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Insurance (reinsurance pool and North Queensland strata resilience pilot)

What is being announced?

Cyclone and Related Flooding Reinsurance Pool

- The Government will establish a reinsurance pool for cyclone and related flood damage, commencing 1 July 2022. The reinsurance pool:
  - will be designed to be cost-neutral to Government over time and backed by an annually reinstated Government guarantee of $10 billion to the Australian Reinsurance Pool Corporation (ARPC); and
  - cover the following insurance products: Home building, home contents, strata, and small businesses.
- In order to finalise the technical details of a reinsurance pool, the Budget will also provide $2.4 million to Treasury in 2021-22 to establish a Taskforce to develop and consult on the final design of the pool.

North Queensland Strata Title Resilience Pilot Program

- Complementing the pool, the Government is providing $40 million in funding for a capped, three-year pilot program to subsidise the cost of cyclone risk mitigation works for eligible residential strata title properties in North Queensland.
  - The Government intends to partner with the Queensland Government on delivery, with program implementation expected to commence from January 2022.
- The resilience pilot program will subsidise cyclone risk mitigation works for residential strata properties in North Queensland, with the aim of sustainably reducing insurance premiums for properties that take part.

Background – Cyclone and Related Flooding Reinsurance Pool

- The cost of property insurance is high and rising in cyclone-prone areas, mainly located in Northern Australia, and is leading to high levels of underinsurance and non-insurance. The ACCC's Northern Australia Insurance Inquiry found that:
  - In 2018-19, the average combined home and contents insurance premium was about $2,500 in Northern Australia, compared to about $1,400 for the rest of Australia.
  - in 2018-19 the average strata premium was $6,800 in North Queensland compared with the Australian average of only $3,300.
  - These costs are expected to increase over time as the risk from natural hazards rises.
  - The ACCC also estimated about 20 per cent of properties in Northern Australia have no home building insurance, compared with 11 per cent for the rest of Australia.
- The Royal Commission into National Natural Disaster Arrangements highlighted that uninsured or underinsured households have reduced resilience to natural disasters and may not have the financial capability to recover from a disaster.

- Eight insurers supply the vast majority of home, contents and strata insurance in Northern Australia.
  - Suncorp, Allianz Australia Insurance Limited, Commonwealth Insurance Limited, Insurance Australia Group, QBE Insurance Limited, RACQ Insurance Limited, Westpac General Insurance Limited, and You Pty Ltd.

Size of Northern Australian market

- In 2018–19, there were over 500,0000 insurance policies in Northern Australia covering policyholders for the risk of loss or damage to home (home insurance) or belongings (contents insurance) or both (home and contents insurance).
  - For the 475, 000 households, despite representing only around 5.6 per cent of the approximately 8.5 million home and/or contents policies nationally, people in Northern Australia paid around 10 per cent in premiums ($733 million compared to an estimated $7.4 billion nationally).
  - This is due to the high cost of property insurance in Northern Australia.

How will a Government backed reinsurance pool lower premiums?

- Reinsurance can be thought of as 'insurance for insurers'. Insurance companies buy reinsurance from global companies (reinsurers) for large natural disaster events.
- Australia already has a reinsurance pool. The ARPC operates an Australian Government backed reinsurance pool for terrorism risk following the September 2001 terrorist attacks.
- The proposed Government reinsurance pool for cyclone and related flood damage will lower the cost of reinsurance by operating on a cost-recovery basis – removing the profit margin charged by global reinsurers, leveraging a Government guarantee, taking advantage of economies of scale and facilitating the entry of more insurers into the market to support more competitive outcomes.
  - The government guarantee will lower insurance premiums because it means the ARPC does not have to charge higher premiums to ensure it has enough liquidity (that is, cash on hand) to cover the cost of rare and catastrophic events (e.g. a 1 in 100 year cyclone). These cost-savings can then be passed on to consumers.

How much of a reduction in premiums can we expect to see?

- Indicative estimates suggest the pool may result in over $1.5 billion in premium savings over 10 years for properties in Northern Australia, with the variation in premium reductions across individual policies depending on cyclone and related flood risk.
  - Depending on the final design of the reinsurance pool, this may save a higher cyclone risk household $500-$1000 or more a year on their insurance premiums, depending on the risk profile of the policy.

Previous studies on a reinsurance pool

- The 2011 Natural Disaster Insurance Review (NDIR) recommended a reinsurance pool for flood risks for home and contents policies to provide more affordable flood cover, backed by a government guarantee.
  - The NDIR considered that some form of premium discount was required to make flood insurance affordable. This proposal also required the insurers to still hold onto some parts of the flood risk themselves.
  - This was rejected by the then Labor Government in early 2013.
- The 2015 Northern Australia Insurance Premiums Taskforce (NAIPT) considered a reinsurance pool for cyclone risks in home, contents, and strata insurance to be run by the Australian Reinsurance Pool Corporation (ARPC) and backed by government guarantee.
  - The NAIPT concluded that a reinsurance pool which charged premiums to cover the estimated long-run cost of claims might offer a premium reduction for consumers of 10 to 15 per cent.

Overseas examples of natural peril reinsurance pools

- The Flood Re scheme, which was established in the UK in 2016, caps reinsurance costs for high risk properties and thereby puts downward pressure on insurance premiums.
  - Flood Re charges a fixed reinsurance premium per policy (£210 to £1200). As such, insurance policies with a particularly high exposure to flood risk can receive large discounts, with reported premium reductions of more than 50 per cent.
  - However, Flood Re imposes a cross-subsidy (LSE estimated in 2016 at £10.50 per policy), raising the cost of most insurance policies while subsidising high risk ones.
- The French government's national catastrophe reinsurer Caisse Centrale de Reassurance is backed by a government guarantee. The scheme leads to lower premiums for consumers in high risk areas because of its use of flat rate premiums.
- The Japanese Earthquake Reinsurance Company provides compulsory reinsurance for earthquake, tsunami and some other natural peril insurance policies. The scheme is backed by government guarantee and provides 'excess of loss' reinsurance coverage, taking on the risk of earthquake damage past a certain threshold.

Background – North Queensland Strata Title Resilience Pilot Program

- Strata properties face some of the most acute insurance affordability pressures in Northern Australia. The ACCC noted that, in 2018-19, the average strata premium was $6,800 in North Queensland, compared with the Australian average of only $3,300. Strata residents have few options other than to pay this because strata properties are required to hold insurance under Queensland legislation.
- The North Queensland Strata Title Resilience Pilot Program will subsidise up to 50 per cent of the estimated costs of cyclone risk mitigation works for eligible strata title properties, with an additional 25 per cent co-contribution sought from the Queensland Government. The

remaining amount will be covered by property owners through standard strata fee arrangements.

- Mitigation activities that may be covered include retrofitting roofs and cladding, repairing sealants, installing overflows in gutters, and replacing or installing roof fasteners and window debris screens.

Eligibility

- Residential strata properties will be eligible for funding, with the pilot geographically targeted to areas north of the Tropic of Capricorn (from Rockhampton northwards) and within 100 km of the coast (including islands off the Queensland coast).
- In 2018-19, there were approximately 6,600 strata insurance policies in North Queensland.
- To ensure that subsidised mitigation works are targeted to at-risk properties, strong program assurance arrangements will be established for the program, including certified inspections to ensure that mitigation works will boost resilience.
- Further details of the eligibility criteria and application process will be announced prior to the commencement of the pilot program, but would be expected to be similar to that under the North Queensland Strata Title Inspection Program.

How will this program reduce insurance premiums?

- Sustainable reductions in insurance premiums can only be brought about by improving the resilience of strata properties to natural disasters, which will in turn reduce the severity and frequency of insurance claims.
- The National Resilience, Relief and Recovery Agency, in consultation with Treasury, will work with the Queensland Government to secure agreement from key insurers that funded mitigation works would be recognised with lowered premiums.
- A similar program, the Queensland Household Resilience Program, subsidised private mitigation works on household properties. That program successfully spurred retrofitting activity, which produced a 9 per cent average reduction in insurance premiums for participating households, with some households saving up to 25 per cent on their insurance.

Case Study

- Access and affordability pressures are particularly acute for strata properties. For example, over the past three years, the insurance premiums for one strata complex in Trinity Beach, Cairns, has more than tripled from $25,000 to $97,000. This has created financial difficulties for residents, particularly as strata properties require insurance under Queensland legislation.