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The Manager
Cyclone Reinsurance Pool Taskforce
The Treasury
Langton Crescent
Parkes ACT 2600

Submission from the National Insurance Brokers Association in response to the consultation paper: Reinsurance pool for cyclones and related flood damage

Thank you for the opportunity to provide this submission in response to the Treasury consultation paper on the proposed reinsurance pool for cyclones and related flood damage.

This submission is in many ways preliminary, in that the consultation paper raises a number of issues and asks questions in relation to how the pool might operate and who might benefit from its implementation. The actual level of benefit likely to be provided to policyholders in northern Australia is also not yet clear.

The National Insurance Brokers Association represents large, medium and small insurance broking firms operating across Australia, and especially in northern Queensland, the Northern Territory and northern Western Australia. Our members have first hand knowledge and experience with the insurance markets in the northern regions of Australia. This includes knowledge of the insurance coverage available to individuals, small businesses and strata lot owners.

The ACCC reports on insurance issues in northern Australia document the movements in premiums over the past 10 years, as well as the claims costs that have arisen as a result of severe weather events during that period. The ACCC noted that the insurance market in northern Australia is extremely unusual, in that insurance companies are often competing to lose business rather than competing to gain business.

The day to day experience of insurance brokers in northern Australia confirms this position. Insurance brokers are consistently reporting extreme difficulty in gaining quotes for property and related risks in northern Australia, and when quotes are available they are invariably extremely expensive.

In recent times, high premiums have also been accompanied by high levels of excesses or deductibles (for example, a property might be insured for \$600,000, but the property owner might be required to carry the first \$100,000 of loss), and/or low levels of sub-limits within the policy (again for example, a property might be insured for \$600,000, but there might be a sub-limit which limits cover for cyclone related loss to only \$250,000). These examples are for illustration purposes only, but are indicative of real experiences in the markets today.

Recent discussions with insurance brokers operating in north Queensland and brokers in Western Australia with clients in the far north of the State confirm that these extremely difficult market conditions are continuing.

Balance

In announcing the initiative, the Prime Minister has given some indications of the extent of support to be provided to policyholders. That therefore raises the issue of what needs to be done, compared to what the Government's announcement will allow to be done. It will therefore be necessary for the design of the reinsurance pool to take account of Government imposed limitations and requirements.

For example, we note the Government has committed to a Government guarantee of the reinsurance pool, but has not committed to funding the pool from revenue or other sources. NIBA therefore assumes –

- The reinsurance pool will have to operate in a manner that allows the pool to fund its losses over time (in other words the need to fund the pure risk premium – cost of claims without any costs of administration or financing etc will continue and will not be subsidised by the Government); and
- If the Government guarantee is called upon by the pool, the amount funded will need to be replenished by pool income over time.

If this assumption is correct, the ability of the reinsurance pool initiative will have limited capacity to significantly reduce premiums in northern Australia, or to make insurance more affordable for those not currently able to insure their property.

This inherent limitation can be demonstrated by the following example (this example was provided by a member in north Queensland):

For example on my \$5,500 net (ie without commission or brokerage) home policy if the reinsurance component of the premium is say 30% or \$1,650 then if the reinsurance pool savings are based on nil profit/lower costs etc then what will that do to the reinsurance component of the premium?

If it only reduces the cost of reinsurance by 20% then all I am saving is \$330, which will not have a significant impact on the total premium.

Other members have indicated that with the high current costs of premiums for homes and strata lots in north Queensland in particular, a reduction of 10% will leave a premium that is still very significantly more expensive than those in south-east Queensland or across southern Australia, and will most likely continue to be unaffordable for currently uninsured property owners.

NIBA looks forward to the opportunity to assess and comment upon the likely cost savings that will arise from the preferred reinsurance pool model.

Incentive

The experience of insurance brokers is that for many property owners in northern Australia (including small business owners and strata lot owners) there are limited and in some cases no options for insurance cover. As the ACCC has noted, the market features strategies to limit the provision of product to the region rather than promote sales.

NIBA submits that before serious design, modelling and costing is undertaken, Treasury needs to meet privately with the leading insurance companies and ascertain (no doubt in a commercially confidential manner) what would be the factors and design elements that would encourage the insurers to return to northern Australia and provide cover to the majority of properties on a more competitive basis.

Unless and until this information is known, any model for a reinsurance pool may well fail to gain what insurance brokers and property owners seek most: greater choice of cover, from a competitive insurance market that meets the needs of most property owners.

Once the views of insurers are known, analysis can be undertaken to determine the design parameters of a scheme that would achieve the desired outcome, and appropriate modelling could then follow.

Scope

According to the Bureau of Meteorology, cyclones typically involve very high winds, very significant rainfall and a high risk of storm surges. Experience from cyclones in northern Australia in the past 10 years indicates that the rain can result in flooding in across large parts of inland Australia, over many months following the conclusion of the cyclone event itself.

Also important is the consideration of how extensive the scheme coverage will be. For example, NIBA understands Cyclone Debbie and the resulting weather conditions originated near Vanuatu, almost destroyed Hamilton Island, did severe damage to Airlie Beach, and then travelled south causing serious rain and flood damage to most of eastern Queensland and north eastern New South Wales, and subsequently crossed the Tasman Sea to cause further damage to the north island of New Zealand.

Careful consideration will need to be given to how much of that exposure is intended to be covered by the proposed reinsurance pool.

Given the very high cost of insurance in northern Australia, NIBA's preference is for as much benefit to be provided to as many property owners as possible. This has the dual benefit of providing cover to a significant proportion of the community, while also spreading the associated cost across a large number of policyholders.

NIBA members are keen for most business owners to have access to the reinsurance pool, as most business owners are struggling to get access to reasonable levels of cover at affordable rates. We accept that the ultimate scope of the coverage provided by the pool will depend very much on the modelling and likely pricing of the pool reinsurance.

A further matter requiring consideration is the need to provide protection for residential homes on agricultural land. Homesteads can and are affected by cyclones and need to have access to the benefits provided by the cyclone pool. Consideration also needs to be given to the need to support small business owners operating in premises owned by large property owners.

Design

From a design perspective, NIBA believes the ultimate design of the reinsurance pool will need to be guided by what insurance companies require to become active participants in the northern Australia insurance markets, having regard to the modelling of that approach.

Nevertheless, NIBA believes the pool should assume a significant portion of the losses currently carried by insurers and commercial reinsurers.

This could be done in two ways:

- The reinsurance pool would provide excess of loss cover above a relatively low amount retained by the insurance company;
- The reinsurance pool would operate along the lines of the New Zealand Earthquake Commission, and cover the first \$150,000 of losses sustained by the property owner, for cyclone or related losses.

Again, the modelling will need to balance the need to provide incentives to encourage insurers to (re)enter the northern Australia market, provide genuine premium relief to property owners, and ensure the reinsurance pool remains financially viable in the medium and longer term.

In relation to the product itself, it may be necessary to avoid the potential for any gaming of the system by requiring all insurers to provide a similar level of cover (as does the terrorism reinsurance pool) with protection being provided by the cyclone pool or the broader market if/when cover for the defined product is available from that market. Discussions with insurers will need to determine how best to achieve this careful component of product design.

Governance

The cyclone reinsurance pool is likely to be active (far more so than the terrorism pool), and will require very careful monitoring, management and governance. We also expect the Government will wish to ensure the full benefits of savings generated by the cyclone reinsurance pool are passed on to policyholders.

There are many elements which give rise to property insurance premiums, and reinsurance can have an important impact on this. Quota share reinsurance is a feature of the Australian market, these and similar features will need to be taken into account when monitoring the impact of the cyclone reinsurance pool on property insurance premiums in northern Australia.

An important consideration is the fact that insurance pricing is adjusted constantly, potentially every time new information becomes available to the insurer. Price monitoring will need to allow for this.

NIBA does not support the disclosure of reinsurance costs to policyholders, simply because insurance companies are likely to have different approaches to their overall reinsurance positions, and mandatory reporting of reinsurance costs will only confuse property owners and will add little or no value to the process. The Government may need to consider the use of statutory powers to gather and analyse pricing information from insurance companies.

NIBA would support a triennial review of the cyclone reinsurance pool along similar lines to the review that is undertaken for the terrorism pool.

Mitigation and Resilience

NIBA is a strong supporter of the need for all levels of government to encourage and promote improved levels of risk mitigation and resilience in the built environment. Australia must be better at coping with the nature and extent of weather events that will continue to have major impacts on communities, especially those across northern Australia.

Our concern is that the overall aim of the cyclone reinsurance pool is to provide relief to property owners in northern Australia, and this will not occur if significant groups in the community do not get access to the pool (such as buildings that do not comply with modern building standards, buildings that are less than 2 years old, etc). It may well be necessary for the Commonwealth to enter into separate arrangements with the States and Territory to ensure the implementation of the cyclone pool does not detract from actions (and funding) to support greater levels of risk mitigation and community resilience across northern Australia.

ARPC

As manager of the cyclone reinsurance pool, NIBA expects the ARPC will gain extensive knowledge and experience of catastrophe reinsurance financing in the international reinsurance markets. This knowledge will be extremely valuable to the Australian insurance market more broadly in future years as we continue to meet the needs to manage and finance risk arising from cyclones and other major weather events.

Conclusion

For the reasons stated in this submission, NIBA has not answered the specific questions in the consultation paper. We believe many items of detail will only be able to be addressed once key pre-considerations identified in this submission have been considered and resolved.

We would be pleased to discuss any aspect of this submission with the Treasury Taskforce.

Dallas Booth

Chief Executive Officer

National Insurance Brokers Association of Australia