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Business School

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Response to the 'Reinsurance pool for cyclones and related flood damage' draft legislation

Validity to comment

I am a Professor of Strategic Management at the University of Queensland Business School, Australia, and also at City, University of London, UK. I am an expert in global insurance and reinsurance markets, as evidenced by my industry reports, Masterclasses, academic papers, media appearances and my widely acclaimed 2015 book on changes in the global reinsurance industry, entitled "Making a Market for Acts of God" with Oxford University Press. My current research examines how governments and insurance markets can work together to address the growing threat of disaster. My research on this topic has informed disaster response policy in different countries. For example, my 2018 report on this topic is cited in the appendix of the Australian Terrorism Insurance Act Review, 2018; my 2020/21 research into Covid19 is cited in the 2021 UK House of Lords Report on Preparing for Extreme Risks: Building a Resilient Society; and I am a member of the Organization for Economic Cooperation and Development (OECD) High-Level Advisory Board for Financial Management of Catastrophic Risk.

Response

We fully support the implementation of a reinsurance pool for cyclone and related flood damage and commend Treasury for its progress to date, particularly the pool's breadth of cover to include strata properties, mobile homes, small business, and landlords. However, we highlight the following points that we believe need further consideration.

Efforts to tightly define 'cyclone and related flood damage' has excluded the effects of rainfall beyond a 48-hour period. Rain depressions associated with cyclones may cause significant rainfall and resulting damage over a prolonged period (Shepherd et al, 2007). Our research with other risk pools, such as the Caribbean, which is also highly prone to tropical storm, reveals that after a cyclone the resulting rain depression is often a key source of damage beyond the cyclone itself. Our research shows that, where this excess rainfall is excluded from the reinsurance pool coverage, public confidence in the pool is undermined (Jarzabkowski et al, 2021), and may result in demands for legislative changes to include excess rainfall. Extending the definition of the peril now, pre-empts the need to amend the legislation at a later point in response to public demand. Currently there is a 48-hour cut off in the claims period after a BoM-declared cyclone has ended, which may not provide adequate flood protection against a rain depression.

A key purpose of the proposed pool is to ensure access to affordable insurance, and part of that is reducing premiums for policyholders who undertake risk mitigation. It is not clear how appropriate risk mitigation measures will be developed and validated, how these measures will be communicated to policyholders, and how they will be supported to carry out risk mitigation works. Importantly, there is no clarity over how, ultimately, the legislation will result in insurers reducing their premium. There is no reference to mitigation in the regulations and only one clause in the exposure draft legislation (under 8D) that refers to mitigation. When setting reinsurance premiums 'the Corporation is to seek as far as practicable: (c) to maintain incentives to reduce and mitigate the risk of eligible cyclone losses.' Mitigation mechanisms require greater attention, ideally now within the legislation, or through a parallel process that examines ways to strengthen mitigation as the cyclone pool is rolled out.

Further related to the mitigation role of the reinsurance pool, the factsheet states that 'Additionally, the ARPC will collect data through the pool that will help the Government to plan its response to natural disasters'. Additional work will be required to identify the types of data needed and how it will be used to inform government planning and response; ideally to prevent cyclone and flood disasters rather than only providing insurance payments for recovery. We draw attention to this because research on slowly developing (or creeping) crises indicates that policy makers and stakeholders typically have a weaker understanding of the pre-conditions of disaster and to place more emphasis on resilience and recovery after the fact (Boin and Lodge 2019, Boin, Ekengren et al. 2021). Yet disaster prevention is

more cost effective, and has greater social benefit, than recovery (Clarke & Dercon, 2016). Creating new collaborations between Federal, State, and Local governments and community initiatives to link mitigation of cyclone and flood risk with disaster recovery, should be an explicit goal of the reinsurance scheme. This work might be partially funded by accrued premiums, in years where there are few claims.

It is not clear how the reinsurance pool will avoid encouraging increased risk taking; a point that was raised during earlier consultation. This aspect requires a further program of data gathering, monitoring and investigation in parallel with the implementation of the pool, to ensure that, in providing financial cover, the pool does not make the mistakes of other pools, such as the National Flood Insurance Program in the USA (Elliott, 2020; Jarzabkowski et al, 2018), by unintentionally incentivising ongoing building and rebuilding in cyclone and flood prone areas.

According to our research, pools better meet the needs of stakeholders when they have a robust post-event evaluation process that incorporates learnings and redesign of both the products and the scheme into the pool's future operations (Jarzabkowski et al, 2021). Post-event evaluation helps to identify whether policyholders received the benefit that their premium covered, whether the policy was triggered on agreed conditions, whether those policies and those triggers are appropriate to the nature of the disaster experienced by policyholders, and provides opportunities to both educate policyholders in disaster risk management and address weaknesses in the risk pool. A formal post-event evaluation process supports confidence in the pool's capacity to continue to improve in the way it provides reinsurance that is targeted to the needs of policyholders.

Based on these points, we make the following recommendations:

Recommendation 1

Expand of the definition of 'cyclone and related flooding' to include associated rain depression to encompass the full flood event, not limited to 48 hours after advice of end of cyclone.

Recommendation 2

Demonstrate how accrued money will actively filter to mitigation and resilience programs in cyclone prone areas.

Recommendation 3

Outline how the reinsurance pool will avoid encouraging increased risk taking

Recommendation 4

Clarify how the establishment of this reinsurance pool will inform Government's response to cyclone and flood-based disaster.

Recommendation 5

To support mitigation and resilience programs, establish a working group to facilitate relationship building between government departments relating to infrastructure, housing, education, health, mitigation and disaster management.

Recommendation 6

Commitment to a post-event evaluation process with published learnings.

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The co-authors of this submission are currently co-funded by the ARPC on a terrorism risk research project. This response is an independent document, which has had no oversight by or influence from ARPC. It is based on the team's global research on reinsurance pools.

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