheme enables members to 'cap' their occupational liability under the Scheme in the unfortunate event that they are pursued in court.

Member experience

The API has sought feedback from members regarding their professional indemnity insurance policies and attitudes towards availability, cost and restrictions.

Over 43% of members said PI insurance was difficult to purchase.

Smaller member firms are paying, on average, more than *$64,000 annually in premiums* for their PI insurance policies, with some medium size businesses paying up to $900,000. 48% of members experienced an increase in their premium (compared to 43% in 2018 and 40% in 2017).

Exclusions

Members report having significant exclusions included in their professional indemnity insurance policies which restrict the type of work they are able to undertake or the loan to value ratios for properties valued, of which they are mostly not aware of in their instructions. Valuers have no knowledge or awareness of their clients' (lenders') risk exposure or policy decisions as to reliance.

When surveyed, the most common restrictions included mortgage valuations, valuations for developments, managed investment schemes or solicitor loans. Some exclusions also applied to how the valuer may undertake valuations including exclusions for kerbside inspections or restricted assessments.

Feedback from members

Comments received from members and the impacts regarding professional indemnity insurance in relation to the Terms of Reference have been collated below. Comments may have been edited for clarity or confidentiality.

> *Our long standing underwriters withdrew from providing coverage reportedly due to perceived industry risks following from the Banking Royal Commission and the new Banking Code of Practice. New insurance was secured through [broker] but it was/is much more expensive and complicated coverage.*

> *Difficult due to sub standard service provide by [broker], but easy to purchase after instructing [broker].*

> *Banks refuse to use our firm without signing a waiver to ensure that more cover is provided than what is required under the Limited Liability Scheme.*

> *For this current renewal market seemed tighter but was able to secure cover after much work*

> *Although not difficult there is very limited available and those that do offer cover also include numerous restrictions particularly for development valuations.*

> *Brokers were clearly working for [insurer] and the underwriters and not for the valuers.*

> *We specialise in Mine, Quarry and Waste management asset and business valuations. Thus PI is difficult to purchase.*

> *I was only able to obtain 6 months cover.*

> *Only our current insurer ([insurer]) would provide a quote for cover. They mentioned they felt our exposure to Residential Development was too high at circa 15%, so the premium jumped 33%. Does not equate to any economic sense.*

> *Generally a purchase process worked through except for the most recent period when broker could only obtain a cover for 6 months. I was able to place the cover with another insurer for 12 months.*

> *New policy wording is far more prescriptive and cover is restricted, and the premiums rose significantly (i.e. lower quality policy costing more).*

> *Increasingly difficult to obtain insurance as many underwriters are withdrawing from the market, require larger excesses and higher premiums.*

> *PII for the 20-21 year is proving difficult.*

PI Insurance is always time consuming.

Main overseas insurer pulled out. Historically have found PI to be very expensive and fails to take in what we consider to be very low risk work.

The availability of PI insurance and how difficult it is to obtain varies from year to year. Some years I have 2 or 3 insurers aggressively seeking my business and other years I struggle to find an insurer. I have had years when I had to split my cover between 2 insurers to reach my required cover level.

We did a 6 month renewal at last year's agreed rate, not a stable business operation continuity p. Covid-19 made timing difficult.

The total cost increased by 42.8% in 12 months. The broker was far from helpful to say the least. For coverage that is basically for State Government acquisition/compensation work, it is excessive.

Less insurance companies in the market place. 6 month policy offered.

I was able to obtain a 6 month extension then I was forced to go to another insurer as my insurer had left the market/had placed an "embargo" on valuation policies due to Covid-19.

Only one underwriter operating at time of renewal. Lucky to renew cover due to our good no claims history, non mortgage practice and very high proportion of low risk valuations over a long period. This is not a 'business plan '

It is expensive for a Sole Trader like myself. Around 10-15% of my income.

No issues, simple process as I have a very professional broker.

We could only achieve cover for 6 months rather than for a 12 month period which has always been able to be obtained.

Only two choices were available to a small independent firm.

Turnovers going down since 2015/2016, but premiums increasing.

PI Insurance appears more difficult over the past 6 months, which is very disappointing/frustrating.

Policy is due to be renewed in June 2020 however broker had advised insurer has withdrawn from the market and they are seeking alternate insurers. In the meantime they had obtained a six month extension on existing policy at same premium pro-rata as last 12 month policy.

Due to being a small business, we cannot get Valex or Valocity mortgage residential work - we are therefore low volume and low income - insurers typically have limited appetite for this type of work - therefore we have found it hard to obtain cover.

There were very few insurers/underwriters willing to insure valuers according to the brokers. We could only get 6 months cover up to June 2020. I have only owned the business since July 2019.

Too few insurers in the market, especially for development work. Should be an industry insurer.

Our difficulty was about obtaining a quote which didn't significantly increase the premium. The insurance market generally is very tight at the moment with some insurers no longer wanting to insure valuers. The fact that our premium has only increased by 13% is a reflection of the fact we have only had one (disputed) claim in 36 years of trading

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Changed brokers for 19-20 policy as we felt we were not being given adequate service from previous broker.

I usually get two quotes from two brokers. [Broker] were engaged for the first time as previously they did not reply to my quote requests. Previously I have used [broker] who could not source insurance for me, but could only 'hold over' my current policy.

Brokers saying issues with insurers capacity on PI coverage, many insurers have left the market, only able to obtain premiums of 6 months at a time as carry over with existing insurer.

PII was easy until March 2020 at which time I could only secure a 6 month extension.

Just bloody expensive! I am not sure what will happen in 2020/2021 - my PI underwriter is not underwriting valuers any longer and due to Covid-19 no other underwriter was prepared to take on a new client, so [broker] have been able to roll me over with [insurer] for six months at pro-rata costing, renewal now due in November 2020. Wait and see...

Bloody expensive for someone who has never had a claim.

I had to drop mortgage work all together in order to survive (given requirements under this scheme).

Very expensive until we changed brokers.

I was unable to get cover for LRV [low-risk valuations] in 2019/20.

Unable to obtain additional $5m cover at a commercially viable level in 2020 compared to previous years. 1 provider to choose from only, lack of competition.

We had significant difficulty as our existing insurer withdrew from the market. We ended up securing a 6 month extension via [broker]. The best offer we received was a 185% increase on inferior terms.

Very time consuming and the premium is very high.

Limited options in the market though.

Sums insured need to be taken into account. 2017 and 2018 years were only $5m cover and then I jumped it to $10m.

Premium increased but more restrictions imposed. It is apparent that insurers are unwilling to cover single person boutique companies even though no mortgage work is undertaken.

Ultimately we renewed due to long tenure with our insurer, however it was at an adverse price outcome. Further, there is very little alternative market for this policy.

My current insurer can only cover me for the real estate sales and leasing, not for valuation work.

Relationship to financial sector

The API's monitoring of current and emerging market risks and agility in its guidance of its members is critical in ensuring that API, APIV and member firms remain viable and stable and meeting regulatory stakeholder requirements.

The API's submission to the Financial Services Royal Commission highlighted the poor risk controls across different functions and interests within some lenders and brokers. The competing interests, less than best practice and accountabilities between credit risk, property risk and procurement operations have led to increased insurance premiums for API members. It may be submitted that PI insurance policies held by API members have effectively underwritten poor lending practices and the risks associated with cyclical changes in the property market. This has led to unnecessarily high PI insurance requirements on members who provide valuations services to lenders. Some feedback suggests that it may be possible that the financial services sector has been misusing PI coverage held by our members and this disproportionate risk has made obtaining insurance more difficult for valuers.

Valuers, relying on PI insurance policies, can often be the only source of redress for consumers/borrowers with a grievance because a loan did not proceed, a property was repossessed by a lender, or the property market simply corrected. In these cases, borrowers appear to be provided with limited information about other factors in their situation, including banking decisions.

In addition, the number of claims may be somewhat misleading as financial institutions will often test a valuer's PI Insurance to contribute to recovery of losses incurred by poor credit risk decisions. The mere fact that a claim is made in the first place, or is settled on commercial grounds does not necessarily reflect any negligence.

Due to the concentration of the banking sector, valuers often rely on the financial institutions, who are making claims against them, for ongoing work.

In the API's experience, there is often a rise in the number of claims against valuers after a fall in the market and resultant decline in property values, as was the case in the post-GFC era. Often claims are brought simply because a loss has been suffered by a lender, even in circumstances where there has not been a wrongdoing or negligence on the valuer's part.

Members also report having to acquiesce to higher levels of PI insurance cover in order to gain work. For example, they may be a Category A member under the APIV scheme but they may still be required by the bank to obtain a PI policy insurance with a $10 million indemnity limit, which adds additional costs to the firm in order to gain bank work.

Banks routinely use Automated Valuation Models (AVMs) in valuing property, which are not insured and do not afford the banks the same level of protections that are provided by valuers by virtue of their ongoing APIV Scheme membership and their PI insurance.

The API is of the view that the banking sector's excessive PI insurance requirements for valuers are unnecessarily consuming underwriters' capacities in the valuers' PI insurance market, which continue to detrimentally affect the availability and accessibility of PI insurance for the valuation profession.

The API strongly recommends that government, through the Australian Prudential Regulation Authority (APRA), reviews the banking sector's procurement practices and contracts relating to PI insurance requirements to ensure that they align with the valuers' respective Monetary Ceilings and PI insurance requirements under the APIV Scheme.

Relationship to government

API members have also experienced conflict between the principles of our regulated Professional Standards Scheme and contract requirements sought by government procurement and tender processes.

It has been reported that in some tender contracts, clauses around liability often require 'opting' out of the API members' Professional Standards Scheme and often mandate a higher PI insurance coverage than required under the Scheme. It is imperative for necessary intervention in the procurement practices of government departments to give due consideration and effect to Professional Standards Schemes.

In some states, valuation work for local government rating has been exempted from requiring PI insurance – as a model procurer, government should consider more opportunities for government work to not require PI policies to enhance availability of PI insurance to those professional services that are of higher risk (e.g. valuations for mortgage purposes).

COVID-19

The API's agile responses to the current COVID-19 situation is a great example of how the API is leading the property profession and enhancing consumer protection through proactively monitoring and mitigating market risks, protecting our SME businesses.

At the outset of the COVID-19 crisis, the API released a Valuation Protocol – Significant Valuation Uncertainty for the purpose of providing guidance for API Members. In essence, the Protocol recommends that where there is evidence of significant market uncertainty at the date of valuation, the API member must include a disclosure statement relating to significant Valuation Uncertainty in their valuation reports. This was important to have in place to allow valuations for the banking and financial sector to go ahead in an uncertain market and ensure firms' PI coverage remained intact.