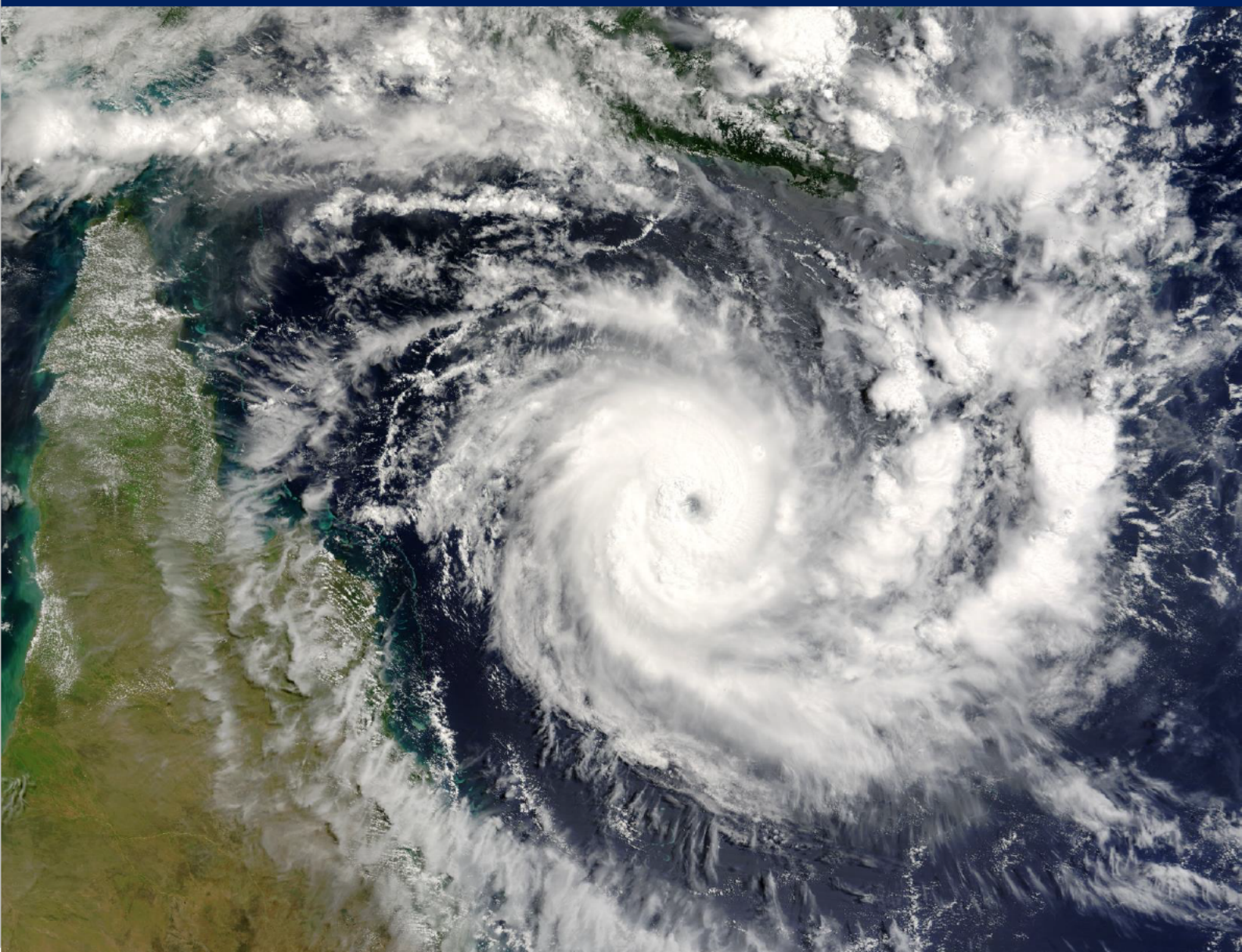
QBE

Submission

Reinsurance pool for cyclones and related flood damage

18 June 2021



About QBE

QBE Insurance Group Limited is an international insurer with insurance products covering a diverse portfolio including property, crop, energy, marine and aviation. Headquartered in Sydney and listed on the Australian Securities Exchange, we employ more than 11,700 people in 27 countries around the world.

QBE Insurance (Australia) Ltd (QBE) has offices in all Australian states and territories and provides a broad range of general insurance products to personal, business, corporate and institutional customers.

Since its origins in Queensland over 130 years ago, QBE has been an integral part of the Australian business landscape, providing peace of mind to Australians during normal business and times of crises.

QBE is proud of its heritage and the support that it has provided to our customers and policy holders during this time. Our purpose is to give people the confidence to achieve their ambitions.

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Overview

On 4 May 2021, the Australian Government announced its intention to establish a reinsurance pool providing cover for the risk of property damage caused by cyclones and cyclone-related flood damage. The intent is for the pool to seek to improve accessibility and affordability of insurance for households and small businesses in cyclone-prone areas, which are mainly located in Northern Australia.

QBE appreciates the opportunity to provide feedback on the Consultation Paper *Reinsurance pool for cyclones and related flood damage* (***Consultation Paper***) released by the Treasury on 21 May 2021. We also sincerely appreciate the Treasury's collaborative engagement with the industry and insurers since the release of the Consultation Paper.

QBE has participated in, and supports, the general insurance industry submission on the Consultation Paper by the Insurance Council of Australia (ICA). Our submission aims to provide supplementary information from a QBE perspective.

General observations

Numerous independent reviews and inquiries[1] have examined the cost of insurance in Northern Australia and have found there are genuine reasons why insurance premiums are more expensive in this region. Communities in Northern Australia are commonly exposed to extreme and destructive weather events when compared to other areas of Australia and the costs to service the region by insurers can be very high. Unfortunately, the expectation is that these natural disaster events will continue to increase.

We appreciate the Federal Government's support and commitment to solutions intended to improve access and affordability of insurance. We believe it is important to continue to invest in mitigation, improve planning laws and strengthen building codes to support more resilient communities and reduce both the social and economic costs of natural disasters. Focusing on risk reduction and mitigation will also assist insurance accessibility and affordability. In this context, we welcome the Federal Government's recent announcements on disaster preparedness and building resilience including:

- establishment of the National Recovery and Resilience Agency, with $600 million to be invested in a new program of disaster preparation and mitigation;
- establishment of the Australian Climate Service, enhancing the Commonwealth's climate and natural disaster risk information to build Australia's climate resilience;
- commitment of $40 million for the North Queensland Strata Title Resilience Pilot Program to subsidise the cost of cyclone mitigation works for strata title properties from 2022; and
- provision of $50 million (through the Government's $4 billion Emergency Response Fund) for projects across Australia this year under the National Flood Mitigation Infrastructure Program, with 22 identified projects funded or co-funded.

QBE also acknowledges the Queensland Government's Household Resilience Program, which provides funding for homeowners undertaking cyclone mitigation. QBE recognises the program and provides premium discounts for eligible mitigation works.

There are also additional measures that we believe will meaningfully impact on insurance premiums and broader community resilience such as:

- tax reform, given numerous reviews have found insurance taxes to be very inefficient and counterproductive;
- disclosure of natural peril risks by local governments to homeowners and potential purchasers prior to sale to better inform decisions; and
- further investment in public and private mitigation to boost resilience.

[1] For instance, reviews have been undertaken by the Australian Government Actuary, the House of Representatives Standing Committee on Social Policy and Legal Affairs, the Productivity Commission, the Northern Australia Insurance Premiums Taskforce and the Australian Competition and Consumer Commission.

The Consultation Paper[2] indicates the reinsurance pool would seek to improve the accessibility and affordability of insurance for households and small businesses in cyclone-prone areas, which are mainly located in Northern Australia. QBE appreciates that there will be many complex issues and challenges in designing a reinsurance pool to achieve this objective. We look forward to participating in this initiative and contributing our experience and expertise, as required.

As indicated in the Consultation Paper, the extent of the reduction in premiums and improved accessibility will depend on the final design of the reinsurance pool. Lower insurance premiums for households and small businesses are intended to be achieved by decreasing the cost of reinsurance for policies with high cyclone and related flood damage risk. We understand this intended outcome relies on the presumption that lower cost reinsurance should be able to be provided by the pool to insurers as the pool will forgo a commercial profit margin and be backed by a government guarantee. This should allow insurers to reinsure the risk of losses from cyclone and related flood damage claims at a lower cost than in the private reinsurance market.

We believe it will be critical in designing the reinsurance pool to ensure that any potential consequent effects (such as reduction of diversification benefits and additional operational or frictional costs) are carefully identified, weighed and considered. Otherwise, any potential reductions in premiums for consumers and small businesses may not be achievable.

QBE also believes it is important that the design of the reinsurance pool embed the right incentives for, and be coupled with, longer term solutions such as mitigation and appropriate land use planning and development. This will be critical to ensure underlying risk issues are not exacerbated over time.

In addition, given many of the levers that control natural disaster risk are within the remit of state, territory and local governments, QBE encourages the Federal Government to ensure state, territory and local governments also do their part in reducing underlying risk. Any increased concentration of people, infrastructure and economic activity in areas exposed to significant natural peril risk is a key driver of increasing loss, particularly when the urbanisation occurs without appropriate mitigation to reduce vulnerability.

Reinsurance pool design considerations

This section outlines QBE's feedback in response to the questions set out in the Consultation Paper.

Reinsurance pool coverage

1. How should 'cyclone' and 'cyclone-related flooding' be defined for the purposes of defining the reinsurance pool's coverage?

QBE supports the ICA position that 'cyclone' be defined by reference to the Bureau of Meteorology (BoM) definition. QBE considers there would also be benefit in testing any proposed definition for fairness and consistency against historical cyclone events.

Cyclones typically start and end as tropical low pressure storm systems and can move over long distances in the days immediately before and after the period when they are classified as a cyclone. Storm systems that become named cyclones can cause significant storm and flood damage over a wide geographic area that is directly impacted by the storm during the entire time that the system is active (i.e. from the time it emerges as a tropical low until the storm abates, is downgraded, or moves out to sea). As the rainfall can take some time to move through complex river systems, flood damage can also occur beyond both the directly impacted area and the timeframe in which the storm system is active.

Accordingly, we anticipate it will be challenging to fairly and consistently define the geographic reach and time period within which storm and flood losses should be reasonably attributed to a given cyclone. There will be additional complexity when more than one storm system impacts a particular geographic region and one of these is not classified as a cyclone.

[2] Consultation Paper, pp2-3.

Conventional reinsurance programs avoid boundary issues between cyclones and non-cyclone storms and between cyclone-related flooding and all flooding from other causes, typically through use of a time-based boundary. Alternatively, the use of an "event" definition could be considered to avoid complexities and issues associated with time and geographical based boundaries.

In considering these definitional issues, QBE suggests that a guiding principle could be adopted from the NAIPT Final Report[3]:

> *Any definition would need to capture the bulk of cyclone damage, be easy to understand and allow the relationship between cyclone insurance (or reinsurance) products and complementary (non-cyclone) insurance products to be as seamless as possible*.

In addition, QBE suggests that the application of a proposed definition be tested against historical cyclone events with the aim of ensuring the effectiveness of any definition. In this way, the outcomes could be examined in terms of the extent of losses that would have fallen within the scope of the cyclone reinsurance pool had it been in operation at the time of the events. For instance, Tropical Cyclones Oswald (2013) and Debbie (2017) provide two recent examples of events that caused widespread storm damage and flooding over a broad region.

The NAIPT Final Report noted that if cyclone damage were defined as that 'caused by a *named tropical cyclone* in the geographic area that experienced wind speeds equivalent to Category 1 or faster', then:

> *… the flooding caused by Ex Tropical Cyclone Oswald outside the areas of high winds would fall outside the definition of cyclone damage for the purpose of a 'cyclone policy'*.[4]

2. Should storm surge be covered by the pool and included in a definition of 'cyclone-related flooding'?

QBE supports the ICA position that storm surge should be included in the definition of 'cyclone-related flooding'.

This position is consistent with the guiding principle noted in our response to question 1. As indicated in the NAIPT Final Report, the bulk of cyclone damage should be captured including damage caused by high winds, flooding, storm surge and water ingress.

QBE considers that excluding storm surge losses would be problematic and is unlikely to meet community expectations. It is also likely to cause unnecessary frictional costs for insurers (for instance associated with reinsurance arrangements and claims management), which in turn are likely to erode reductions in premiums and improved accessibility achievable by the pool.

3. Is it desirable for the use of standard definitions of 'cyclone' and 'cyclone-related flooding' to be required in policies covered by the pool?

QBE supports the ICA position that consistency in definitions between insurance policies and contractual arrangements with the cyclone reinsurance pool is not required.

Distinguishing between storm and flood damage caused by a cyclone or otherwise in an insurance policy is unlikely to be of any material benefit to consumers and small businesses and is more likely to introduce unnecessary complexity.

Community expectations are more likely to focus on the inclusion of storm damage (with the expectation being that is it included regardless of the cause) and flood damage (whether it is included or not, again regardless of the cause). To overcomplicate these elements of coverage by reference to the cause is unlikely to be helpful for consumers.

[3] NAIPT Final Report, November 2015 (***NAIPT Final Report***), p27.
[4] NAIPT Final Report, p27.

4. Are there any difficulties which may arise from including home building, home contents, or residential strata policies in the reinsurance pool and how should the scope of this coverage be clarified?

QBE supports the ICA position. In principle, there are no difficulties in applying the pool to home building, home contents or residential strata policies, however the application to small business is complex. QBE also supports the explicit inclusion of landlord policies.

For strata properties, QBE notes there is likely to be complexity associated with mixed use strata complexes, that is, where there are residential and commercial (SME and large commercial) units within a single strata scheme. In such situations, it will be highly problematic to attribute the premium for a given scheme between residential and commercial use, and for commercial schemes between small and large business use.

5. Are insurers able to separately price or estimate the value of the property component of business insurance packages?

QBE supports the ICA position that it is possible to separately estimate the value of the property component of business insurance packages. QBE also suggests consideration be given to including business interruption coverage.

Although it is possible to separate the property component of a business insurance packages, QBE suggests that including business interruption (BI) coverage within the scope of the pool should be considered. BI cover is offered in combination with commercial property insurance and mainly sold as part of a 'business pack' of insurances, or under an industrial special risks (ISR) policy. BI cover is generally only triggered where the insured's business is interrupted by physical damage from an insured peril to insured property at the business premises. Given BI could be a direct consequential loss caused by a cyclone, or cyclone-related flooding, it may be reasonable to include within the scope of the pool.

We note there may be challenges in separately estimating the property and BI coverage premiums by peril, particularly in the case of flood where insurers will not usually distinguish between cyclone-related flood and non-cyclone related flood. This capability is likely to vary by insurer.

6. Are insurers able to separately price or estimate the value of the residential and small business components of mixed-use strata title policies?

QBE notes the complexities associated with mixed-use strata complexes.

QBE suggests that whilst capability across insurers may vary, it is not generally within the scope of pricing approaches to separately price or estimate the value of residential and small business components of mixed-use strata title policies. This will require careful consideration given the potential complexities.

7. Are there any difficulties which may arise from including mixed-use strata title policies in the reinsurance pool and how should the scope of this coverage be clarified?

Yes, this will require careful consideration during the design process. Also, refer to comments in response to questions 4 and 6.

8. How should 'small business' be defined for the purposes of eligibility?

QBE, in principle, supports the ICA position that rather than focusing on the characteristics of the policyholder (which is problematic for insurers), policies designed for small business usage should be covered. While QBE is also supportive of a harmonised definition across legislation, it should be recognised that current definitions remain problematic. QBE would also welcome clarification in relation to farms.

QBE's view is that definitions of "small business" linked to the number of employees and/or the turnover of the business are problematic. For instance, businesses can potentially move in and out of these boundaries and would need to be re-validated at the point of a claim to assess whether the insured's loss falls within the scope of the reinsurance pool or not. This data is also not often collected by insurers given it is typically not relevant to the risk being assessed.

QBE's preference would be to utilise a small business classification by a government department or agency (possibly the Australian Taxation Office) that could be relied on by an insurer. The classification could be based on defined criteria and would allow insurers to rely on a more objective and verifiable source (rather than collecting additional data such as employee base or turnover).

Another alternative may be to use the total sum insured as a proxy (for example - total insured value up to $10 million). While this provides a simple and more practical approach over measures such as employee base or turnover, we recognise it may not be an accurate measure of a "small business" in all cases and may create opportunities for manipulation.

9. Are there any difficulties which may arise from including small business property insurance policies in the reinsurance pool and how should the scope of this coverage be clarified?

QBE notes this the scope of coverage may create expectations in relation to the inclusion of flood cover.

QBE notes that there is wide variability in small businesses' take up of flood cover. Many small businesses make an informed decision not to insure for flood risk. While a clear disclosure regime may go some way to addressing this, there may be benefit in joint public-private initiatives to ensure transparency and clarity for small businesses as it relates to flood risk.

The existence of a reinsurance pool may potentially create an expectation that flood cover be included in all small business policies, even where the insured may not have chosen to purchase such cover.

Reinsurance product design and insurer participation

10. What is the current approach used by insurers to assess and measure cyclone, storm surge, and related flood damage risks, to what extent are individual policy level data available, and how are cyclone related risk premiums calculated in insurer pricing models?

The general methodology used by insurers to assess, measure and price the cyclone and related risks is outlined in the ICA submission.

QBE accesses a range of industry and specialist models for our catastrophe pricing. We source information from a variety of providers and continue to factor in new information and findings as it becomes available to help inform our view of risk, and as a result, price. Overall levels from industry models are validated using a range of techniques, including consideration of QBE's own claims experience.

11. How should the reinsurance pool design a risk rating system for cyclone and related flood damage risks, and what are the trade-offs associated with using risk tiering and with the level of granularity used?

QBE agrees with the ICA that a risk rating system will be complex and involve a range of considerations, but that any system should continue to provide the appropriate pricing risk signal.

As the ICA has indicated, this is a complex but key element for the design of the reinsurance product.

QBE suggests there would be benefits to utilising a more granular risk-based approach given this is common market practice. This would require minimal change to current methodologies which would assist in avoiding additional transitional costs. More importantly, this approach to pricing would continue to reflect the underlying risk rather than see some form of cross-subsidisation occur that may negatively impact some customers whilst positively impacting others, without reference to the customer's risk profile.

Where a pricing risk signal is lost or distorted in any way (for example through cross subsidisation, or government subsidisation or regulation), risk signals and market information can be impaired or lost, which can exacerbate the risk. As noted by the ACCC[5]:

[5] ACCC, Northern Australia Insurance Inquiry, Final Report, November 2020 (***ACCC Final Report***), p166.

A government reinsurance pool which sets risk based prices would not impact the ability of insurance premiums to act as risk signals. However, where the government reinsurance pool is subsidised (via a levy, cross-subsidisation between policyholders or by the use of a government guarantee), the reinsurance premiums will not be reflective of risk at the individual property level.

QBE recognises that the cyclone reinsurance pool will need to establish its own methodology and approach to pricing and exposure management. This is also likely to involve operational complexities and costs. QBE suggests these costs will need to be carefully balanced against the benefits of granular risk-based pricing and the overarching affordability objective.

12. How much risk exposure should primary insurers retain?

QBE suggests the nature of the reinsurance arrangement, together with financial modelling, will be key to determining insurer retentions.

QBE believes it is important that insurers retain some risk, however we suggest there is likely to be a greater positive impact on affordability of insurance, the greater amount of risk is ceded to the reinsurance pool.

The nature of the reinsurance arrangement will also be a key consideration. QBE notes the NAIPT Final Report proposed an excess of loss treaty arrangement[6]. However, an excess of loss arrangement will mean insurers are likely to maintain a large proportion of primary working losses which will necessitate insurers retaining a higher proportion of the risk premium – in turn reducing the opportunity for savings to customers. Alternatively, a proportional quota share arrangement would share a greater proportion of the risk and losses, thereby providing greater scope for premium discounts to customers. We assume the reinsurance arrangement would also need to factor in an exchange commission from the reinsurance pool to insurers to cover acquisition costs.

QBE recognises that modelling will be particularly relevant in this context as the alternatives noted will require careful consideration given the potential impacts. For instance, the Report by Finity Consulting prepared for the NAIPT[7] assumed an industry retention of $100 million per event "aimed at balancing the competing requirements to reduce the claims costs of insurers and to ensure that calls on the pool are not too frequent"[8].

13. Would implementing a reinsurance pool have any effect on the claims management process, and how could this be addressed in the reinsurance pool's design?

QBE supports the ICA position that the expectation is claims will continue to be dealt with by the primary insurer. Insurers are already required to meet high claims management standards which are soon to be further strengthened through legislative reforms to claims handling. It would be important that the reinsurance pool will not of itself impact the delivery of these standards.

QBE makes the following observations:

- The scope of the reinsurance pool, including definitions, will be central to the claims management process, therefore clarity of these elements will be particularly important to ensure the claims management process is not delayed or otherwise negatively impacted.
- Insurers and reinsurers do not typically distinguish between the cause of flooding (refer to our response to question 1), so if this is required, causation would need to be determined by an appropriately qualified expert (for example, a hydrologist). This may result in additional claims costs and delay where such a report would not otherwise have been required (for example where a policy includes flood cover).
- The claims management process will also be more complex when more than one storm system impacts a particular geographic region and one of these is not classified as a cyclone (refer question 1). Again, causation will need to be determined and depending on the scope of the reinsurance pool, losses may need to be separately quantified which adds further complexity to the claims management process.

[6] NAIPT Final Report, p48.
[7] NAIPT Final Report, Appendix C.
[8] NAIPT Final Report, p49.

14. What is the appropriate level of participation in the pool, and how should considerations of coverage and the amount of risk to be ceded be addressed?

QBE agrees with the ICA position that this will be largely dependent on the outcomes of more detailed modelling.

QBE notes that an intrinsic feature of insurance is diversification, whereby the spreading of risk across different products and geographies lessens the concentration of risk. While the opportunity for diversification within the reinsurance pool will be somewhat limited given the intended scope, QBE suggests that the inclusion of all cyclone and cyclone-related flooding risk Australia-wide, combined with a proportional ceding of such risk is more likely to have greater benefits for consumers and small businesses. QBE suggests that ceding of risk should not be based on geography (i.e. there should be no differentiation between high and low cyclone risk zones across Australia) as this may not realise the expected reinsurance cost savings and would be administratively problematic.

Also, as indicated in response to question 12, QBE notes the nature of the reinsurance arrangement will be a key consideration in the amount of risk to be ceded to the reinsurance pool and the consequent potential affordability impact.

QBE also understands the scheme would be voluntary – this is consistent with the approach considered in the NAIPT final report.

15. How should industry transition be managed and what is the best format and timeframe for it to take place?

QBE supports the ICA position that certainty on the design of the pool is needed prior to insurers being able to commence implementation, and that such implementation will be complex.

In addition to the implementation challenges noted by the ICA, particularly if there are implications for disclosure documentation which will require sufficient lead time to ensure clarity for consumers, QBE notes that restructuring reinsurance programs will also pose a range of challenges. Issues include:

- where timeframes of existing reinsurance programs do not align with the reinsurance pool commencement date; and
- potential overlaps in reinsurance programs (i.e. with the private market and reinsurance pool) may have implications for the ability of insurers to pass on any potential premium discounts given reinsurance premiums may in fact be higher for insurers during this period.

In addition, QBE notes that it is likely insurance policies having already incepted prior to the commencement of the reinsurance pool will not have any potential premium reduction applied.

Reinsurance pool governance and monitoring

16. What should be the key goals for a regular review of the reinsurance pool and what would be the optimal timeframe?

QBE supports the ICA position that Government is best placed to establish the metrics for review of the reinsurance pool and that consideration should be given to any correlation between the pool's operation and the level of mitigation being undertaken. We also suggest if the pool has a planned exit date, monitoring of the progress to exit would be desirable.

17. Should the reinsurance pool have a planned exit date?

QBE supports the ICA position that there should be a plan for the reinsurance pool to exit the market.

QBE notes the ACCC and NAIPT[9] found it would be feasible for government to gradually withdraw support for the scheme, albeit noting that overseas experience shows this is challenging. QBE believes the reinsurance pool should be transitional and coupled with longer term solutions such as mitigation and

[9] ACCC Final Report, p165 and NAIPT Final Report, pp xii and 56.

appropriate land use planning and development to ensure underlying risk issues are not exacerbated over time.

A possible mechanism for withdrawal was considered by the NAIPT[10]:

> *There is a mechanism to slowly reduce support to the scheme and, if the scheme did not have an adverse impact on the capacity of the reinsurance industry, the private sector should return to providing cyclone reinsurance. The mechanism to withdraw support would be to gradually raise the retention level of insurers or require insurers to share an increasing proportion of the claims (through a cost sharing arrangement). Insurers would turn to the private market to manage these risks.*

18. Which mechanisms will ensure the pass-through of reinsurance premium savings to insurance policyholders? For example:

QBE supports the ICA position that the nature of any potential price monitoring is likely to be dependent on the final design of the reinsurance pool and that price monitoring should be cost effective. QBE also supports the ICA position that disclosure of information to policyholders needs to be meaningful and help them understand their risks.

18.1. Explicit price monitoring of insurance premiums?

As highlighted by the ICA, the design of the reinsurance pool is highly likely to influence the nature of price reduction and any monitoring. For instance, if the reinsurance pool is an excess of loss arrangement, we would expect a large proportion of potential premium savings would derive from geographical areas with major cyclone risk aggregation (e.g. Brisbane, Gold Coast and Perth). If the aim is to spread these cost savings across a broader geography (e.g. Northern Australia) then monitoring how insurers achieve this across their portfolio is likely to become quite complex.

Price monitoring can also impose additional administrative and compliance costs for insurers as was the experience in NSW with the Emergency Services Levy (ESL) price monitor. These costs can become significant depending on the nature and regularity of the monitoring. This would have implications for insurers' systems and resourcing and may quickly erode any potential affordability benefits of the reinsurance pool arrangement.

18.2. Additional requirements to disclose the cost of reinsurance to policyholders?

We support a more effective general insurance disclosure regime to improve consumer awareness and provide greater transparency about product coverage. However, similar to our response to question 3, QBE suggests information on the costs of reinsurance may introduce unnecessary complexity and additional cost and may be unlikely to enhance consumer understanding. We believe consumers also need to understand their risks, and options for managing them.

18.3. Any additional mechanisms that may be appropriate?

QBE has no additional comments.

Links to risk reduction

19. To what extent do insurers price in discounts into insurance premiums for mitigation action undertaken by or affecting policyholders?

QBE expects that where mitigation is effective we would expect to see the risk premium associated with the relevant peril drop in accordance with the reduction in the level of risk.

Insurers run sophisticated catastrophe models to estimate the level of natural catastrophe risk associated with properties across Australia. If the level of risk drops due to effective risk reduction, then risk premiums for that peril will drop too.

There are a variety of examples that demonstrate this, including Roma, an acutely flood prone location in Queensland. When flood cover was introduced for the first time in Australia in 2007, average premiums in

[10] NAIPT Final Report, p56.

Roma began to climb steeply. In 2015, the risk of flooding to large parts of Roma was reduced through the completion of the first stage of a flood levee and average premiums significantly reduced in a short period of time. Key to this reduction in premiums was the insurance industry being given access to all of the necessary data required to factor in the completion of the mitigation. Without this, reducing premiums simply would not have been possible.

As the ICA has advocated previously, Australia lacks a publicly available built environment dataset. This is a critical enabler to all other built environment risk management which would provide a single point-of-truth for the standard of household mitigation applied by an owner, so all insurers can recognise the risk reduction[11].

Without this dataset, there are a range of factors that may impact on an insurer's ability to apply mitigation discounts. For instance, mitigation works may differ based on a range of factors (e.g. quality, implementation, the surrounding terrain, underlying construction). Such works would need to be assessed manually and on a case-by-case basis (at least prior to any market-wide assessments that may potentially develop over time).

It is however, important to understand that not all drivers of pricing are within the control of domestic insurers. For example, factors such as increased demand for building resources due to scarce resources or government stimulus measures can drive up claims costs.

20. How might mitigation be encouraged by the reinsurance pool's design? For example:

QBE supports the ICA position that effective mitigation should be taken into account in the reinsurance pool's pricing structures. QBE also notes the limitations in the ability of the reinsurance pool to encourage mitigation without appropriate funding.

20.1. Should the pool provide discounts for properties that undertake mitigation?

As noted by the ICA, we agree that effective mitigation should be taken into account in the reinsurance pool's pricing structures.

20.2. Should the pool have an explicit mandate to encourage mitigation?

Many reviews over the past decade[12] have consistently found that mitigation is the only way to effectively address the root cause issues of insurance affordability by reducing the underlying risk and increasing the resilience of our communities for the future. QBE notes that mitigation also boosts productivity and helps boost the economy.

While the intent is that the reinsurance pool be designed to be cost-neutral to the Government over time, we suggest consideration be given to utilising any short-term surplus to incentivise mitigation and improve resilience. This may ultimately benefit the longer-term goal of a planned exit date for the pool.

Acknowledging the limitations in the ability of the reinsurance pool to encourage mitigation, QBE nevertheless strongly supports any measures that encourage and promote mitigation (public and private).

[11] QBE notes the ACCC has recommended "The Australian Government should, in consultation with state and territory governments and the insurance industry, consider developing a voluntary building resilience register that would record key building specification data (such as floor height or structural improvements for better resilience) of properties" (ACCC Final Report, Recommendation 13.4).

[12] Including both the ACCC and NAIPT.

21. How should the pool's design seek to discourage any increase in risky behaviour? For example:

21.1. Should there be a time-based cut-off to exempt new builds from the pool?

21.2. Should the pool only allow new builds that have been built to adequate standards and in suitable locations?

QBE supports the ICA position that there be no limitations that restrict reinsurance pool coverage to new builds provided arrangements with the states and territories reflect commitment to rigorous building standards, risk sensitive land use planning and risk mitigation.

QBE notes that planning laws and building codes play a key role and should also be a key focus for consideration (refer response to question 22).

22. To encourage further action by states and territories on insurance affordability:

QBE supports the ICA position that there should be an incentive for states and territories to commit to strengthened building standards, land use planning and risk mitigation. QBE also strongly supports tax reform.

22.1. What settings could be included in the design of the pool?

Given many of the levers that control natural disaster risk are within the remit of state, territory and local governments, QBE encourages the federal government to negotiate arrangements to ensure state, territory and local governments also do their part in reducing underlying risk. Any increased concentration of people, infrastructure and economic activity in areas exposed to significant natural peril risk is a key driver of increasing loss, particularly when the urbanisation occurs without appropriate mitigation to reduce vulnerability.

There are examples that demonstrate the effectiveness of "future proofing" against the risks of significant weather events. For instance, Geoscience Australia[13] has modelled the impacts of the 1974 Cyclone Tracy on Darwin if the same event occurred in 2008. This modelling considers the potential impact of the Cyclone having regard to the reconstruction of the city to new and revised building standards and codes. The impact of the Cyclone in 1974 is believed to have destroyed or rendered unliveable approximately 80% of residential buildings with damage estimated at 36% of full reconstruction costs.

The 2008 modelling estimated that the damage from a cyclone identical to Cyclone Tracy impacting Darwin in the (then) present day landscape would be 3.5% of full reconstruction costs reflecting a 90% reduction in mean losses compared with the 1974 impact. In contrast to the 1974 simulation, the improved building standards mean there would be a vast reduction in the number of buildings suffering complete destruction.

The ACCC also notes[14]:

> *analysis after cyclones Vance (1999), Larry (2006) and Yasi (2011) showed that the updated regulations have resulted in much less building damage and consequent loss of life. During Cyclone Yasi, for example, 12% of older homes suffered severe roof damage, but only 3% of newer homes.*

22.2. Which policy options could be introduced alongside the pool?

Federal and state taxes add significantly to the cost of insurance. Numerous reviews, including the ACCC Northern Australia Insurance Inquiry, have unanimously found that state taxes, duties and levies on insurance are very inefficient and in fact counterproductive and should be abolished. QBE believes the best method of reducing premiums is for taxes on insurance to be reduced or even removed.

[13] The Australian Journal of Emergency Management, Vol. 23 No. 4, November 2008
[14] ACCC Final Report, p315.

These taxes are proportional to the premium, so the higher a homeowner's risk, the higher the tax burden[15]. In addition, stamp duties are applied on the GST-inclusive amount of premium, further magnifying the impact.

Given the importance of affordability of insurance and the potential implications of non or under-insurance for the Government and the community, we believe it is time to act to remove all these specific imposts on insurance as has previously been recommended. State and Territory governments should be actively encouraged by the Australian Government to implement this reform.

Interactions with the ARPC's existing functions

23. What are the potential interactions between the terrorism reinsurance pool and the new cyclone and related flood reinsurance pool?

QBE agrees with the ICA position that the terrorism reinsurance pool and new cyclone reinsurance pool should be operated separately by the ARPC.

QBE also recognises the operation of a cyclone reinsurance pool by the ARPC will require a more sophisticated data and pricing model than terrorism, which is relatively straight forward. We also envisage a need for enhanced claims transaction capability by the ARPC given the frequency of cyclone and cyclone-related losses compared with that experienced for terrorism to date. We understand funding has been allocated to enhance the operations of the ARPC in this context.

Conclusion

QBE appreciates the opportunity to respond to the Treasury Consultation Paper and would be happy to discuss and provide any further information to support this response. We look forward to participating in further consultations.

Should you have any questions or require further clarification or information, please do not hesitate to [redacted]

[15] Dependant on the state, the average cost per policy could be significantly higher or lower dependant on the state regulations and rate of tax.