The Northern Australian Reinsurance Pool – Back from the Brink?

Those of us who live and work in Northern Australia have a modicum of hope that the incredible cost of property insurance is to be at last addressed. Those of us who work as insurance brokers are probably advising our clients, 'let's pray it works but don't hold your breath.'

The Federal government has announced a reinsurance pool initiative to help reduce and stabilise the cost of property insurance in Coastal Northern Australia (north of the Tropic of Capricorn.) The yet to be formulated plan has at this stage one broad undertaking – a $10 Billion guarantee that the Prime Minister claims will put "a floor underneath the insurance industry"

It's mooted that Treasury will work with Insurers, presumably the Insurance Council of Australia (ICA) to come up with the model. The Member for Leichardt, Warren Entsch, a long-term campaigner for more equitable insurance pricing has expressed with some justification a degree of reservation about the ICA's commitment, considering that organisation has until very recently pushed back against the concept of a government reinsurer.

At the end of the day, there's no question that insurers and actuarial experts must be at the table. I strongly suggest that insurance brokers are also critical stakeholders, especially when it comes to their small / medium business and homeowner clients. Brokers should be represented along with relevant consumer organisations. Even at the Pool's genesis we need to ensure that the project is not restricted to a pure actuarial exercise.

One envisages that this body will look at new global initiatives in underwriting catastrophic events. However, we need to be very mindful that some of these models are based on large populations. I believe this could be a fundamental problem, indeed a flaw, with the insurance industry's existing pricing model in Australia. In short, the insurers have imported a European model to fix a very Australian problem – a relatively small population with apart from the capital cities is spread over a vast continent. It's all very well to mathematically load a geographical region's premium costs based on its adverse catastrophic risk factor (cyclone, flood, bushfire, earthquake etc.) *if you have a population base to support that pricing*.

I'm not an actuary but I have a strong 'gut-feel' that Australia would be better served with *the one base rate percent of premium that should apply across the whole country*.

North Australian insurance brokers have consistently argued that if a [property] insurer has an Australian licence then it should write business across Australia. The brutal reality is that most insurers don't. This of course has severely punished consumers but has also been unfair to the insurers who do cover Northern risks.

Many may feel very little sympathy with that latter assertion. Let me explain.

Some years ago, when Northern property insurance costs really started to bite I recall a discussion over a merlot or two with a senior executive of one of the big insurers. He bemoaned the fact that his company had lost business hand over fist in capital city markets because for years they had cushioned North Australian property premiums by padding Sydney Melbourne and Brisbane premium rates whereas the insurers who won't participate in Northern Australia can run more competitive rates. (I find it ironic that one particular insurer which touts itself as "Australian Insurer of the Year" in its advertising won't cover any property risks in the north half of the country.)

I digress. My merlot colleague said his company could no longer afford to subsidise its northern book of business. In vino veritas.

Which brings us to this point in time where the Federal government was to consider the national reinsurance pool.

One catastrophic insurance model we should explore belongs to our friends across the ditch. The New Zealand Earthquake Commission https://www.eqc.govt.nz provides up to a $100,000 Sum Insured per homeowner or business proprietor in the event of an earthquake. The home or business must have purchased conventional insurance. The NZ government significantly improved the claims system by authorising each policy owner's insurer to acts as a claims agent for the EQC. There is a flat levy built into each premium.

From a consumer's perspective it empowers them when purchasing cover. In effect the Insured or the Insured's insurance broker on their behalf approaches the market with a $100,000 deductible (claims excess) on the greatest risk exposure in that particular area.

Given that Cyclone Debbie cost the insurance companies $1.7 Billion, Yasi $1.532 Billion and Tracey in today's numbers $4.1 Billion, these losses spread over time could well make the $10 Billion guarantee / government reinsurance pool (with appropriate funding) quite viable.

But we could go further, if not now, then later. In my view the model can be expanded to other catastrophic losses. It is inevitable that there will be significant natural catastrophes across the nation. Bushfires in all states and territories, Cyclones, Blizzard events in the alpine region, earthquake exposures in South Australia and parts of New South Wales and floods in many areas.

A wish list could look something like this;

- Define what we mean by "catastrophe" both by the type of loss event and dollar quantum
- Federal government floats the catastrophe re-insurer.
- Let's ensure that the R/I structure the Pool develops let's ensure that the model can be manipulated so that it directly covers (and therefore empowers) a significant number of homeowners and SME's; for example, the first $100,000 of every home policy and a similar formula (on say, a sliding scale) of SME and commercial property policies
- Every Australian domestic and commercial property policy has a flat, transparent catastrophe levy as a portion of their premium

But these are only interim measures. The ICA has previously argued risk mitigation (reduction of risk exposures by strengthening buildings and infrastructure) rather than a reinsurance pool. Technically the ICA mitigation position is correct. But it fails to acknowledge that immediate mitigation is just not financially realistic for many families and for small businesses as tenants, almost impossible. Mitigation, especially a professional retrofit can be very expensive. *You cannot leave this kind of work to your home handyman*.

That said in many ways a catastrophe reinsurance pool might need be regarded as breathing space – to allow mitigation to take place over time. The great unknown is a definitive prediction of exactly how devastating future catastrophic events are likely to be. We may perhaps need this reinsurance pool for the next two decades.

But the ICA mitigation mantra does have a point. In order to keep a catastrophe-levy realistic and cost effective, mitigation is the key. Mitigation needs to be encouraged.

For example, it may require tax-break incentives to encourage property owners to bring buildings up to cyclone or bush fire codes, raise houses above flood levels etc.

Equally, local and state governments need to significantly lift their game regarding infrastructure mitigation and planning against significant loss events. Imagine the wrath of voters if their catastrophe premium levy went to a penalty rate because a recalcitrant local government failed to implement yearly mitigation work of an acceptable level.

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Note: The above submission represents my views as a private individual. Whether it is consistent with the views of my employer I cannot say but I certainly do not claim any of the above views expressed are those of my employer, Joe Vella Insurance Brokers Pty Ltd.

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