Reinsurance Pool for Cyclones and Related Flood Damage

Submission by John Devaney

Apart from a one year hiatus the writer, resident in far North Queensland since 1983, has worked in the general insurance industry since 1973, co-owned a licensed insurance broking firm from 1987 to 2005 and has been employed as a senior insurance broker from 2005 to the present day.

At the outset I must stress that the views expressed in this submission are strictly my own and do not necessarily represent those of my employer. That said the submission is made in the context of every insurance broker's prime duty to represent the best interests of clients in a sustainable insurance market.

Let me state that overall, the Reinsurance Pool initiative has the *potential* to bring the insurance market back to a degree of normalcy, (certainly within a measurable parity with non-cyclone prone regions) and at the same time it could clearly demonstrate the real cost of Cyclone & Flood insurance protection to insurance consumers.

This submission touches on the Treasury Draft papers (particularly the Fact Sheet) on the following areas:

- Cyclone declaration protocols clarity
- Potential Cyclone cessation (Cyclone Related Flood)
- Small Business cap at $5 Million
- Strata anomaly
- Lloyds of London anomaly
- Farm (Business Property) anomaly
- The ARPC premium charge to insurers (and the ACCC monitoring of Insurance Premiums)
- "Crunching the Numbers"

SUBMISSION:

1. **Cyclone declaration protocols clarity**
    - The ARPC seems to define the claim scope as a reliance by the Bureau of Meteorology (BOM)
    - Care needs to be taken as to whether certain areas are on Cyclone Watch or Warning for example
    - Currently Insurers embargo property insurance either within their policy wording (e.g. for "new business" there no cover for cyclone related damage for the first 72 hours the policy is in place) or a general refusal to accept any new business once a "cyclone" has been declared. This reasonably stops uninsured consumers suddenly deciding to buy insurance because of the declaration of a cyclone. The current issue is the discrepancy between insurers as to when they apply the embargo, and for that matter, when they deem the threat of cyclone has passed.
        - Some impose the embargo as soon as a cyclone is named by BOM.
        - Some impose the embargo at the Watch stage.
        - Some insurers accept an incoming Insured swapping from one insurer to another at renewal (where the renewal quote was done prior to a cyclone's announcement) but some do not.

- Some allow new real estate purchases that coincide with the BOM announcement (on the proviso that the consumer is an existing customer) but many do not.

- ***Recommendation***: *There should be a uniform embargo protocol across all insurers to ensure fair application of the ARPC's reinsurance program.*

2. Potential Cyclone cessation anomalies (Cyclone Related Flood)

- The draft indicates that the ARPC will rely on BOM to declare a Cyclone Event to be concluded
- It seems that the ARPC must then make a determination within 24 hours of the BOM declaration
- At first glance the draft seems to allow a gap that might not be picked up by the ARPC (unless the intent is only to pick up "immediate" riverine flooding.) For example, Cyclone Fred crosses the coast north of Rockhampton, does not re-form and turns into a rain depression as it moves inland. It then takes a week for the flooding Nogoa River to impact houses in the township of Emerald. Will the BOM declaration of the End of Cyclone mean that insurers cannot access the ARPC funds?

  Recommendation*: If not already factored into the Draft, ensure that time frames for riverine flooding related to a Cyclonic Event allow for a delay factor commensurate with a region's known river and stream characteristics*

3. Small Business cap at $5 Million

- Small business is to be capped at $5 Million worth of Business Property Assets (BPA) (Buildings / Contents / Stock/ Business Interruption)
- Respectfully, a business with BPA of $10 Million can endure just as much of a financial burden as a smaller business.
- It can act as a disincentive. For example, the Business which decides to forgo its Business Interruption cover to stay under the $5 Million BPA cap. (A high-risk decision of course but when faced with the loaded cost burden the mindset is understandable.
- Or, what about the anomalous situation of a business with a BPA of $5.1M? They appear to miss out completely
- ***Recommendation (A):*** *Increase the cap to $10 Million and/or*;
- ***Recommendation (B):*** *Provide a **Sliding Scale Calculation** on the first $5 Million or $10 Million of BPA. In the vast majority of cases businesses with a BPA of $5 Million or greater retain the services of an insurance broker. It is a simple matter of the broker working with the holding insurer to layer the BPA over 2 policies. Policy 1 to the $5M / $10M Sum Insured where the insurer relies on the ARPC reinsurance. Policy 2 where the insurer rates the excess BPA accordingly. This 2nd Recommendation will have the benefit of the insurer providing a reduced premium rate percent because the BPA has achieved a $5 Million / $ 10 Million Cyclone deductible*.

4. The Strata Anomaly

- The ARPC has defined eligible Strata as any Body Corporate that is at least 80% residential in total floor space
- Conversely, any Strata that has more than 20% commercial floor space is ineligible.
- Thus a 10 storey $20 Million Residential Building with say, 5 shops on the ground floor taking up 19% of floor space is eligible.
- But a commercial body corporate of say 5 units owned by 5 separate owners who in turn rent each of their units out to 5 trade tenants and the Strata's BPA is say, $4 Million is ineligible.
- And even though the Commercial Strata falls under the $5 Million "Small Business Cap" it has been deemed ineligible
- In my view this is inequitable and to a large degree illogical
- ***Recommendation****: Treat Commercial Strata with the same parameters as the ARPC eligible Small Business Cap*

5. The Lloyds Anomaly

- Lloyds is exempt because of its unique nature
- The anomaly is created because a classification of business property is perceived as "high risk" by mainstream insurers
- Typical risks in this sector can be country hotels, backpacker establishments, guest and boarding houses.
- The majority of these are well run establishments
- Many of these have a BPA under $5 Million
- Most are insured through Lloyds Syndicates.
- Therefore, they endure a Named Cyclone Exclusion (i.e. there is no cover against cyclone damage) or a Named Cyclone Claims Deductible of $50,000 to $100,000.

Observation: *Perhaps market forces will see numerous Lloyd's Syndicates avail themselves of the ARPC.*

6. Farm (Business Property) anomaly

a. The ARPC reinsures Farm Residential
b. Many farmers are small business people with BPA's under $5M that are made up of Machinery Sheds and valuable contents
c. ***Recommendation****: With care on property definitions Farm BPA's should easily be eligible*

7. The ARPC premium charge to insurers (and the ACCC monitoring of Insurance Premiums)

- This requirement makes sense
- ARPC charges are to be rated on age, structure, location etc.,
- Given the compulsory nature of the impost one assumes the premium charge should be relatively calculable on every ARPC eligible policy
- A disclosure of the ARPC Premium component on every policy will make <u>all stakeholders</u> accountable.
    - Insurers on the amount charged
    - The ARPC and the Australian Government Actuary (AGA) and by extension, the Federal Government of the day
    - Each Insured – in the context of an incentive to minimize the ARPC charge by risk improvement.

        - Similarly, if a postcode location is part of the Risk Calculations it will encourage all tiers of government to review their infrastructure investments in relation to cyclonic hazards, especially flood and storm surges.
    - ***Recommendation:*** *The ARPC premium component should be displayed as part of the total premium on every eligible policy*

8. "Crunching the Numbers"

Most of this submission was completed prior to the Reinsurance Pool North Queensland Stakeholder's Webex meeting of December 6, 2021. Point 4 "The Strata Anomaly" and this summation are completed post that meeting.

Clearly the NQ stakeholders are anxious to see what the actual savings will look like, especially on a per policy basis. At the December 6 meeting, I made the observation that we are largely talking about a single event pool. While some of my NQ colleagues were perhaps a bit animated about the ARPC Terrorism pool, I point to its success and would hope that the results can be replicated in relation to Northern Australia's Cyclone Reinsurance Pool.

Indeed, while it is not part of this exercise I and others predict that with Climate Change causing waters to get warmer it is inevitable that large scale weather events will include more coastal Australian communities. Inland will see greater and more catastrophic bushfires. The cost of these events will possibly surmount the traditional and historical insurance industry risk modelling. In short, I can see the necessity for the expansion of this special purpose reinsurance pool.

And that brings me to the conclusive point that the collective "we" need to get this right. In my view this will mean;

- The Federal Government should take the longer cyclical view and allow loss adjustments to its "revenue neutral" mantra over a longer term. For example, the ARPC might sustain "losses" in Years 1, 2 and 3 and not gain a neutral position until Year 5 or 6.
- It might need to delay its risk partnering with insurers to achieve its revenue neutral position. So be it. There will be pay-offs in other areas of the economy.
- The modelling should therefore perhaps look at a 10 year life-span.
- Consequently, RI premium calculations should be priced to that model
- Do not be bound by some of the current insurer treatments of certain risk categories. For example, it was admitted at the December Stakeholder meeting that Treasury followed [insurer] market convention regarding body corporates. Insurance brokers would argue (as we did at the December meeting) that some of that insurance underwriter thinking was very hide-bound.
- Building on the previous point, I respectfully contend that in terms of Business Insurance, my proposed ***Sliding Scale*** Calculation in Point (3) Recommendation (B) above will be easily implemented, and achieve far more flexibility and universality. Because it could be open-ended (e.g. no sum insured cap) *it would also have the benefit of substantially increasing the Reinsurance Premium pool*.

- Transparency at the individual policy level (as outlined in 7 above) is achievable and in my view, critical. There may well be some industry grumbles about alteration to systems but the benefits as out lined in (7) far outweigh some one-off costs

John Devaney

7th December 2021

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