Australian Government
The Treasury

TSY/AU

Reinsurance pool for cyclones and related flood damage

Consultation paper

May 2021

Manager
Media and Speeches Unit
The Treasury
Langton Crescent
Parkes ACT 2600
Email: media@treasury.gov.au

Contents

Consultation Process

Request for feedback and comments

Interested parties are invited to comment on the issues raised in this paper by 18 June 2021.

The purpose of this consultation paper is to seek comments on key design features of a reinsurance pool for cyclones and related flood damage, which would aim to improve the accessibility and affordability of insurance in cyclone-prone areas.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted. All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

Legal requirements, such as those imposed by the Freedom of Information Act 1982, may affect the confidentiality of your submission.

Further consultation process

The Treasury-led Cyclone Reinsurance Pool Taskforce (the Taskforce) will also consult broadly with industry, community representatives and other interested parties on the topics discussed in this consultation paper.

Closing date for submissions: 18 June 2021

Email	ReinsurancePool@treasury.gov.au
Mail	Manager Cyclone Reinsurance Pool Taskforce The Treasury Langton Crescent PARKES ACT 2600
Enquiries	Enquiries can be initially directed to the Cyclone Reinsurance Pool Taskforce manager.
Phone	02 6263 3693

The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Introduction

Background

On 4 May 2021, the Australian Government announced that it intends to establish a reinsurance pool covering the risk of property damage caused by cyclones and cyclone-related flood damage. The pool would seek to improve the accessibility and affordability of insurance for households and small businesses in cyclone-prone areas, which are mainly located in northern Australia.

The Australian Reinsurance Pool Corporation (ARPC) would administer the pool, which would operate from 1 July 2022. A Treasury Taskforce will consult with industry and community representatives to inform a decision on the reinsurance pool's final design.

Insurance affordability and availability in northern Australia

Northern Australia is more exposed to extreme weather events than other areas of Australia. The damage to residential and business property caused by extreme weather events is often severe, and on a scale that leads to the displacement of people from their homes and disruption to business activity.

Over the past decade, several environmental disasters have impacted the region. These include the destructive Tropical Cyclone Yasi in 2011, which was one of the most powerful storms to hit the region on record, and the devastating floods in Townsville and surrounding areas of north Queensland in February 2019.

Due to the greater risk of extreme weather events, including cyclones, insurance premiums are significantly more expensive in northern Australia. While there are legitimate reasons for this, including the greater cost to insurers to provide property insurance in northern Australia, this has led to cover becoming less affordable and accessible for consumers in the region.

The Australian Competition and Consumer Commission (ACCC) found that the average combined home and contents insurance premium in 2018-19 was about $2,500 in northern Australia, compared to about $1,400 for the rest of Australia. Between 2007-08 and 2018-19, combined home and contents premiums increased by 122 per cent in northern Australia, compared to 71 per cent for the rest of Australia.

Consequently, consumers in northern Australia select higher excesses – that is, the cost that policyholders will incur themselves in the event of a claim – as a means of managing high insurance premiums. The ACCC found that in north Queensland and north Western Australia, average excess levels selected in 2018-19 were about 50 to 60 per cent higher than the average level selected in the rest of Australia.

High insurance premiums are the main cause of underinsurance and non-insurance. For instance, the ACCC estimated about 20 per cent of properties in northern Australia had no home building insurance in 2016, compared with 11 per cent for the rest of Australia.

The Royal Commission into National Natural Disaster Arrangements (Royal Commission) highlighted that uninsured or underinsured households have reduced financial capability to recover from a natural disaster. This can increase costs and pressures for communities and for governments, through increased pressure on health, emergency and welfare systems. It can also slow the economic recovery of a region following a disaster.

Purpose of a reinsurance pool for cyclones and related flood damage

'Reinsurance' is insurance for insurers; it is purchased by insurers to manage their exposure to large losses resulting from insurance claims made in response to a major event, such as a severe natural disaster.

Reinsurance can take different forms and there exists a global private reinsurance market that provides reinsurance in Australia for natural hazard risks. Private reinsurers diversify their exposure across many regions globally and, like any commercial business, ensure that the prices they charge will allow them to remain solvent and profitable.

Internationally, there are several government-supported reinsurance pools, such as the French government's national catastrophe reinsurer Caisse Centrale de Reassurance, Flood Re in the United Kingdom (UK), and the Florida Hurricane Catastrophe Fund in the United States of America, which have been established to meet objectives such as improving affordability for those households at highest risk of natural hazards, or increasing the availability and choice of insurers for consumers.

Establishing a government reinsurance pool for cyclones and related flood damage in Australia would allow insurers to reinsure the risk of losses from claims at a lower cost than in the private reinsurance market, as the pool would:

- forgo a commercial profit margin and charge premiums that correspond to the long term expected cost of cyclone and related flood damage events and administration of the reinsurance pool; and
- be backed by a government guarantee, so the reinsurance pool would 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).

The establishment of a reinsurance pool would lower insurance premiums for households and small businesses by decreasing the cost of reinsurance, which is a significant cost component of premiums for policies with high cyclone and related flood damage risk. The extent of the reduction in premiums and improved accessibility depends on the final design of the reinsurance pool.

Improving insurance affordability in regions with high cyclone risk is expected to reduce rates of underinsurance and non-insurance in cyclone prone areas, including many parts of northern Australia. This would strengthen the financial capability of individuals, businesses and communities to recover from natural disasters and, consequently, hasten the economic recovery of regions following a disaster. It could also reduce costs to governments, through reduced pressure on health, emergency and welfare systems.

In addition, by reducing reinsurance costs and sharing the risk of meeting cyclone damage claims in northern Australia, the pool would be expected to encourage additional insurers to enter the northern Australian market. As high natural peril reinsurance costs are a barrier to entry into this market, the new pool would provide a stable and lower cost means for insurers to manage their cyclone risk exposure. The entry of additional insurers would be expected to increase competition and place downward pressure on insurance premiums.

Natural hazard risk mitigation also plays an important role in achieving sustainable insurance premium reductions. The reinsurance pool is complemented by $40 million in funding for a capped, three-year pilot program to subsidise the cost of cyclone risk mitigation works for eligible strata title properties in North Queensland. The Government has also announced $600 million to be invested in a new program of disaster preparation and mitigation, to be managed by the new National Recovery and Resilience Agency. The program will support resilience projects across the community and for individuals' homes, such as bushfire and cyclone proofing houses, building levees and improving the resilience of telecommunications and essential supplies.

Summary of key features

Some features of the reinsurance pool's intended design are outlined below. Other key aspects remain to be settled and are outlined in the 'reinsurance pool design considerations' section.

- **Risk (hazard) coverage:** Cyclone and related flood damage in cyclone-prone areas across Australia, with definitions to be determined prior to the establishment of the pool.[1] I suggest that flood data, which is available in many of the more populated parts of northern Australia, be used to inform whether, in fact, some property owners should even be forced to select flooding in their insurance at all. I live in a set of units that has been in Townsville since 1992. The units are on a hill in a suburb which has many parts which are flood-prone but also many parts, because they are on a hill, are NOT flood prone. Therefore, any assessment re: flood vulnerability should not be per suburb or postcode. And those in areas that are not flood prone should not be required to have flood insurance.
- **Insurance policies to be covered:** Household, strata and small business property insurance policies.
- **Reinsurance pricing and product design:** The pool will be designed to provide a reduced reinsurance premium per property based on properties' risk profiles, where higher risk properties receive higher discounts.

I'd first address the issue, above, where properties currently identified as "high risk" are not.

- **Funding arrangement:** The reinsurance pool would be funded by reinsurance premiums paid by insurers and be designed to be cost-neutral to the Government over time. That is, the reinsurance premiums charged would cover the expected long-term cost of insured risks and the operating expenses for the pool.
- **Government guarantee:** The ability of the reinsurance pool to meet claims in any given year would be backed by an annually reinstated Government guarantee of $10 billion.
- **Administration vehicle:** The reinsurance pool would be administered by the ARPC.

Related past reviews and inquiries

Concerns about the affordability and availability of insurance cover for natural disasters are not new, and there have been numerous reviews and inquiries in recent years. All past reviews and inquiries have recognised that no one policy option will solve all insurance challenges.

Natural Disaster Insurance Review

The 2011 Natural Disaster Insurance Review (NDIR) reviewed insurance issues relating to damage and loss from the series of storms, floods and cyclones that affected many parts of Queensland and some parts of Victoria in late 2010 and early 2011. The NDIR primarily focused on flood risk but also noted there were immediate affordability problems associated with cyclone risk insurance.

The NDIR made four broad recommendations for a solution to the availability and affordability of flood insurance. These included a standard definition of 'flood', a reinsurance pool supported by a government guarantee, and that all home insurance, home contents and home unit insurance policies include mandatory flood cover.

Following the NDIR, the then Government initiated a consultation process to consider premium discounts for flood insurance, among other recommendations. The Productivity Commission, in their 2013 report *Barriers to Effective Climate Change Adaption*, opposed government-funded subsidies to

[1] The inclusion of Australian external territories will be considered by the Taskforce.

address high insurance premiums. They considered that subsidies would dull incentives to manage risks and would be a short term and potentially costly solution. The then Government accepted the view of the Productivity Commission and decided against proceeding with the proposal.

Northern Australia Insurance Premiums Taskforce

The Northern Australia Insurance Premiums Taskforce (NAIPT) was established in 2015 to consider options to lower insurance premiums in areas subject to high cyclone risk. In its assessment, the Taskforce found that the only way to sustainably reduce premiums is through mitigation activities that reduce the risk of damage from cyclones. It recommended that the insurance industry develop insurance pricing systems that provide greater recognition of mitigation action and that, where mitigation actions are unaffordable for consumers, the Government may subsidise the cost.

The NAIPT also investigated the feasibility of a reinsurance pool. It found that a reinsurance pool could deliver premium reductions with the support of a Government guarantee and promote competition through new entrants to the northern Australia market. It also noted that the Government assumes significant risk in order to provide these premium reductions through a reinsurance pool and that it is a challenging arrangement for the Government to exit in the future.

In response to the NAIPT's report, the Government enacted several policy measures, including the establishment of the North Queensland Strata Title Inspection Scheme, which commenced in 2019, as well as tasking the ACCC with undertaking an inquiry into insurance premiums in northern Australia.

Royal Commission into Natural Disaster Arrangements

The Royal Commission was established in 2020, following the events of the 2019-20 Australian bushfire season. In addition to bushfires, it considered all other natural disaster events, with a focus on national natural disaster coordination.

The Royal Commission noted that maintaining an appropriate level of insurance is important for households and businesses to manage financial risks from natural hazards. Markets that operate effectively are beneficial for consumers, the insurance sector and governments.

The Royal Commission recognised that the cost of insurance is based on the price of risk, and that lowering risk through mitigation actions can be advantageous for both consumers and the insurance sector. It found that the recognition of mitigation actions by insurers can reduce insurance premiums while also creating financial incentives for mitigation.

ACCC Northern Australia Insurance Inquiry

The Australian Government tasked the ACCC with a three-year inquiry into insurance affordability and availability in northern Australia and how more competitive and informed insurance markets may be encouraged in the region. The final report was published in December 2020.

The inquiry made 38 recommendations directed to the Commonwealth, states and territories, and industry. It recommended consideration of direct subsidies over other measures if governments want to provide immediate relief to consumers facing acute affordability pressures. However, the ACCC noted there are some risks with subsidies, such as distorting price signals for consumers and the subsidy being absorbed by insurers over time. The ACCC also noted that reinsurance pools in other jurisdictions have generally been introduced in situations where insurance or reinsurance was not available through private markets, which it considered is not currently the case in northern Australia.

The inquiry also identified that addressing acute affordability issues would help to lower levels of non-insurance, which may lower future costs to governments of providing relief to affected communities following disasters.

Consultation objectives

The success of a government reinsurance pool relies on its careful design. The objectives of this consultation are to seek feedback from stakeholders that will assist the Taskforce to:

- design a reinsurance pool scheme that improves the availability and affordability of insurance in cyclone-prone areas;

The most important part of this scheme will be to ensure compliance to the intent by the insurance companies – suggest adequate penalties (i.e. that deter non-compliance and would NOT be "the cost of doing business") for non-compliance of insurance providers and also an embedded, systematic system of "naming and shaming" any insurance companies that rort the system.

- understand risks associated with the establishment of a reinsurance pool to be mitigated across short-, medium-, and long-term horizons;
- guide the industry transition to reinsuring with the pool, by ensuring that the industry is informed adequately and in a timely manner to undertake the relevant actions; and
- minimise any adverse or unintended impacts arising from the establishment of the reinsurance pool.

In addition to seeking feedback in response to this paper, the consultation process will involve broad consultation with industry and community representatives.

Next steps

The Taskforce is seeking feedback on this consultation paper by 18 June 2021. Please submit your feedback in response to the questions below. When drafting your submission, please note that you may answer all the discussion questions raised or, alternatively, only the questions that are relevant to you. Once the consultation period has closed, and further consultation methods are complete, the Taskforce will develop advice for Government consideration based on stakeholder feedback.

All submissions will be published on the Treasury website unless they have been marked as confidential.

Reinsurance pool design considerations

Outline of key design considerations

Reinsurance pool design is a highly technical process, subject to trade-offs and consequences that will require detailed consideration.

The Taskforce seeks views on the following key design features in this paper:

- **Reinsurance pool coverage**, including**:**
  - How should ‘cyclone and related flooding’ be defined?
  - Separate “cyclone” from “related flooding” because many properties that may be impacted by any cyclone may not, because of their geography, be impacted by any “associated flooding”.
  - Which insurance policies should be eligible to be covered?

  –

Formatted: Indent: Left: 1 cm, No bullets or numbering

- **Reinsurance product design and insurer participation,** including:
  - How should the reinsurance product be priced and designed?
  - How should insurer participation and transition to the pool be managed?
- **Reinsurance pool governance and monitoring**, including**:**
  - What are the most appropriate governance and review arrangements?
  - How can the pass-through of insurance premium reductions for consumers be ensured?
- **Links to risk reduction**, including:
  - How can the reinsurance pool help encourage households and business to undertake mitigation?
  - How will the reinsurance pool avoid encouraging increased risk taking?
  - How might the reinsurance pool encourage further action on insurance affordability?
- **ARPC terrorism reinsurance functions**, including:
  - How might the ARPC's terrorism reinsurance pool functions interact with its new functions?

Reinsurance pool coverage

The reinsurance pool will provide reinsurance for the risk of cyclones and related flood damage across Australia for households, strata and small business property insurance policies. This section invites feedback on how this scope should be defined and clarified.

How should 'cyclone and related flooding' be defined?

An important question for the design of the reinsurance pool is how to define 'cyclone' and 'cyclone-related flooding', as these definitions may determine eligibility for coverage and claims.

Definition of 'cyclone' and 'cyclone related flooding'

'Cyclone' has no standard legal definition across insurance contracts — definitions vary between insurers and insurance policies and, in many cases, 'cyclone' may not be separately defined at all. However, cyclones are monitored and declared by the Bureau of Meteorology (BoM), who provide a technical definition of a tropical cyclone as:

> 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.[2]

One option is to use BoM's cyclone declaration as a 'trigger' for cyclone claims eligibility. Alternatively, it may be preferable to use a separate legal definition of 'cyclone' for the purposes of defining the reinsurance pool's coverage, which might use the BoM's definition as a starting point.

In contrast, there is a standard legal definition of flood for insurance purposes in the Insurance Contract Regulations 2017*,* which is a mandatory definition for home building and home contents, small business, and strata title insurance contracts. However, insurers are not bound to this definition for contracts with large businesses.

The standard legal definition defines flooding as:

> the covering of normally dry land by water that has escaped or been released from the normal confines of a lake, river, creek, or another natural watercourse (whether or not it has been altered or modified); or a reservoir, canal or a dam.[3]

However, there is currently no standard legal definition for 'cyclone-related flooding', which is what the reinsurance pool is intended to cover. Reinsurance contracts will need to distinguish between 'regular' flooding and 'cyclone-related flooding'. This may be achieved through a standard definition — potentially an extension of the existing definition — or some other method that ensures the necessary connection to 'cyclones'.

Two options are:

- requiring that flood damage occur within a fixed proximity and time of a cyclone event.
  - This could be administratively difficult to assess in each case.
- by measuring the amount of rainfall brought by the cyclone that has not dissipated when flood damage occurs.

[2] Australian Bureau of Meteorology, *What is a Tropical Cyclone?* http://www.bom.gov.au/cyclone/tropical-cyclone-knowledge-centre/understanding/tc-info/, accessed 10 May2021.
[3] *Insurance Contract Regulations 2017,* s34. https://www.legislation.gov.au/Details/F2021C00206. The format of this definition has been altered from how it appears in the regulations to aid readability.

– For example, if the water level of a river is elevated by a cyclone and subsequently a flood breaks out due to further rainfall or some other events, this flood could be attributed to the preceding cyclone.

Question

1. How should 'cyclone' and 'cyclone-related flooding' be defined for the purposes of defining the reinsurance pool's coverage? Use the BOM definition of cyclone. For cyclone-related flooding: by measuring the amount of rainfall brought by the cyclone that has not dissipated when flood damage occurs. It's important to cover instances where the rain from the cyclones bring about the overflow of rivers, creeks, dams etc etc.

Formatted: Left

Should storm surge be included in 'cyclone-related flooding'?

The current standard legal definition of flood does not include storm surge. A storm surge is a temporary rise in sea levels that can be induced by cyclones and can potentially cause or exacerbate an existing flooding event. Coastal properties in northern Australia are particularly vulnerable to storm surges and are also more likely to be in the highest cyclone risk category.

Question

2. Should storm surge be covered by the pool and included in a definition of 'cyclone-related flooding'? Yes.

Standardisation of concepts in contracts

Additionally, if legal definitions of 'cyclone' and 'cyclone-related flooding' are adopted as part of the reinsurance pool's design, this raises the question of whether these definitions should extend to relevant insurance policies. Common definitions may promote efficient functioning of the reinsurance pool, as well as reduce gaps in coverage and inconsistencies in policy terms. This could be implemented by making reinsurance eligibility conditional on policies using the same standardised definitions of 'cyclone' and 'cyclone-related flooding' as used by the pool.

Question

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? Yes. The reinsurance pool must also consider rain-damage from cyclones which is NOT flood related e.g. broken windows etc etc and rain enters and damages home and/or contents.

Which insurance policies should be eligible to be covered?

The eligibility of policies covered by the reinsurance pool should be clearly outlined. This section invites feedback on how this scope should be defined and clarified.

Household property policies

Household property policies are intended to be eligible for coverage by the reinsurance pool. In general terms, these can be understood to mean the following:

- home building policies cover stand-alone residential properties, including detached houses, duplexes and non-strata townhouses;
- home contents policies insure contents of all types of residential properties; and
- residential strata policies cover residential buildings with shared property, such as apartments and townhouses.

Question

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? I can't see any problems here. In general, with many strata properties in northern Australia, they multi-story and many have been built after cyclone building codes were introduced. So many of the buildings can and have withstood cyclones. In addition, all but the ground floor will not be subject to flooding. And, often, the "ground floor" is actually used as a car park and people can move their cars.

Small business property insurance policies

Complexities in capturing small business policies

It is intended that the reinsurance pool provide coverage for small business property insurance. In general terms, this is taken to include cover for loss or damage to the equipment, stock, inventory or premises of a small business.

However, small business property insurance policies are often sold in packages or with 'add-on' insurance. For instance, an insurance 'business pack' may include not only property insurance, but liability and business interruption insurance too. Difficulties may arise if insurers are unable to readily separate out combined policy premiums into components.

Difficulties may also arise where a policy covers multiple businesses (such as in a large shopping centre), some of which may be considered small businesses and some of which may not.

In addition, some businesses may share building premises with residential properties in some strata complexes. It is also intended that these 'mixed-use' strata policies be eligible for coverage by the reinsurance pool. In general terms, this is taken to mean building insurance policies for strata title properties that contain both residential and commercial occupants.

The reinsurance pool may be able to provide more targeted support to households and small businesses if insurers are able to separately price (or estimate the value of) the residential and small business components of these policies. If not, benefit may accrue to entities that would not otherwise be eligible for coverage (for example, where the non-residential part of a mixed-use strata property is used exclusively by large businesses).

Definition of 'small business'

The Taskforce will also consider how 'small business' is defined for the purposes of eligibility.

'Small business' is defined in the Insurance Contracts Regulations 2017 (for the purposes of applying the standard definition of 'flood') as a business that has a turnover of less than $1 million and 5 or less full-time equivalent workers. However, there are many definitions of 'small business' in use, including:

- under the unfair contracts terms regime, a business that employs fewer than 20 people;
- for eligibility to make a complaint to the Australian Financial Complaints Authority, an organisation with less than 100 employees;
- under the General Insurance Code of Practice, a manufacturing business with fewer than 100 employees or a non-manufacturing business with fewer than 20 employees; and
- for most small business tax concessions, a business that has less than $10 million in turnover.

Recently, the Australian Small Business and Family Enterprise Ombudsman recommended a standardised definition of 'small business' for the purposes of all insurance legislation, regulation and codes as: a business with less than $10 million in turnover or fewer than 100 employees.

There are significant trade-offs between definitions. For instance, a turnover threshold could result in businesses near the threshold fluctuating between being eligible and ineligible for coverage, while other definitions may impose a greater administrative burden on businesses, insurers and/or the reinsurance pool.

Questions

5. Are insurers able to separately price or estimate the value of the property component of business insurance packages?
6. Are insurers able to separately price or estimate the value of the residential and small business components of mixed-use strata title policies?
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?
8. How should 'small business' be defined for the purposes of eligibility? It should be standardised. I suggest 'Small business' as defined in the Insurance Contracts Regulations 2017 or, if for good reasons I don't understand (having run a small one-person business) as per the Ombudsman: business with less than $10 million in turnover or fewer than 100 employees
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?

Commented [A1]: I understand the difficulties explained above. I suggest that, if these difficulties take some time to sort out, perhaps the reinsurance scheme can be rolled out in stages eg. Household/strata insurance first, business second etc.

Reinsurance product design and insurer participation

How should the reinsurance product be priced and designed?

Measuring cyclone and related flood damage

Measuring and modelling cyclone and related flood damage risk is a key element in pricing reinsurance offered by the pool. Insurers will still be expected to conduct their own assessments of a property's risk exposure to cyclone and related flood damage for properties covered by the reinsurance pool. However, attributing damages to cyclones and related flooding may be a difficult task.

Commented [A2]: See my comments above. Many properties are required to have and pay for flood insurance they don't need because the way the insurers currently assess risk in incorrect. Property owners whose properties will never, and arguably cannot ever, flood are forced to pay flood insurance. This is part of the problem and should be fixed. This will also make the reinsurance scheme considerably more valuable in terms of "bang for buck".

Based on the ACCC's analysis of peril claims, insurers appear to have different methods for evaluating cyclone and related flood damage risks, and there is likely some overlap between cyclones, storms and floods in insurers' categorisation of claims. The reinsurance pool may require a detailed breakdown of risk premiums between cyclones, cyclone-related floods, and other perils. This may require additional work and improved system capabilities on the part of insurers.

Question

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? You need to get a short-term, independent consultant on board to do this analysis.

Using a tiered risk rating system

The pool would be intended to provide targeted reinsurance premium reductions at the individual property level based on each property's risk profile, where higher risk properties receive higher discounts. It is also intended that savings reach individual policies even in low population areas (that is, eligibility would not depend on the total amount of risk in a particular community).

The reinsurance pool may use a tiered risk rating system that assigns a risk tier to each property based on characteristics such as location, age, roof type, construction material and floor elevation. This could allow the premium to reflect the underlying risk more accurately, though there is a trade-off between the accuracy and the cost of risk assessment, which would influence the desirable level of granularity in risk ratings.

The number of risk tiers used by the reinsurance pool may be more or less than the number of risk rating levels used by insurers. Therefore, the reinsurance pool may need to design a risk rating system in consultation with industry so that insurers can efficiently convert their current risk ratings to the new standard.

Question

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? As an on-going commitment by the government, a higher level of accuracy of the risk assessment will lead to a greater number of positive outcomes for the same money, in the long run.

Retention by insurers

A 'retention' for insurers taking out reinsurance is similar to an excess for insurance policyholders – it is the level or proportion of costs that the insurers will pay out themselves in the event of a claim. Insurers may retain some proportion of cyclone and related flood damage risk rather than transferring this risk to the reinsurance pool entirely. Similarly, there may be circumstances where it would be prudent for the ARPC to purchase retrocession (that is, reinsurance for the reinsurance pool).

Though the type and size of retention is yet to be determined, the insurer's retention level would influence the price of reinsurance. For example, insurers may retain a fixed dollar amount per property regardless of the property's risk rating, a fixed proportion of each property's sum insured or have a flexible retention level based on risk ratings.

The frequency of claims is also a consideration for the determination of retention. For instance, following the conventional design of catastrophe reinsurance, the reinsurance pool may pay out claims based on each separate occurrence of cyclone and related flood events rather than aggregate claims over a specific period.

These and other settings may lead to different levels of desirable retention.

Question

12. How much risk exposure should primary insurers retain? As much as is required to "set a level playing field" in terms of how much northern Australians pay in excess and insurance compared to the rest of the country.

The claims management process

Claims management, also known as claims handling, is the process during which insurers assess claims and decide whether to accept or reject them.

The Taskforce expects that insurance claims for cyclone and relating flood damage would continue to be assessed and managed by insurers, with insurers expected to maintain a high standard of claims management for policies covered by the reinsurance pool. Deterioration in the claims management process would result in poorer outcomes for consumers.

Question

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? A poor outcome would be insurance companies paying for unsubstantiated or poorly substantiated (fraudulent) claims and then being "reimbursed" or compensated for this by the taxpayer through the reinsurance pool. I don't know how much this is possible or likely but, if at all, the scheme should be designed to avoid this.

How should insurer participation and transition to the pool be managed?

Insurer participation

Insurers may not want to cede certain cyclone and related flood damage risks into the reinsurance pool, particularly where policies have only low cyclone risk and would only achieve a marginal reduction in premiums if they were reinsured by the pool.

The Taskforce will consider the type of insurer participation in the reinsurance pool and how it would work in practice. This requires consideration of questions such as:

- whether participation should be mandatory or voluntary;
- how much risk would insurers need to cede to the pool, if participation were mandatory; and
- the threshold of cyclone risk for insurers to cede policies to the reinsurance pool, if it were mandatory, and whether this could be implemented through 'hazard maps' or self-assessment by insurers.

Question

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? I don't know the answer. However, this decision should be entirely that of government (who aims to better the public good) and not the insurance industry (who aim to maximise profit). However, of course, information and insights from the insurance industry will assist the government in this decision-making.

~~14.~~15. Is there any advantage to making the participation voluntary and then offering heaps of incentives/support to those insurers who agree to participate BECAUSE the government would REQUIRE clear and publically available reporting on how the benefits were being passed onto consumers.

Transition into the reinsurance pool

Ensuring a smooth transition to the pool is important for the efficient functioning of the insurance market.

As the reinsurance offered by the pool is expected to be cheaper than what is available in the market, it would be advantageous for insurers to switch over as soon as practicable so they can offer more competitive premiums to customers. Otherwise insurers could risk losing market share if they do not match the lower prices offered by competitors due to higher reinsurance premiums paid under existing contracts.

Providing sufficient lead time for insurers to plan and undertake the transition is important. Two options for the transition arrangements are listed below:

- allow insurers to keep their current reinsurance arrangement until they expire; or
- the Government would set a fixed date by which insurers must exit their existing reinsurance contracts and transition into the reinsurance pool.

Question

~~15.~~16. How should industry transition be managed and what is the best format and timeframe for it to take place? In my (limited, consumer) experience, insurance is generally reissued annually – perhaps the insurer's current reinsurance arrangements are similar? If so this should inform the timeframes for change e.g. insurers must transition within 12 months of date X. If my understanding is not correct, and if you don't know what the case is, then get a short term consultant on board to get a "bird's eye" overview of what the insurance landscape looks like, in this regard.

Reinsurance pool governance and monitoring

The Government intends to establish the reinsurance pool within the ARPC. The ARPC would take on the new functions of this reinsurance pool for cyclone and related flood damage alongside its existing terrorism reinsurance function.

What are the most appropriate governance and review arrangements?

Regular review of the reinsurance pool

In taking on an expanded role, the ARPC may require changes to its existing review arrangements. This could be achieved by expanding the terrorism reinsurance scheme's current triennial review mechanism, which requires a review at least once every three years evaluating the need for the terrorism reinsurance scheme to continue, to also cover the cyclone and related flood damage reinsurance pool.

However, consideration would need to be given to varying the review's frequency, as three years may be insufficient time to identify and implement significant changes and issues relating to the ARPC's cyclone reinsurance coverage. There may also be a need for an interim review shortly after the establishment of the cyclone and related flood damage reinsurance pool to evaluate its early operation.

Reviews of the cyclone and related flood damage reinsurance pool could consider indicators of success, such as reductions in property insurance premiums, incentives to mitigate risk, differences in rates of under-insurance and non-insurance between areas prone to cyclones and areas that are not, trends in cyclone risk exposure over time and indicators of market failure.

Question

17. What should be the key goals for a regular review of the reinsurance pool and what would be the optimal timeframe? The reinsurance scheme should be set up with the expectation of change, on the basis that lessons will be learned. This also speaks to the potential desirability of a staged roll-out e.g. households first, then small businesses.

Step 1 for the reinsurance scheme overall should be to define its objectives (and priority for those objectives). From the consultation brief, I understand the objectives to be:

i. Lower insurance premiums for households and small businesses (priority 1)

ii. Reduce rates of underinsurance and non-insurance in cyclone prone areas (priority 2)

iii. Strengthen the financial capability of individuals, businesses and communities (priority 3)

iv. Hasten the economic recovery of regions following a disaster (priority 4).

v. Reduce costs to governments, through reduced pressure on health, emergency and welfare systems (priority 5).

vi. Encourage additional insurers to enter the northern Australian market (priority 6).

I understand that priority objectives 1 and 2 are intended to lead to 3, 4 and 5 but I think they are all worth listing out separately. There may be other objectives to do with effective/efficient governance of the system as a whole.

Then, the goal of the regular review of the reinsurance pool should be to assess achievement against these objectives – by setting SMART performance indicators (or redefining the objectives to be SMART). Create opportunities for "fixes" early on to un intended

Formatted: No bullets or numbering

Formatted: Numbered + Level: 1 + Numbering Style: i, ii, iii, … + Start at: 1 + Alignment: Right + Aligned at: 0.63 cm + Indent at: 1.27 cm

Formatted: Indent: Left: 1.27 cm, No bullets or numbering consequences, outside of a complete "review" process but against a framework of objectives.

Timeframes for full review, obviously, will need to be flexible. Perhaps a brief review early on (within a year), then three years but also, after a big cyclone event.

~~16.~~

Formatted: No bullets or numbering

Reinsurance pool lifespan

An exit date could provide the market with greater certainty about the duration of the reinsurance pool, though this may be unnecessary with a well-structured review process that provides sufficient transitional time for major changes. An exit date may also complement other objectives of the pool, such as how the pool encourages mitigation.

The Flood Re reinsurance pool in the UK, established in 2016, has an exit date set for 2039. This was set to ensure that Flood Re was a temporary solution and that insurance affordability would otherwise be addressed over the long-term by increased investment in natural hazard mitigation.

Question

~~17.~~18. Should the reinsurance pool have a planned exit date? Yes – but it should be at least for 25 years.

How can the pass-through of insurance premium reductions for consumers be encouraged?

Commented [A3]: This should NOT be encourage but required!

Individuals and small businesses will be expected to benefit from more affordable insurance premiums following the introduction of the reinsurance pool. Potential options to monitor insurers passing on premium reductions include explicit price monitoring arrangements and disclosure of reinsurance costs to insurance policyholders.

Price monitoring

Explicit price monitoring would seek to measure whether insurance premiums are reduced by the corresponding reduction in reinsurance premiums. Both public and private sector options exist:

- **Public sector options** — A Government agency with strong information gathering powers could directly monitor prices. For example, the ACCC has undertaken price monitoring on a number of products, including the removal of GST on menstrual products in 2018-19. These gathering powers could be used to compel insurers to provide access to certain otherwise unavailable data.
- **Private sector options** — Several private companies provide professional price monitoring services. Unlike some government agencies, they do not have the ability to compel information from insurers; however, they may take more innovative approaches, such as using price-scraping tools that monitor premium quotes provided to consumers over time.

Disclosure reforms

The Government could also regulate greater transparency of insurance pricing in policy product disclosure statements and renewal notices, including showing the different components of the premium, change in reinsurance costs from the scheme, and the subsequent savings to the consumer. This would empower consumers to better compare insurance policies and could increase competitive pressures to encourage pass-through. Although there are already legal disclosure requirements for insurance products, a number of previous inquiries have raised disclosure related issues and have suggested reforms. This includes the ACCC's *Northern Australia Insurance Inquiry*.

Questions

~~18.~~19. Which mechanisms will ensure the pass-through of reinsurance premium savings to insurance policyholders? For example:

~~18.1~~19.1 Explicit price monitoring of insurance premiums? Yes, by government (ACCC or Productivity Commission?)

~~18.2~~19.2 Additional requirements to disclose the cost of reinsurance to policyholders? Also, yes.

~~18.3~~19.3 Any additional mechanisms that may be appropriate? There need to be, in addition, randomised, independent, thorough, infrequent audits of insurers in this regard. Although I'm suggesting these audits are infrequent (to save the government money and effort) the penalties for non-compliance significant enough to be deterrents (including, but not limited to, "naming and shaming")

Links to risk reduction

The Taskforce will explore how the reinsurance pool's design could encourage the sustainable reduction of natural hazard risk over time, how the reinsurance pool can avoid encouraging risk taking behaviour, and how the pool might encourage further action to improve insurance affordability.

How can the reinsurance pool help encourage mitigation?

There may be scope for the reinsurance pool to encourage mitigation, including through an explicit mandate to do so, or by providing premium discounts for properties that undertake mitigation.[4]

The ACCC found that, while some insurers provide premium discounts in response to mitigation works at a household level, several insurers did not have measures in place to allow them to take private mitigation activity into account.

As a result, consumers that undertake mitigation works to improve their property's resilience do not always see the benefit through lower insurance premiums. The ACCC and the Royal Commission recommended that insurers improve recognition of household risk mitigation and provide guidance to consumers on which types of mitigation they will recognise and the discount this is likely to provide.

As such, any mitigation activities that receive discounts as part of the reinsurance pool would need to be similarly recognised by insurers. That said, recognition of household level mitigation may be better left to insurers than incorporated into the design of the reinsurance pool.

Questions

~~19.~~20. To what extent do insurers price in discounts into insurance premiums for mitigation action undertaken by or affecting policyholders? I'd be careful here – one good way to mitigate is to build up the land on your property so it doesn't flood as easily – thereby shifting any floodwaters onto one's neighbours.

~~20.~~21. How might mitigation be encouraged by the reinsurance pool's design? For example:

~~20.1~~21.1 Should the pool provide discounts for properties that undertake mitigation?

~~20.2~~21.2 Should the pool have an explicit mandate to encourage mitigation?

How will the reinsurance pool avoid encouraging increased risk taking?

By reducing reinsurance costs for high risk properties, there is a risk that the reinsurance pool may encourage new construction in high-risk areas or to a standard that is vulnerable to cyclones and related flood damage. The Taskforce will consider options to address this, such as limiting eligibility to properties which:

- have been built, or were being built, prior to the reinsurance pool's establishment; or
  - This approach has precedent in the UK's Flood Re pool, which does not cover properties built after 1 January 2009.
- properties constructed after the reinsurance pool's establishment that comply with building codes (which govern how something is built) and land-use planning standards (which govern how land is used) that adequately mitigate cyclone and related flood damage risk.

[4] A reinsurance pool may also be able to establish catastrophe models to enhance the market's understanding of cyclone risk and these models could assist the prioritisation of risk mitigation.

Questions

~~21.~~22. How should the pool's design seek to discourage any increase in risky behaviour? For example:

~~21.1~~22.1 Should there be a time-based cut-off to exempt new builds from the pool? No

~~21.2~~22.2 Should the pool only allow new builds that have been built to adequate standards and in suitable locations? Yes

How might the reinsurance pool encourage further action on insurance affordability?

The ACCC and Royal Commission identified that state, territory and local governments can take action to reduce cyclone and related flood damage risk by investing in mitigation and reforming building codes and land-use planning regimes. This would help improve insurance affordability in the long term.

In addition, most states and territories tax insurance. Removing or reducing insurance taxes would be one of the most direct, immediate, and effective state government levers to improve insurance affordability. State insurance taxes are also economically inefficient as they change consumer behaviour by increasing the cost of insurance above what it would otherwise be, leading to under- and non-insurance.

The Insurance Council of Australia has estimated that, in northern Australia, state and territory insurance taxes add about 10 per cent on average to a home and contents insurance premium. The Royal Commission also highlighted recommendations from multiple inquiries for states and territories to abolish taxes on insurance to lower insurance costs.

Questions

~~22.~~23. To encourage further action by states and territories on insurance affordability:

~~22.1~~23.1 What settings could be included in the design of the pool?

~~22.2~~23.2 Which policy options could be introduced alongside the pool?

Interactions with the ARPC's existing functions

How might the ARPC's terrorism reinsurance pool functions interact with its new functions?

The ARPC's new role to operate a cyclone and related flood insurance pool may pose challenges and opportunities for its terrorism reinsurance functions. As part of the Review, the Taskforce will closely consider the ARPC's strategic settings to ensure that they remain appropriate.

Question

~~23.~~24. What are the potential interactions between the terrorism reinsurance pool and the new cyclone and related flood damage reinsurance pool?

List of consultation questions

Reinsurance pool coverage

1. How should 'cyclone' and 'cyclone-related flooding' be defined for the purposes of defining the reinsurance pool's coverage?
2. Should storm surge be covered by the pool and included in a 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?
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?
5. Are insurers able to separately price or estimate the value of the property component of business insurance packages?
6. Are insurers able to separately price or estimate the value of the residential and small business components of mixed-use strata title policies?
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?
8. How should 'small business' be defined for the purposes of eligibility?
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?

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?
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?
12. How much risk exposure should primary insurers retain?
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?
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?
15. How should industry transition be managed and what is the best format and timeframe for it to take place?

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?

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

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

18.1 Explicit price monitoring of insurance premiums?

18.2 Additional requirements to disclose the cost of reinsurance to policyholders?

18.3 Any additional mechanisms that may be appropriate?

Links to risk reduction

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

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?

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

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

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

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

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?

22.2 Which policy options could be introduced alongside the pool?

Interactions with the ARPC's existing functions

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

Please see also my comments in the consultation paper itself.