TOWNSVILLE CHAMBER

Townsville Chamber *of* Commerce

# Reinsurance Pool

## Draft Legislation Feedback

December 2021

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## Introduction

The Federal Government currently has the opportunity to rectify an issue that has been holding back the development of Northern Australia for over 20 years. Disappointingly, the framework and fundamental premise on which this draft legislation has been developed is flawed. The reinsurance pool was intended to accomplish two things; reduce the cost of insurance premiums and increase competitive participation in the insurance market. There is great concern that the proposed draft legislation will in fact have the opposite effect.

To understand why this is the case there must be an understanding that the basic principle of insurance is to spread the risk as far and wide as possible.

> *"The premiums of the many pay for the claims of the few."*

Industry feedback on the draft legislative framework is unfavourable. The view of the Treasury taskforce appears to be that reduction in premiums will be generated because insurers will have access to cheaper reinsurance costs as a result of buying from the government rather than the private market.

At best, savings could only be achieved as a result of not having to factor in a cost for a profit margin. This will be insignificant and quickly disappear as a result of applying a risk-based pricing methodology. Further, the mandatory participation component of the legislation, without providing the market costings, is seen as a major issue. The fundamental concept of the reinsurance pool is to reintroduce competition which will in turn reduce premiums. Without providing costs and then mandating the involvement, the adverse effect will occur. We will witness the withdrawal of insurance contracts offering cyclone and related flood coverage in ranges outside of the reinsurance pool framework. This is already happening in business related insurance over $5m.

## Charging Premiums to Insurers

The draft framework proposes the pool will be funded by charging reinsurance premiums to insurers with a pricing formula yet to be finalised but intended to use property level data such as geography, building characteristics, and mitigation to determine premium pricing for insurers.

Presumably, it is intended that those premiums will be less than premiums currently charged by the private market reinsurers and those savings will be passed onto the end policy holders. This concept will not encourage competition and as the reinsurance pool is intended to be cost neutral for the government over time, as the premiums charged to insurers increase, these increases will be passed onto end policy holders either as increased premium costs or higher excesses.

A complex model that requires insurers to provide commercial data about profit margins and then determine a cost for insurers to access the reinsurance pool intended to lower the cost for polices with medium to high exposure to cyclone risk is, respectfully, doomed to fail. The same system operates in the open marketplace already and has resulted in the market failure we are now trying to address with insurance providers already identifying it will be much more profitable to sell cyclone damage cover in all parts of Australia, other than where cyclones actually occur – Northern Australia.

The framework provides no incentive for new insurers to enter the market in Northern Australia to address the market failure, introducing competition and resulting in real long term affordable premium pricing for end policy holders.

If implemented in its current form, people in the North expect the reinsurance pool will fail.

Please see the below excerpt from the Townsville Chamber of Commerce's Federal Budget Submission from January 2021 highlighting the need for a sustainable and successful reinsurance pool.

**RECOMMENDATION ONE**

**Expanding the Australian Reinsurance Pool Corporation remit to include Northern Australia and the natural events of cyclone and floods**

**Precedent and justification for the Reinsurance Pool**
The justification for the Terrorism Insurance Act 2003 and the development of the terrorism reinsurance pool was:

*"The terrorism events in the United States on September 11, 2001, caused massive losses to commercial property and corresponding insurance payouts.* ***Following these events, global reinsurers refused to underwrite for loss or damage to commercial property caused by terrorist activity****. In turn, when existing primary insurance policies expired, and property owners sought to renew them,* ***primary insurers explicitly excluded terrorism cover*** *in those renewal policies. As a result,* ***commercial property owners, including in Australia, were forced to assume the risk of loss or damage to*** *their properties if there were a terrorist event."*
(www.arpc.gov.au)

The Australian Government decided to intervene in the Australian insurance market to protect the Australian economy from the potential flow-on effects of the global withdrawal of terrorism reinsurance. In particular, the Government was concerned that forcing property owners to assume their own risk for terrorism would reduce financing and investment in the Australian property sector, including a substantial reduction in commercial building activity.

Subsequently, a scheme was established under the Terrorism Insurance Act 2003 (the Act) to replace terrorism insurance **coverage for commercial property and associated business interruption losses and public liability claims**. Under the Act, the scheme is administered by the Australian Reinsurance Pool Corporation (ARPC). The scheme commenced on July 1, 2003.

The basic principle of its success is charging for the risk everywhere and providing cover for the few that are affected. This is the basic framework of the reinsurance pool for terrorism.

While the insurance industry will argue that the answer to the market failure with insurance in Northern Australia for the cover of cyclone and flood is mitigation either through building resilience into buildings, levies for flood events or other infrastructure improvements, there is no mitigation used by the insurance industry or ARPC when it comes to the risk of terrorism. No one would argue that mitigating against a terrorist act would be easier than mitigating against an unpredictable natural event like a cyclone or flood.

The reasoning and justification for the reinsurance pool are clearly being replicated in Northern Australia with the risk of cyclone and flooding rather than terrorism. Since the inception of the ARPC, there has been a levy on all premiums in Australia to cover this risk. Policy holders in Northern Australia have been paying between 2% and 5.3% on their premium since 2003. While this is collecting a little from many to cover the risk of a few where there is a market failure, it is indeed following the definition of insurance.

According to the ARPC 2019-2020 Annual Report, the terrorism insurance scheme currently has $13.7 Billion available for claims that arise from a terrorist attack.

The Allianz Australia Insurance Limited submission to the ACCC dated September 13, 2019, clearly articulates, and supports the idea of a reinsurance pool. Allianz's model predicts a saving of over 50% on premiums for a standard home in North Queensland if there is a reinsurance pool. Allianz also indicated that they would re-enter the market with an insurance pool in place. This is seen as the most significant advantage to sustain lower premiums and thereby stimulate and re-introduce competition into the marketplace which will be the critical component in providing a platform to develop Northern Australia.

The terrorism insurance scheme reinsurance pool must be expanded to include the geographical area of Northern Australia and the natural events of cyclones and floods. This is a critical first step in ensuring competition and sustainability of insurance markets in Northern Australia.

## Unnecessary Complexity

In January 2021, the Townsville Chamber of Commerce made 4 recommendations as to how the market failure for affordable insurance in Northern Australia might be addressed, the first of which was a reinsurance pool. The submission and recommendations were caveated with caution as reinsurance pools have been successful in Australia and around the world however, there have been many reinsurance pool models that have failed.

For the reinsurance pool to be successful, it must be founded in the fundamental basic principles of insurance – a lot of people contribute a small amount to cover the risk of an unfortunate event occurring to a few. This principle was applied when the reinsurance pool for terrorism was established, and the pool has been successful.

In simplistic terms, the reinsurance pool should provide a base line cover for cyclone and flood related damage. The free market should then compete for the remaining components that usually create an insurance contract, including but not limited to fire, theft, alternate accommodations etc.

The draft legislation framework appears to have ignored that feedback.

## Covering the Cost of Claims

The proposal for the pool to provide first loss cover reinsurance is supported. This will be necessary to give insurers confidence and re-enter the marketplace.

## Playing with Excesses

The draft proposes the reinsurance pool operates for coverage over the excess. Where premium affordability is concerned, insurers will be inclined to raise excesses to lower premiums. It is proposed insurers can purchase reinsurance for cyclone and flooding cover, and as a pre-condition should have a zero excess apply to building and contents cover for cyclone and flooding to ensure the competitive nature in premiums and individual contract offerings are not diluted by insufficient coverage or "self-insuring" (which is no insurance) by significantly increased excess amounts for such claims.

## Households, Strata and Small Business

The reinsurance pool needs to cover building and contents insurance. Attempting to identify by definitions the types of buildings, purpose of use and value, undermines the ability for the pool to reduce the cost of premiums and increase competition.

Property owned by a small business will be located in buildings. Strata buildings are buildings. Commercial buildings are buildings.  Small businesses either have or lease buildings with plant and equipment that are their contents.

A reinsurance pool that covers loss and damage caused to buildings and contents by cyclone and flooding provides a base line reinsurance pool that will enable and allow a competitive insurance market to build competitive and innovative policies to address the market failure, meet market demands and create a healthy competitive environment for affordable insurance coverage in Northern Australia.

## Local Representation

There has been no representation from Northern Australia on the committee advising Treasury of the design of the reinsurance pool. This means multiple opportunities to ensure the draft legislative framework will be successful for policy holders in Northern Australia has been lost.

With a government commitment that the reinsurance pool will be available from 1 July 2022, an expedited legislative framework is required and to achieve this, complexities will need to be removed, and tried and tested frameworks should be adopted.

## Closing

Insurance is fundamentally one of the largest factors inhibiting investment and growth in Northern Australia.

The reinsurance pool was seen by many, including the Townsville Chamber of Commerce, as the first real commitment in addressing the market failure. Unfortunately, this draft legislation does not address the issue and the Townsville Chamber of Commerce has serious concerns that the draft legislation could exacerbate the problem for policy holders.

Attached is the Townsville Chamber of Commerce's Federal Budget Submission that provided recommendations to address the market failure of affordable insurance in Northern Australia in January 2021 and Townsville Chamber's Reinsurance Pool Consultation Paper – Answers that were provided in June 2021 for reference to this submission.

Considerable recommendations in those papers have been overlooked in the draft legislation.

Townsville Chamber is willing to continue to engage in the process and contribute to addressing the market failure for insurance in Northern Australia. It must be reaffirmed that Australia is one country and Northern Australia contributes to it. If this issue is not addressed, the harsh reality is the Federal Government must become the insurer of last resort.

TOWNSVILLE
CHAMBER

# TOWNSVILLE CHAMBER *of* COMMERCE

## Federal Budget Submission

## 2021 - 2022

# Introduction

For 138 years the Townsville Chamber of Commerce has been the independent voice for the Townsville business community. As an apolitical, membership-based organisation, the Townsville Chamber is focused on advancing our members' interests and looking to grow future opportunities in the North. We work collaboratively with all levels of Government, other representative bodies, and public and private sector organisations.

The Townsville Chamber of Commerce welcomes the opportunity to present the Commonwealth Government with the following submission for the 2021-2022 budget.

# Industry Support

As the market failure of insurance is a problem faced by a wider geographical area than just Townsville, the Townsville Chamber of Commerce has spoken to a number of Chambers and Industry Groups to support the recommendations made in this submission. We are pleased to advise the following organisations are not only supportive of the recommendations but have also added content and feedback in relation to the issues faced by trying to get affordable insurance in their regions.

TOWNSVILLE CHAMBER

Regional Development Australia
TOWNSVILLE AND NORTH WEST QLD

. . . the natural place to be
Hinchinbrook
Chamber of Commerce, Industry & Tourism Inc

NW
COMMERCE North West

Charters Towers
CHAMBER of COMMERCE and MINES Inc.

CCiQ AYR
Powering business potential

CAIRNS CHAMBER OF COMMERCE
building business since 1909

# Insurance: The Market Failure of an Essential Service in Northern Australia

## Overview

The ACCC has recently finalised its much-awaited Northern Australia Insurance Inquiry (NAII). The report broadly highlights the issues known only too well to the residents and business owners in Northern Australia. Unfortunately, the report fails to expressly state the market failure of the essential service that is insurance, which will not only impede, but will ensure Federal Government objectives of developing Northern Australia remains unachievable without intervention.

## Insurance is an essential service

A business or individual cannot operate in a free market in Northern Australia without insurance. It is a requirement:

- by a financier when borrowing money
- for an individual or business that provides goods or services at the legislated Australian Standards
- when renting a premise
- as part of standard procurement, supply, and grant funding contracts with Local, State and Federal Governments
- to operate a business legally in Australia in most industries
- to lawfully own or occupy for specific types of buildings and public spaces
- to import or export for trade and commerce
- to comply with both State and Federal legislation

Insurance is not a choice. Any Australian that contributes to making this great country a better place must have insurance. The Australian Government's stated agenda to develop Northern Australia cannot be successful if insurance is not readily available and affordable in a competitive marketplace. Insurance is not a product that is available in the open marketplace for consumer choice, it is a legislative requirement and financial pre-requisite. Insurance is an essential service to conduct business, to buy a home, or contribute in a meaningful way to the economy.

## The principle of insurance

It is crucial to understand the basic principle of insurance. Insurance is when many people pay a little amount of money to create a bigger pool of money so that anyone unfortunate enough to suffer a loss is reimbursed financially for that loss from the pool.

The principle of insurance is profitable in Australia. According to the ACCC's NAII over the 12 years to 2018-19, insurers made an estimated profit of $8.2 billion from home, contents, and strata insurance in the rest of Australia at a gross profit margin of 12%. (See page 108 of the NAII)

Not insuring particular geographical areas or specific events means more profit, at less cost, which is good for the insurance industry but supportive of a practice that is contrary to the fundamental basic principle of insurance to spread the cost of the risk of any single event across many people. When the delivery of an essential service is motivated by profit rather than the basic principle underlying the need for the service, government intervention is required. This is the basis for our call for government intervention.

Government intervention into the insurance industry does have precedence in Australia. In 2003 an insurance pool was created because terrorism cover was removed following the

September 11 attacks in America, leading to market failure.

The ACCC's NAII does not address the definition of a market failure but suggests that even if there is not yet a market failure across the whole of the country, government intervention is still justified.

*"This has included considering the extent to which affordability and availability issues stem from market failures, other impediments to robust competition or underlying cost drivers.* ***Without market failure, government intervention to reduce premiums may still be justified on social equity grounds or in support of broader policy objectives***". (Page 145 of the NAII)

The term "market failure" was defined by Allianz in their submission to the inquiry in 2019.

*"While an unavailability of needed insurance would meet the technical economic definition of market failure, Allianz suggests that an effective market failure arguably exists if such insurance is out of reach to those who need it because they cannot afford to purchase it."* (page 6)

The NAII has identified that there was significant non-insurance taking place which is a clear market failure of an essential service. The NAII data that is already outdated and will only exacerbate the market failure in Northern Australia.

## THE NEED FOR GOVERNMENT INTERVENTION

Several industry professionals, including insurance brokers whose business it is to identify insurance products within the market, have been unable to source suitable products for customers in Townsville and Northern Australia. Insurance brokers within the industry, who are also members of the Townsville Chamber of Commerce, are unwilling to participate or provide evidence for fear of retribution by the insurers. It also needs to be highlighted that the market sees significant issues in renewing premiums due in 2021. The ACCC's NAII highlights that Northern Australia is not a profitable place to offer insurance and the publication of this inquiry's findings will only exacerbate the existing problems without Government intervention.

## A SOLUTION FOR A COMPLEX PROBLEM

The insurance industry is complex. That does not mean there is no solution, it means a real solution may not be a simple one. The Townsville Chamber of Commerce believes that due to the complexities within the industry and to avoid further limitations being placed on Northern Australia's development, an environment must be created where there is not only a baseline for the essential service that insurance provides, but insurance at that baseline is affordable and healthy competition remains within the marketplace. More than one of the following recommendations needs to be implemented to ensure a competitive and responsible industry remains available in the open market. Provided there is a combination of more than one of these recommendations the Townsville Chamber of Commerce believes the issue can be resolved and the development of Northern Australia can be a realistic and achievable outcome for the Australian Government:

### RECOMMENDATION ONE

**Expanding the Australian Reinsurance Pool Corporation remit to include Northern Australia and the natural events of cyclone and floods**

**Precedent and justification for the Reinsurance Pool**

The justification for the Terrorism Insurance Act 2003 and the development of the terrorism reinsurance pool was:

*"The terrorism events in the United States on September 11, 2001, caused massive losses to commercial property and corresponding insurance payouts.* ***Following these events, global reinsurers refused to underwrite for loss or damage to commercial property caused by terrorist activity****. In turn, when existing primary insurance policies expired, and property owners sought to renew them,* ***primary insurers explicitly excluded terrorism cover*** *in those renewal policies. As a result,* ***commercial property owners, including in Australia, were forced to assume the risk of loss or damage to*** *their properties if there were a terrorist event."* (www.arpc.gov.au)

The Australian Government decided to intervene in the Australian insurance market to protect the Australian economy from the potential flow-on effects of the global withdrawal of terrorism reinsurance. In particular, the Government was concerned that forcing property owners to assume their own risk for terrorism would reduce financing and investment in the Australian property sector, including a substantial reduction in commercial building activity.

Subsequently, a scheme was established under the Terrorism Insurance Act 2003 (the Act) to replace terrorism insurance **coverage for commercial property and associated business interruption losses and public liability claims**. Under the Act, the scheme is administered by the Australian Reinsurance Pool Corporation (ARPC). The scheme commenced on July 1, 2003.

While the insurance industry will argue that the answer to the market failure with insurance in Northern Australia for the cover of cyclone and flood is mitigation either through building resilience into buildings, levies for flood events or other infrastructure improvements, there is no mitigation used by the insurance industry or ARPC when it comes to the risk of terrorism. No one would argue that mitigating against a terrorist act would be easier than mitigating against an unpredictable natural event like a cyclone or flood.

The reasoning and justification for the reinsurance pool are clearly being replicated in Northern Australia with the risk of cyclone and flooding rather than terrorism. Since the inception of the ARPC, there has been a levy on all premiums in Australia to cover this risk. Policy holders in Northern Australia have been paying between 2% and 5.3% on their premium since 2003. While this is collecting a little from many to cover the risk of a few where there is a market failure, it is indeed following the definition of insurance.

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The terrorism insurance scheme reinsurance pool must be expanded to include the geographical area of Northern Australia and the natural events of cyclones and floods. This is a critical first step in ensuring competition and sustainability of insurance markets in northern Australia.

## RECOMMENDATION TWO

### The obligation for an insurer to provide insurance for all of Australia

As part of obtaining an insurance licence in Australia you must provide products to cover every part of Australia. This system works in parallel to a reinsurance pool. The pool provides confidence for insurance companies to re-enter the market and competition is critical to ensuring any government intervention reaches its full potential.

Regionalising the profitability of insurance completely contradicts the definition of insurance. When the risk is spread over the whole of Australia, the profitability of the insurance industry is indeed healthy. An estimated profit of $8.2 billion from home, contents, and strata insurance in the rest of Australia, on a gross earned premium of $69 billion, at a gross margin of 12% over the 12 years to 2018-19 is a healthy industry (See page 108 of the NAII). Singling out Northern Australia as one region that was not profitable, with a recorded loss of $856 million or profit loss of 13%, does not mean insurance in Australia is not profitable, it just means you can indeed make more profit, and have less costs, if you are allowed to operate in just the profitable areas and not insure specific parts of Australia. As profit margins are pressured and shareholders require returns, multiple insurance companies are choosing to exit these areas and the NAII now provides documented justification for CEO's of corporate insurers to recommend their company exit the market in Northern Australia if they have not already. If we continue to allow insurance companies not to spread the risk, insurance will become harder to get in Australia.

The ACCC's NAII has highlighted a problem that people in Northern Australian and the insurance companies already knew existed. This report will escalate the problem of affordable and obtainable insurance in Northern Australia. In the long term, this will not be contained to Northern Australia if insurers are allowed to only insure in "safe" or "low risk" areas.

By understanding the basic principle of insurance, it is clear that Australia is not being provided with the essential service that is required and Northern Australia is not insured to the standard that Australians require. Removing cover from particular areas, either through geographical boundaries, postcodes, street names, or not providing cover for named events like cyclones, floods, or terrorist attacks, is not spreading the risk. Rather, insurance companies are eliminating their exposure via exiting the marketplace. The risk is not being spread across the entire country.  The hard reality at the moment is Northern Australia is contributing to a re-insurance pool to address a market failure for terrorism which will most likely occur in major capital cities, but major capital cities are not contributing to cyclone and flood risks in Northern Australia.

To drive a competitive and robust market, the risk of insuring in Australia must be shared across the whole of Australia.

## RECOMMENDATION THREE

### National Insurer – Baseline of insurance for all Australians

There is a market failure of an essential service in Northern Australia and if there is not a willingness from the private sector to provide affordable insurance to the entire country then there is no other option but for the Government to provide a baseline cover for the essential services required by legislation.

As a minimum, the standard cover should include building and contents and public liability for properties. In the same way the Government delivers other essential services to Australians like health care, the private market can continue to operate and provide optional products and levels of choice coverage in healthy competition freely above the essential service baseline offered by the National Insurer.

As highlighted in the ACCC's NAII, offering the baseline service would be profitable for the national insurer and achieve the objectives of developing Northern Australian.

### RECOMMENDATION FOUR

**Abolish Additional Fees – Stamp Duty and GST**

The Queensland State Government has a role to play and there should be an abolishment of stamp duty on home, contents, and strata insurance products.

This should be expanded to all premiums in Northern Australia, including cover for business policies.

The Queensland Government should abolish stamp duties on home, contents, and strata insurance products. State and Territory revenue needs could be more equitably met through other means or distribution of some of the profits from the National Insurer as per recommendation three above.

It has been widely acknowledged that stamp duties on insurance products are an inefficient form of taxation. This recommendation is in line with recommendations from previous inquiries into insurance and taxation issues. Governments have previously received and continue to enjoy a windfall gain from the increase of insurance premiums in Northern Australia.

As an essential service (similar to fresh fruit, healthcare and bank account keeping fees) the insurance products provided by the National Insurer should be GST free, whether nationwide or only in Northern Australia where there has been a market failure.

As both GST and stamp duty are calculated on premiums, the direct impact on affordability of premiums for Northern Australia will be significant and the comparative loss of revenue for the respective governments would be negligible due to the population of Northern Australia and the extent of non-insurance and impending further decline of re-insurance.

It should be noted that removing State and Federal taxes without ensuring healthy competition in the marketplace will see these benefits disappear.

## CONCLUSION

In the upcoming budget it is imperative that provisions be made in relation to building a competitive, robust, and sustainable insurance market in Australia.

A combination of the above recommendations is critical to ensure fair and affordable insurance premiums in Northern Australia.

With the migration of individuals and businesses to northern parts of Australia as a result of COVID-19 lockdowns and restrictions in the south, it is timely that the Commonwealth Government seriously consider the aforementioned recommendations to support the prosperity and development of the nation.

TOWNSVILLE CHAMBER

Townsville Chamber *of* Commerce

# Reinsurance Pool

## Consultation Paper Answers

June 2021

# Overview

The insurance industry is complex and constantly evolving. The failure of the insurance market for Property, Contents and Strata in Northern Australia has been clearly articulated and the announcement on the 4th of May 2021 sent a clear message that government intervention is required to not only make insurance affordable in Northern Australia, but also attainable. The Townsville Chamber of Commerce put forward four (4) recommendations in its 2021 Federal Budget submission.

1. **Expanding the Australian Reinsurance Pool Corporation remit to include Northern Australia and the natural events of cyclones and floods.**
2. **Obligation for insurers to provide insurance for all of Australia.**
3. **National Insurer – Baseline of insurance for all Australians.**
4. **Removing additional fees on premiums – Stamp Duty and GST.**

A combination of the above recommendations is critical to ensuring that an equalisation of insurance premiums across Australia is achieved. The announcement of the $10b reinsurance pool for cyclone and related flood damage (RPCFRD) is an excellent first step however, its design and sustainability will determine the government's effectiveness in addressing the market failure of the essential service that is affordable insurance in Northern Australia.

The Townsville Chamber of Commerce has spoken to industry experts and local representatives with a vested interest in developing Northern Australia. For the design of the RPCFRD to be successful, industry representatives from Northern Australia, and in particular, Northern Australian insurance brokers representation is critical. People with experience in having to find insurance products for people living in Northern Australia must be included in the consultation and design of the RPCFRD. Without people truly invested in the success of the RPCFRD, its effectiveness in addressing the market failure and removing impediments towards developing Northern Australia will be diminished.

The consultation paper released in May 2021 asked 23 questions about the design and structure of the RPCFRD. Some of the questions asked will ultimately be determined by market forces seeking competitive advantages. It is important when asking and addressing questions to assist with designing the reinsurance pool that the fundamental focus reverts to how the RPCFRD will place downward pressure on the cost of insurance premiums while encouraging the re-entry of more competition into the Northern Australia insurance market to ensure sustainability.

# Reinsurance Pool Coverage

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

Duplicating and introducing new definitions for the purpose of the RPCFRD should be used with caution to avoid ambiguity and inconsistencies. The RPCFRD will not be accessed by policy holders directly and therefore standard legal definitions between insurers and insurance policies should continue to allow flexibility to ensure competitive advantages remain possible.

The insurance industry already has a definition for flood and can continue.

The Bureau of Meteorology (BOM) has a technical definition of a tropical cyclone that can be used for the RPCFRD.

*"a non-frontal low pressure system of synoptic scale developing over warm waters having organised convection and a maximum mean wind speed of 34 knots or greater extending more than half-way around near the centre and persisting for at least six hours"*

The existing definition of "flood" needs to be directly linked to the new definition of "cyclone". Creating a new definition of "cyclone related flooding" will create complexity. Insurance companies should have access to the RPCFRD for their first loss cover for "cyclone" and "flood" that are directly linked.

If a cyclone by definition becomes a rain depression causing "cyclone related flooding" in South Australia, the fundamental purpose of the RPCFRD and addressing the market failure in Northern Australia is eroded.

In line with the above, there is already a catastrophe declaration system used and recognised by the Insurance Council of Australia (ICA) and applied within the industry, any new definitions should be done in conjunction with and consistent with pre-existing systems within the industry.

2. **Should storm surge be covered by the pool and included in a definition of "cyclone related flood"?**

Storm surge events should be covered by the pool and should be aligned with the industry catastrophe systems as stated above, there should be no definition of "cyclone related flooding".

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?**

No, the catastrophe system is already in place and the response to definitions are detailed in Questions 1 and 2.

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?**

The pool should provide reinsurance for property damage to buildings and contents. This captures property damage to homes and businesses and removes complexities and difficulties that would otherwise arise where buildings and contents have mixed uses such as strata complexes.

There will only be difficulties if there is an attempt to create narrow definitions. The lack of insurance and the unavailability of insurance in Northern Australia is the problem needed to be addressed by the RPCFRD. Creating narrow definitions will erode the effectiveness of the pool and its objectives.

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

Yes, this already happens in the marketplace. By providing a reinsurance pool for the property (building and contents) component, insurers can create competitive products for insureds needing to cover risks tailored to their individual circumstances.

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

Yes, this already happens in the marketplace. By providing a reinsurance pool for the property (building and contents) component, insurers can create competitive products for insureds needing to cover risks tailored to their individual circumstances.

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?**

No. By removing narrow definitions in the criteria, these perceived difficulties can be removed. The pool should provide reinsurance for property damage to buildings and contents. This captures property damage to homes and businesses and removes complexities and difficulties that would otherwise arise where buildings and contents have mixed uses such as strata-title complexes. There will only be difficulties if there is an attempt to create narrow definitions to apply. The lack of insurance and the unavailability of insurance in Northern Australia is the problem needed to be addressed by the RPCFRD. Creating narrow definitions will erode the effectiveness of the pool and its objectives.

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

Small business should not be defined by the RPCFRD. The purpose of the reinsurance pool is to place downward pressure on the cost of premiums in Northern Australia and encourage new insurers to enter the market. The RPCFRD should cover all property and contents regardless of the individual or entity identified as the "insured" on policies between insurers and policy holders.

The government should not become involved in the type of insurance product that insurers can offer to policy holders. Exclusions should only be defined between the insurer and the policy holder not the RPCFRD and the insurer. The RPCFRD should only cover the very clear and precise market failure – property damage (buildings and contents) triggered by the declared catastrophe – "cyclone" and "flood" that are directly linked.

If a definition for small business is used there are several issues that arise. Many small businesses rent or lease commercial space from larger businesses. If insurance is not available for properties to be developed or owned by a "large business" that might rent or lease property to smaller businesses, developing Northern Australia will not occur because the market failure of insurance has not been addressed.

If larger businesses are excluded from the reinsurance pool and experience premium rises then the existing costs of insurance will continue to be passed on to smaller businesses and the pool will fail to address the problem of unaffordable or unattainable insurance. The unavailability of insurance will also remain for larger businesses.

The other major issue with creating a definition for small business and attempting to assist a defined  as part of the design of the RPCFRD is creating another reason for businesses not to grow and create jobs. If a small business is scaling, employing more staff, and creating more economic activity, the business may become too large and be no longer able to access the RPCFRD. We could also see businesses that win large contracts move in and out of the RPCFRD as work fluctuates creating major issues if a claim is made. This will also hinder their ability to tender and price contracts efficiently.

Creating definitions like 'small business' would undermine the principle of the RPCFRD and not address the intended purpose of the RPCFRD and is unnecessary if targeted at property damage (building and contents) for a declared catastrophe event in Northern Australia.

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?**

All property damage should be included regardless of the insured's entity as an individual, business or Body Corporate established under strata title legislation. Assessing the size of an individual insured to determine exclusion from the pool will create significant difficulties and is contrary to the fundamental purposes and objectives for designing the pool.

# 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?**

In general terms, this is understood to be commercial in confidence so the Townsville Chamber of Commerce cannot give any guidance.

There is already a pre-existing structure in place for a reinsurance pool with ARPC – the Terrorism Reinsurance Pool. The approach used by the ARPC to assess and measure terrorism risk and individual policy level data could assist with queries regarding how cyclone related risk premiums should be calculated or pricing models replicated for the new pool. The approach used by the ARPC could be extended where possible.

**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?**

In general terms this is commercial in confidence so the Townsville Chamber of Commerce cannot give any guidance.

There is already a pre-existing structure in place for a reinsurance pool with ARPC – the Terrorism Reinsurance Pool. The approach used by the ARPC should be replicated or extended where possible.

**12. How much risk exposure should primary insurers retain?**

It is imperative that the pool operate similar to the Terrorism Reinsurance Pool. Insurers must have access to the RPCFRD for their First loss cover retention. This is critical to reintroduce competition to the marketplace. Insurers may then negotiate for access to other reinsurers as required by the individual insurance company's requirements based on products offered to insureds and market exposure.

**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?**

It needs to be left to the existing claims model, Insurer to Policy Holder

**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?**

The RPCFRD will be required to provide the first loss cover for insurers. This is the same as the Terrorism Reinsurance Pool structure already in place and its remit must be expanded and replicated for property damage caused by "cyclone" and "flood".

Considerations should be given to what an appropriate level of cover would be on a first loss basis. For example, if an insurer offers $1m property damage cover, what percentage will RPCFRD be providing as the first loss reinsurer. This will require government actuarial input as well as insurance industry input and modelling to confirm what ultimate outcomes could be achieved (cost reductions) as a result of this ceding (risk transfer) from private markets to the pool.

Reference should be made to New Zealand's EQC.

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

A common start date as 1 July 2022 is appropriate. You need to have a start date. There is a side of caution however as insurance companies and underwriters often negotiate three to four (3-4) year underwriting agreements and some insurers may be at a disadvantage during the early stages of the introduction of the government backed reinsurance pool. This however should not delay the introduction as the basic principle is to introduce competition and potentially new insurers into the marketplace to bring the costs of premiums down. This should be at the forefront of any discussion and decision-making process.

# 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?**

There is already a pre-existing structure in place with ARPC in relation to Terrorism Reinsurance Pool and that review structure can be replicated for the RPCFRD.

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

No. Unless there is a planned date as to when development of Northern Australia will have been achieved or cyclones and flood are no longer a risk for Northern Australia. Instead of an end date, review dates are important. These should be aligned with the review structure as timelines will vary and levels of risks, assessments of risks and appetite for risks, mitigation and management of risks will take time. The reinsurance pool should stay in place until a sustainable model is in place to ensure insurance premiums in Northern Australia are available and will for the foreseeable and sustainable future remain affordable and in line with the rest of Australia. Introducing an end date does not give confidence for insurers to re-enter the market or new insurers to seek competitive advantages and gain market share with a long-term view and strategy to make a new affordable product available to insureds in Northern Australia.

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

The mechanism required to ensure pass-through of premium savings to policyholders is healthy private industry competition in the market.

**18.1. Explicit price monitoring of insurance premiums?**

Yes, and there are examples of this in the economy. For example, the Reserve Bank of Australia (RBA) monitors interest rates and how that is passed on to consumers and adopted in the marketplace.

**18.2. Additional requirements to disclose the cost of reinsurance to policy holders?**

No. There are disclosure obligations on insurers and a suitable review and public access to public documents provides sufficient mechanisms for the existing and proposed reinsurance pools in Australia.

**18.3. Any additional mechanisms that may be appropriate?**

A mechanism for viability must be considered. How will the RPCFRD remain financially viable into the future? The current Reinsurance Pool for Terrorism established in 2003 charges a levy on Commercial Property and Business

Interruption policies at a rate of between 2.6% to 16% depending on the location of the property and business insured.

This is done via a three (3) tired system, A, B and C. Tier A is for areas with a population of over 1 million people and a rate of 16% is charged; Tier B is for areas with a population between 100 000 and 1 million people and a rate of 5.3% is charged; Tier C is for all other areas and is charged at 2.6% on the premiums. This model has proven effective for the sustainability and longevity of the fund. It also aligns with the true meaning of insurance where everyone contributes a little so if a few are impacted then they will have cover. This levy model for the whole of Australia must be replicated where all of Australia pays a little for the sustainability of the RPCFRD to achieve the government agenda to develop Northern Australia.

# Links to Risk Reduction

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

Mitigation is considered a separate discussion from the one involving the design of the RPCFRD.

Risk based pricing already exists for many insurers, including to some extent, mitigation. However, the discounts given for mitigation carried out by the policyholder are minimal and are eroded by annual premium increases. For mitigation to have a major effect the timelines are long, and the major effects will be driven more from planning and the building approval processes rather than penalising policy holders in Northern Australia where a market failure has been identified, notwithstanding attempts to address the issue using mitigation incentives in the past. Risk based pricing is a matter for the industry and is a separate discussion to that involving the design of the RPCFRD.

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

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

Policy holders are not buying directly from the RPCFRD so the RPCFRD should not be involved in pricing discounts to policy holders. Attempting to influence insurers to direct the behavioural changes of insureds by using the RPCFRD does not align and will be contrary to the fundamental purpose and objectives of the RPCFRD, that is seeking to reduce the cost of premiums and making insurance affordable and attainable in Northern Australia. Property based assessment and mitigation should not be part of the design of the reinsurance pool.

For mitigation to have any major effect on premium prices, the timelines are long, and the major effects will be driven more from planning and approval processes and is considered a separate discussion to one involving the design of the RPCFRD.

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

There is an opportunity for surplus funds collected by the RPCFRD to be reinvested into mitigation programs. This should only be done once a sustainable and affordable model is in place and the pool is viable and sufficient funds are available to ensure the pool's viability is not jeopardised or the real purpose of the pool is compromised.

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

The risky behaviour that should be discouraged is behaviour of insurers as the pool is accessed by insurers not insureds. The ICA and Code of Practice for insurers must be complied with as a minimum criterion for access to the pool.

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

No. This question assumes the RPCFRD can be accessed directly by insureds. The pool should cover property damage (building and contents) where the claim relates to property damage caused by 'cyclone' and 'flood' when the events are linked. To develop Northern Australia, new builds should be encouraged. The use or further development of old builds should also be encouraged, but this is a separate discussion to the design of the RPCFRD.

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

No. This question assumes the pool can be accessed directly by insureds. The pool should cover property damage (building and contents) for policies entered into by insurers and insureds where the property is located in Northern Australia. To develop Northern Australia, new builds should be encouraged and use, or further development of old builds should be encouraged, but this is a separate discussion to the design for the reinsurance pool.

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

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

The removal of state-based Stamp Duty being charged on insurance premiums.

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

The Queensland State Government has very prescriptive legislation in relation to the types of insurance required for strata developments. Prescription in the type and level of insurance included in legislation should be reviewed and align to encourage and allow competitive pricing for premiums in Northern Australia.

# Interactions with ARPC's Existing Functions

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

The ARPC is well established and has developed a sustainable model that has been in operation for over 18 years. Using the sound reporting and management and operational structures already in place, the reinsurance pool for cyclone and related flood damage should be an extension of or should be modelled on or be used as a base for the design for the new pool. The major aspects that require replication is the levy model created for sustainability and the first loss cover provided by the ARPC for Terrorism.