



**Submission by the
Financial Rights Legal Centre**

Treasury

Reinsurance pool for cyclones and related flood
damage

22 June 2021

About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took over 21,000 calls for advice or assistance during the 2019/2020 financial year.

Financial Rights also conducts research and collects data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how CLCs utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether.

For Financial Rights Legal Centre submissions and publications go to www.financialrights.org.au/submission/ or www.financialrights.org.au/publication/

Or sign up to our E-flyer at www.financialrights.org.au

National Debt Helpline 1800 007 007
Insurance Law Service 1300 663 464
Mob Strong Debt Help 1800 808 488

Monday – Friday 9.30am-4.30pm

Introduction

Thank you for the opportunity to comment on the key design features of a reinsurance pool for cyclones and related flood damage. The Financial Rights Legal Centre (**Financial Rights**) has advocated for many years that Government action needs to be taken to improve the accessibility and affordability of insurance in all parts of Australia that are vulnerable to extreme weather and the effects of climate change.

Financial Rights believes that the following principles must be central to the development of a final model recommended by the Treasury Taskforce to ensure the best outcomes for homeowners and communities, value for money for Australian taxpayers and a functioning insurance market.

Firstly **mitigation** and resilience building strategies should be incentivised wherever and whenever possible. Any government intervention must be directed to ensuring homeowners and communities in regions affected by cyclones and other extreme weather events mitigate their risks when it is effective and cost efficient to do so. Be it linking access to the benefits of the reinsurance pool or improving information asymmetries, mitigation should be a key feature of the Treasury Taskforce's and Government's thinking. Incentives for mitigation must also be aligned to other long term resilience policies such as limiting property development in high risk areas and ensuring building codes protect against property damage as well protecting human safety.

Secondly, premium pricing and risk assessments must be made more **transparent**. If homeowners and communities are expected to change their behaviour with respect to insurance and mitigating risk, or moving away from high risk areas it is critical that they be fully informed of the elements that make-up their premiums and any subsequent increases to those premiums. People will change their behaviour if they are well informed, appropriately incentivised and there is broad community uptake (impact of cultural norms).

Finally greater **contestability** of premium pricing and risk assessments is needed. Policyholders should be empowered to contest decisions made by other parties with respect to their insured interests including premium pricing, risk assessments and other information provided to and relied upon by insurers and policyholders. Enabling policyholders to challenge for example inappropriate, disproportionate or unjustified premium increases, will improve competition and increase knowledge of the risks and promote mitigation strategies.

The interaction of these three principles should inform the Treasury Taskforce's thinking in improving insurance affordability and maintaining sustainable communities in northern Australia. There should also be greatly improved monitoring of insurance affordability, under-insurance and non-insurance nationally so that the effectiveness of any intervention can be accurately assessed.

In this submission will address:

- The consultation questions; and
- Other related issues including
 - the need for a national solution and
 - alternative means of government intervention to improve accessibility and affordability of insurance.

Further stakeholder consultation

Financial Rights is interested in participating in any stakeholder meetings in the future on the reinsurance pool and its implementation. We have given legal advice to insurance policyholders in Northern Australia consistently for nearly 15 years. Our Insurance Law Service provides advice to between 5000-7000 consumers of insurance every year. We are well-versed in many of the consumer pain points when it comes to post-cyclone insurance claims, and insurance affordability in that region, as well as other high risk regions in Australia.

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?***

It is important to distinguish between the definition of *cyclone* and *cyclone related flooding* for the purpose of defining the reinsurance pool's coverage and the definitions included in the consumer facing contracts of insurance. Ideally the consumer facing definition will be as inclusive as possible, covering the majority of risks. Access to the reinsurance pool will necessarily be more restrictively defined.

Consumers are currently covered for storm and flood (unless they opt out of flood cover). Cyclone is not usually separately covered as a distinct event. It would be unfortunate to overcomplicate policies and to create further distinctions that will lead to differences in cover for different policy holders who have endured the same event. It is also important to ensure that the net result of this initiative is greater coverage for policy holders rather than less, and for the benefits to be distributed across policy holders generally, or according to some pre-determined priority system (such as need), rather than accruing to a random sample of policy holders who happen to experience an event in a way that fits a particular definition.

The purpose of the reinsurance pool should be to provide reinsurance at a reasonable price for cyclone risk in particular, with a view to lowering the cost of insurance overall in cyclone prone areas. If it is cyclone risk that is driving up premiums, then addressing the cost of reinsurance for

cyclone risk should bring down the price of policies in those areas, without the need to create further distinctions between types of events in the policies themselves. The residual risks should be borne by the insurer or their commercial reinsurance in the same way they are now.

Financial Rights does not have a view on what definition is chosen for access to the pool. However, it is important that the definition is clearly defined to ensure a level playing field for insurers and to promote competition. Insurers should not get uneven benefits from the costs and risks incurred by government. Similarly, the definitions used in consumer facing contracts should also be the same as each other (standard definitions), but preferably not the same as the definitions used to access the reinsurance pool. This is to ensure that insurers are passing on the benefits of the pool equally. There are many other reasons this is desirable, some of which are outlined below in response to question 2 & 3 below.

Whatever definition is adopted it for the reinsurance pool, it may need to be reviewed after a period of operation to ensure that the desired objectives are being achieved and to address any unforeseen consequences.

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

Financial Rights agrees that storm surge should be covered by the pool as a standalone event and included in a definition of 'cyclone-related flooding'. Storm surge is often excluded along with flood in current policies. Ideally the reinsurance pool will make providing this cover more affordable.

Storm surge events are often (but not always) cyclone-related. They can also be related to a "severe storm". It would be a perverse outcome to create a gap in cover where a consumer suffers loss from a storm surge directly attributable to a cyclone but it is not covered.

It is equally perverse, to have a significant rain event that is less than a cyclone and leave consumers uninsured. Storm surge is often excluded from cover due to the high cost. Given the reinsurance pool is being designed to assist in affordability of insurance premiums it would be absurd to allow a gap in cover by allowing insurers to exclude storm surge or price consumers out of cover for non-cyclone related storm surge.

We would also want to ensure that the definition of 'cyclone-related flooding' included rain-water run-off. Cyclones can bring enormous amounts of rain, which can inundate properties from the street without ever escaping the normal confines of a lake, river, creek. In creating this pool, it is important for all gaps in cover to be plugged otherwise it will create frustration, inequity and a further erosion of trust in insurers.

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?*

As stated above, it is not necessary to have matching definitions in consumer facing policies as are used to access the reinsurance pool. In fact, it is undesirable. It is, however, necessary to ensure that consumer facing policies cover *at least* the same events/conditions as are covered

by the reinsurance pool, otherwise insurers could profit from a government initiative and undermine its objective. We would argue that there should be the same standard definitions in all consumer facing policies, and that these should be as expansive as is commercially possible (given the predicted cost savings to be created by the pool).

Inconsistent definitions risk misleading consumers into thinking they have cover for certain events when in fact they do not. Nuanced differences in each and every term have material impacts upon their coverage. PDSs are long, complex and confusing documents and it is almost impossible for a consumer to appreciate these nuances and their impact and take them into consideration in their purchase decisions.

Financial Rights strongly supports a standardised definition for storm inclusive of cyclones. Without a standard definition for storm we will inevitably start to see gaps in coverage between insurers for the days leading up to a declared cyclone and possibly the days that follow a cyclone being downgraded below the level of a defined cyclone. In fact, we support standard definitions for all insured events, and particularly extreme weather events.

Financial Rights has seen examples of such gaps in coverage even with a standard flood definition in place. After the recent floods in NSW, we have seen examples where neighbours end up with completely different claims outcomes depending on how their insurers defined storm coverage. For example, some policies exclude storm water run-off along with flood if you opt out of flood and some do not. Others confine storm water run-off to within 24 hours of a storm and others do not. This creates considerable acrimony towards insurance as people cannot appreciate these differences until they are directly impacted by them, do not realise they are not comparing like with like when they get quotes for insurance, and would be poorly placed to analyse the relative effectiveness of these policies even if they did.

If cyclone specific definitions, matching access to the reinsurance pool, are introduced into consumer facing policies, then these problems could be exacerbated. For example, high winds could weaken a roof or bring down a tree before a storm is declared a cyclone and not be covered, or the same tree could create an opening that is later inundated by rain but not covered because the hole itself predated the cyclone. Cyclones, by their very nature, are mobile and if consumers are subject to proximity cut offs in time or physical distance, there is the capacity for anomalies and unfair or undesirable outcomes.

Customers with similar damage and storm coverage should receive the same sorts of claims outcomes. If for any reason it is necessary to use the same definitions in policies as are used to access the reinsurance pool, then additional care will be needed in drafting those definitions to ensure that they are not only viable for the pool to succeed but are also as fair as possible and any exceptions or cut off points easily explained to consumers. We reiterate that we do not believe using matching definitions for these purposes is necessary or desirable.

Finally, any definitions should be in plain English and consumer tested. Standard definitions must meet common sense, community expectations of coverage and exclusion. A guidance document with recognised scenarios would be helpful for consumers as well as for adjudicators.

The purpose of any reinsurance pool should be to improve cover and not result in further gaps, complications and exclusions.

Recommendations

1. Standard definitions should be set for 'cyclone' and 'cyclone-related flooding' to access the reinsurance pool.
2. The definition for 'cyclone-related flooding' should include storm surge and rain-water runoff.
3. There should be a standard definition for storm damage for all consumer policies. The definition of storm in consumer facing policies should not be the same as the definitions for accessing the reinsurance pool but should be at least as inclusive as cover provided by the pool (that is, they should include cyclone and storm surge in broader definitions of storm and flood). Standard definitions should be in Plain English and consumer tested.

-
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?***

No comment.

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

No comment.

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

No comment.

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 comment.

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

While we do not have a comment on how 'small business' should be defined, we strongly support a standard definition which would apply across insurers, relevant insurance legislation and AFCA terms of reference. It should be as inclusive as possible.

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?***

No comment.

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?

No comment.

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?

Financial Rights supports some risk pooling, and for that reason would support a less granular risk rating system for cyclone and related flood damage risks. We support everyone in northern Australia that are not members of the hyper-mobile elite to have affordable access to insurance regardless of the risk. We fully recognise the arguments that it is better for individuals to pay a 'fair price' for insurance that accurately reflects individual risk but we think that approach will simply force the most vulnerable in our society into even more vulnerable positions. If we want to have thriving regional communities then there needs to be some risk pooling.

Financial Rights also strongly supports the transparency and contestability of any risk rating system that will be put in place for individual policyholders. We discuss transparency and contestability of premium pricing in more detail below. With regards to a risk rating system, policyholders should have a right to know how their property has been assessed, on an annual basis, and a right to challenge any underlying assumptions about their risk if they believe it has been assessed in error or has not taken into account mitigation strategies.

Component pricing

Consumers currently have limited access to natural hazard data in easily digestible formats and very little motivation to seek it out and use it. This is a serious problem since many consumers remain in the dark about the natural hazard risks including cyclone risks that apply to their homes and are thus prevented from making informed decisions about the insurance coverage they require, the policies that would best meet their needs and potential mitigation they could or should undertake.

Financial Rights supports consumers being empowered to purchase insurance products on the basis of a genuine risk mitigation partnership with insurers. This involves providing more information and data in accessible ways on natural hazards that impact upon them. The key way to do this is to price and/or risk signal, particularly with respect to controllable risks as opposed to uncontrollable risks. In other words, risks that are within the individual's control to mitigate and will benefit society are risks that ought to be transparently priced. For example, rewarding those who undertake flood or fire mitigation projects on their property.

Financial Rights has long argued for the need to provide consumers with the full components of an insurance product's price. Component pricing would provide a healthy signal to consumers of the risk factors taken into account when premiums are set. Knowing that a huge portion of your insurance's base premium is made up of cyclone, flood or storm risk, is incredibly valuable

information to a homeowner and can lead to positive consumer and societal outcomes through risk mitigation and resilience building.

Developing an effective component pricing regime will:

- remove significant information asymmetries between insured and insurer;
- provide consumers with increased understanding about what effect mitigation strategies may have on reducing insurance premiums or what behaviours or conditions might increase premiums;
- potentially alert consumers to changes in the insurer's perception of their risk;
- increase the possibility for a genuine risk mitigation partnership between the insured and the insurer;
- benefit society as a whole from increased risk mitigation and decreased risk taking; and
- allow consumers opportunities to correct errors or misperceptions.

Insurance consumers are currently told very little if anything at all about the risks that they are insuring against. There are some risk mapping services available, for example the NRMA's Safer Homes initiative¹ and ICA's Building Resilience Rating Tool.² It is however unclear the extent to which these tools are currently used by, or even promoted to, consumers. It is clear though that insurance companies are not currently required to make this information available to consumers even when it applies directly to their premium price. It is also not clear how accurate and independent these services are and whether results can be contested if the rating doesn't take into account individual mitigation and resilience factors. Even if they are used, consumers are left in the dark with respect to how those risks identified impact upon the actual premium price they are charged. They are also largely not made aware of what actions they should or could take to lower these risks.

Component pricing is currently being examined by Treasury in its Disclosure in General Insurance consultation. Financial Rights has argued strongly for the need for a component pricing regime be introduced.³

Recommendations

4. Any risk rating system designed by the pool should support some cross-subsidation, be transparent to policyholders and be contestable.
 5. An effective component pricing regime for insurance should be established.
-

¹ saferhomes.nrma.com.au

² <https://www.resilient.property/>

³ https://financialrights.org.au/wp-content/uploads/2019/03/190308_DisclosureReview_Submission_FINAL.pdf

12. How much risk exposure should primary insurers retain?

No comment.

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?

Financial Rights does not believe implementing a reinsurance pool should have much effect on claims management as long as the pool does not require insurers to undertake additional assessments for cyclone claims which might delay the claims process. Ideally the consumer claims handling process should not be affected by any delays in reinsurance claims, but proceed independently.

Claims handling will soon be regulated as a financial service in the *Corporations Act* and ASIC has already set out its expectations for insurance claims handling and natural disaster events.⁴ Any claims handling under the reinsurance pool should be subject to the same regulatory oversight and not be treated any differently.

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?

Financial Rights believes participation in the pool should be mandatory. The ACCC found that where participation is voluntary, insurers will generally only purchase reinsurance from the pool if it is not otherwise available or where it is more expensive on the private market.⁵ If the goal of this pool is to reduce premiums, that is only going to happen if we mandate participation, spreading the costs of the pool across all cyclone-affected properties. Otherwise the only insurers that sign up will be the ones carrying the most cyclone risk on their books.

We also believe mandating participation will be the best way to require standardised definitions and claims outcomes across insurers.

As far as the amount of risk to be ceded we just believe it should be whichever amount reduces premiums the most across the pool, while still facilitating appropriate cover for consumers.

Recommendations

6. Participation in the pool should be mandatory.

⁴ Australian Securities and Investments Commission, Open letter to Directors of general insurance companies: Insurance Claims and natural disaster events (17 December 2020), <https://download.AustralianSecuritiesandInvestmentsCommission.gov.au/media/5896425/AustralianSecuritiesandInvestmentsCommission-letter-to-insurers-insurance-claims-and-natural-disaster-events.pdf>

⁵ Australian Competition and Consumer Commission, Northern Australia Insurance Inquiry, Final Report (November 2020), recommendation 20.2, <https://www.accc.gov.au/focus-areas/inquiries-ongoing/northern-australia-insurance-inquiry/final-report> (pgs 103-104).

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

No comment.

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?

Financial Rights supports a three year time frame for review, especially if insurers are given a long transition time to join the pool. If the Treasury sets a shorter review timeframe we risk having not enough data to assess the success of the pool.

The key goals for a regular review should be to measure all of the following:

- Are policyholders aware of the pool? Have they noticed a difference in their premiums or claims handling since the pool commenced?
- Have there been reductions in property insurance premiums and by how much?
- Have incentives to mitigate risk been implemented?
- Have policyholders and property owners actually undertaken risk mitigation work, and was it because of the incentives designed into the pool?
- Have there been differences in rates of under-insurance and non-insurance between areas prone to cyclones and areas that are not? Are these improvements attributable to improvements facilitated by the pool or to deterioration in conditions in other parts of the country (due to climate change or other causes),
- What have been the trends in cyclone risk exposure over time?
- Have there been any indicators of market failure (which include premiums that are so high no one takes those policies up)?
- Have reinsurance costs-savings and discounts actually been passed on by insurers to policyholders?
- Is the reinsurance pool scalable to other extreme weather perils and other regions of Australia?

Most of these key goals will require clear benchmarking now before they can be reviewed in three years. Record-keeping and data-collection around rates of under-insurance and non-insurance are notoriously poor in Australia, and without better data it will be difficult to assess if the pool has had any effect. Measuring rates of savings will require a well-resourced and empowered pricing monitor. Any subsidised or incentivised mitigation works will need to be recorded and tracked to make sure they are completed and have had a measurable effect on peril exposure for the property and premium levels. Without these things in place it will be impossible to have a useful regular review of the scheme.

Recommendations

7. The optimal timeframe for a regular review of the pool is three years.
 8. An effective review will require benchmarking of key outcomes at the commencement of the pool, as well as improved record-keeping and data collection around rates of insurance affordability, underinsurance and non-insurance and the outcomes of incentivised mitigation works.
-

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

Financial Rights does **not** support a planned exit date.

Climate forecasts show in the coming years severe weather events like cyclones may occur less often but will become more intense and could reach further south in the coming decades. Modelling conducted by Insurance Australia Group (IAG) has found climate change has dramatically increased the risk cyclones moving further south. They also say Australia is “experiencing a 10 per cent increase in the number of the most intense tropical cyclones off the nation's coastline during the decade between 2015-2025.”⁶ That is the same level of increase there had been from the 1960s to 2015.

Beyond the threat of damage from cyclones though the Climate Council has stated that:

Projections for Australia indicate, with considerable confidence, that many extreme weather events will become worse through this century. More frequent and hotter hot days are expected as the century proceeds (very high confidence). Extreme rain events are projected to become more intense (high confidence). Time in drought is projected to increase in southern Australia (high confidence), with a greater frequency of severe droughts (medium confidence). Southern and eastern Australia are projected to experience harsher fire weather (high confidence). ... Extreme sea-level events are very likely to increase (high confidence).⁷

It is therefore not clear that the government will ever be able to step away from assisting those impacted by extreme weather events, be it via preventative market intervention or direct natural disaster funding support. Other methods of ensuring the scheme is meeting its objectives in terms of mitigation and improved planning and building should be built into the scheme, rather than a fixed exit date.

⁶ <https://www.abc.net.au/news/2020-03-06/cyclones-spreading-south-could-cause-tens-of-billions-in-damage/12020218>

⁷ See the Climate Council's latest report: “Climate Change 2015: Growing Risks, Critical Choices” By Lesley Hughes And Will Steffen (28/8/15), available at: <https://www.climatecouncil.org.au/climate-change-2015-growing-risks-critical-choices>

However if the Treasury Taskforce does choose a specific date when support for the reinsurance pool will reduce, consumers need to be regularly informed of date, what will occur when the intervention ends and the percentage that their premiums will increase at that time. Repeated warnings may help encourage long-term mitigation strategies, or even encourage some home owners to move away from high risk regions should they recognise that they will not be able to afford insurance once the Government has reduced its funding.

Recommendations

9. Financial Rights does not support a planned exit date for the pool.
10. If there is going to be a planned exit date consumers need to be regularly informed of the date and the specific monetary impacts on their premiums which will result from the exit of the pool.

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?

Financial Rights strongly supports a well-funded mechanism for the explicit price monitoring of insurance premiums. We believe this function should either be carried out by the ACCC with specific new resourcing and powers, or a specific public sector pricing monitor should be created for this singular purpose.

Financial Rights has been strongly supportive of the role the Fire Services Levy (FSL) Monitor played in Victoria. The FSL Monitor in Victoria was established as an independent statutory appointment with substantial powers to protect consumers when Victoria was transitioning to a Fire Services Property Levy. The Monitor was set up to ensure that insurers genuinely passed on the savings of the abolition of the fire services levy to policyholders. During the time that the Monitor was in operation it found that fifty-six insurance companies and brokers had an over-collection of fire services levy (FSL) in Victoria of \$12.3 million.

We also strongly support a pricing monitor to be given authority and resources to undertake research, particularly about insurance pricing and disclosure, to promote effective competition and accountability. Legislation will need to enable a pricing monitor (or the ACCC) to provide information, advice and guidance in relation to the reinsurance pool. A pricing monitor should be able to use this power to investigate pricing practices more broadly in the insurance sector to promote a well-functioning and competitive insurance market, which is necessary for there to be confidence that insurers are passing on to consumers the full reduction in cost from the reinsurance pool.

Recommendations

11. Financial Rights strongly supports a well-funded mechanism for the explicit price monitoring of insurance premiums in relation to the pool.
- a) Monitoring should be undertaken by the ACCC or a specific new public sector entity.
 - b) The pricing monitor to be given authority and resources to undertake research, particularly about insurance pricing and disclosure, to promote effective competition.

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

Financial Rights strongly supports requirements for insurers to disclose the cost of reinsurance to policyholders. As mentioned above we believe transparency of premium pricing and risk assessment is very important. We support many of the ACCC's disclosure-related recommendations in its Final Report including requiring insurers to disclose the premium, sum insured and excess amounts on the expiring policy on renewal notices along with the proposed terms for the renewal (Rec 18.9). The ACCC concludes this will allow consumers to easily identify how the insurer proposes to vary these terms from the previous year and seek explanations of any changes. Adding the disclosure of reinsurance costs to this list makes perfect sense. It will allow consumers to understand how their premiums have been discounted (or not) because of the new pool, and it will allow policyholders to compare how the pool is being utilised across different insurers and with friends and neighbours.

An academic study of flooded households in Queensland found that social norms have a greater effect on whether people buy insurance than individual risk perception or economic factors.⁸ One of the study's conclusions was that attempts to reduce non-insurance should address aspects of social influence. Similar findings have been made in studies looking at insurance markets in Florida, Thailand and the Caribbean.⁹ Social norms of knowing that neighbours are taking out coverage and word of mouth about the reinsurance pool will be more effective at combating underinsurance than price decreases alone.

Recommendations

12. Insurers should be required to disclose the cost of reinsurance to policyholders, along with the previous year's premium, current sum insured and excess amounts.

⁸ Lo AY (2013b) Household preference and financial commitment to flood Insurance in South-East Queensland. Aust Econ Rev 46:160–175. <https://doi.org/10.1111/j.1467-8462.2013.12009.x>

⁹ Lucas, C.H., Booth, K.I. & Garcia, C. Insuring homes against extreme weather events: a systematic review of the research. *Climatic Change* 165, 61 (2021). <https://doi.org/10.1007/s10584-021-03093-1>

18.3 Any additional mechanisms that may be appropriate?

No comment.

Links to risk reduction

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

We note that a few insurers have already begun thinking outside the box about encouraging mitigation works. What is essential and not clear to date with projects undertaken, is whether consumers are receiving any premium reductions.

Firstly NRMA recently conducted a 3 month trial of the Safety Hub which aimed “to see how safe we can make Australia.”¹⁰ A select group of NRMA Insurance customers were invited to participate. The Safety Hub designed personalised safety tasks based on relevant risks, and then helped the user to complete them. For example, a home owner was asked to check for leaks. According to the app:

Frayed, rusted and kinked flexi hoses are one of Australia's leading cause of water damage in homes between 5 and 30 years old

The user is then given an explanation of what a flexi-hose is and then directed on how to check for leaks. The user is also asked to introduce themselves to their neighbours:

Why it matters? You can't be home every hour of every day. But if you neighbours are keeping an eye out while you're away, you can reduce your risk of crime.

They are then prompted to let NRMA know if they know their neighbours.

According to IAG, undertaking these risk mitigation tasks would then lead to discounts and offers. While premium changes were not included in the trial, Financial Rights understood this option was under consideration moving into the future. There is no available information about whether it did result in premium reductions.

A second example is the use of technology to signal risk in motor vehicle insurance. QBE, for example, offers “Insurance Box for young drivers”. Here, drivers install an electronic device in their car that transmits back to the insurer a detailed breakdown of their driving habits in areas such as their braking, acceleration, steering, cornering, speed and night driving.¹¹ QBE then calculate a “DriveScore” rating to evaluate the driver. The higher the DriveScore the less the policyholder will pay for insurance. The lower the score, the more the driver pays.

The policyholder for all intents and purposes enters into a risk or loss mitigation partnership with the insurance to alter behaviour for improved outcomes for the driver, the insurer and arguably society, through safer driving.

¹⁰ <https://itunes.apple.com/au/app/nrma-safety-hub/id1385354399?mt=8>

¹¹ <https://www.qbe.com.au/news/car/how-insurance-box-works>

The technology enables the individual consumer to take greater responsibility for the risks in their lives (in this case their driving) while at the same time remaining covered for the important and unexpected risks they face. The price-signalling motivates behaviour. How this is calculated is fairly opaque¹² though with the price signal applied annually on a post-facto basis. Further benefits that QBE claim the use of the Insurance Box can include improved social cache,¹³ tracking of your car if stolen,¹⁴ more detailed information in collisions,¹⁵ and the maintenance of the car's value.¹⁶

While the above example raises a number of significant questions¹⁷ it is not inconceivable to develop similar, ethical ways to ensure that component pricing, risk mitigation and price signalling can develop feedback loops that ensure premiums are appropriately lowered.

In its Final Report the ACCC describes several successful examples of risk mitigation partnerships. In the Queensland town of Roma, following several major flooding events in 2010, 2011 and 2012, a levee was constructed to protect the town. The levee is estimated to have protected over 500 homes from flooding, leading to an average premium reduction for combined home and contents insurance of over \$600. However, the ACCC recognises that community level mitigation is not generally an option to meaningfully reduce cyclone risk or storm risk so the potential for this to benefit northern Australia more broadly is limited.¹⁸ The ACCC Final Report also goes into detail about the Queensland Household Resilience Program (HRP) which provides funding to help eligible home owners improve the resilience of their homes against cyclones. Eligible home owners can apply to receive a grant of 75% of the cost of certain eligible improvements, up to a maximum of \$11,250. The Queensland Government estimates that works completed under the HRP have resulted in an average insurance premium saving of 8.21%.¹⁹

¹² QBE state that “we will receive data about your car's actual use and we will use this information to illustrate how you may save premium by driving more safely to minimise risk of collision. Information about your driving habits and your DriveScore are available in your dashboard and contribute to your premium calculation.” http://www.qbe.com.au/content/idcplg?IdcService=GET_FILE&dDocName=PRODUCT048047&RevisionSelectionMethod=LatestReleased&Rendition=primary

¹³ “You can also proudly share your DriveScore with others to prove your driving skills. If you wish to cancel your insurance we will provide you with a Certificate that details your DriveScore and your claim free driving years.”

¹⁴ “Worried about your car being stolen? Insurance Box can even help recover your car if thieves strike.”

¹⁵ “The technology can also be a big comfort if you're involved in a collision. It'll alert us to what's happened so we can get on with helping you, whether the accident was your fault or not.”

¹⁶ “If you have a good DriveScore you can show the person buying your car that you've driven it smoothly - this could help with value retention”

¹⁷ Including: Are their potential discriminatory impacts – for example against shift workers who need to drive at night? What are the consequences for privacy? Can the police access this information? Other insurers? Will it ultimately price risky drivers out of buying insurance but not stop them driving, to the detriment of other road users and roadside property owners?

¹⁸ Australian Competition and Consumer Commission, Northern Australia Insurance Inquiry, Final Report (November 2020), <https://www.accc.gov.au/focus-areas/inquiries-ongoing/northern-australia-insurance-inquiry/final-report> (pg 186).

¹⁹ ID. Pg 187.

Consumers regularly choose different excess options that adjust their premium. We would expect that insurers could easily identify what actions a consumer could undertake to mitigate a particular cost component and pass on that saving to the consumer.

Adequate dispute resolution frameworks would be required to ensure insurers do pass on any premium discounts.

20 How might mitigation be encouraged by the reinsurance pool's design?

A major impediment to increased mitigation efforts is the uncertainty around how mitigation measures undertaken by residents or communities will impact on premiums. There is nothing inherent in the concept of a reinsurance pool that will encourage mitigation strategies unless it is built into the design of the scheme. Providing consumers with more information about risk and mitigation strategies is an important first step. For example, there are two mitigation issues which we as consumer advocates do not believe consumers are necessarily aware:

Firstly, that building codes are designed to reduce injury to people, but not necessarily mitigate against any structural damage in a cyclone.²⁰ This information should be clearly and simply communicated to consumers. Homeowners who have gone to great lengths to make sure their homes are up to the latest building codes may be under the impression that their insurance will be reduced accordingly, when in fact they have not reduced their risk of cyclone damage at all.

Secondly there are steps that can be taken to reduce the vulnerability of cyclone damage before a storm hits which are not expensive. Things like removing loose items around a property or undertaking small-scale home improvements. This information should be distributed to homeowners, and tenants on a regular basis. Many residents in cyclone areas might be new to the area and not aware of the small steps they can take to greatly reduce their cyclone damage risk. However, we have been told anecdotally by actuaries that these minor mitigation steps are very hard to value, thus hard to pass through as premium discounts.

Financial Rights believes that policyholders will only be incentivised to undertake major mitigation projects on their own properties (assuming they can afford to do so) if there is a corresponding reduction in premiums. There does however seem to be some impediments to insurance premiums being responsive to mitigation action. The first is that insurers might want verification of the efficacy of a mitigation strategy before reducing premiums. This could be resolved by having post-mitigation premiums be subject to some independent review. Currently there is no independent or regulatory mechanism for policyholders to contest post-mitigation premiums. An independent inspection process could determine the vulnerability of a property to cyclone damage, give information to consumers about what mitigation action they might take, and provide verification of all mitigation action that a property owner has undertaken. If an insurer refuses to recognise mitigation strategies undertaken by a homeowner by lowering

²⁰ p. 12, *Northern Australia Insurance Premiums Taskforce, Interim report, 2015*

premium, or does not lower premiums enough there must be a way for that homeowner to lodge an independent dispute.

We believe consumers will be more likely to take up adequate insurance and undertake mitigation strategies if they can identify a correlating reduction in premium. This however can only be done by promoting greater transparency and contestability of premiums and risk assessments. Consumers can and do recognise some personal and property risk, but the current premium pricing system does not provide any reliable benefits to homeowners to take any personal mitigation strategies.

Contestability

Financial Rights has advocated for many years now that there needs to be more contestability around insurance premiums, especially home building premiums. Homeowners should be empowered to contest decisions made by other parties with respect to their insurance interests including premium pricing and risk assessments and other information provided to and relied upon by insurers and homeowners. Enabling homeowners to challenge, for example, inappropriate, disproportionate or unjustified premium increases, will improve competition and increase knowledge of the risks and promote mitigation strategies.

Currently, the main way premiums or insurers' decisions in relation to offering insurance are "reviewed" is by consumers shopping around to see what other insurers are offering, a mechanism next to useless in northern Australia.

Outside of market forces the only other mechanism available is for an insured to make a request in writing under section 75 of the *Insurance Contracts Act 1986*. An insured however can only use section 75 when either their insurance is cancelled or by reason of some special risk relating to the insured or to the subject-matter of the contract, or when the insurer offers insurance cover to the insured on terms that are less advantageous to the insured than the terms that the insurer would otherwise offer.

However, the *Insurance Contracts Act* and section 75 provide no guidance as to what information the insurer is obliged to provide in its written reasons, and there is no mechanism for review in the event the decision of the insurer is erroneous or based on incorrect information.

In insurance markets with limited suppliers such as Northern Australia, competition is not an adequate mechanism for consumers to 'review' insurance premiums. If all insurers are using incorrect data or not taking into account localised factors, then competition fails.

As a possible alternative, a consumer may make an application to the Australian Financial Complaints Authority (**AFCA**). However AFCA has a very limited decision making power when it comes to reviewing premiums:

We also can't consider complaints that are only about the level of a fee, premium, charge, rebate or interest rate - unless your complaint is that the cost was not disclosed to you, was misrepresented to you, incorrectly applied, or if the complaint is about a breach of a legal obligation on the part of the financial firm. (AFCA Website describing Rule C.1.2)

and

AFCA must exclude: ... A complaint about rating factors and weightings an insurer under a General Insurance Policy applies to determine the insured's or proposed insured's base premium that is commercially sensitive information. (AFCA Rule C.1.4.c)

It is Financial Rights' view that insurers should not be able to hide behind vague reasons and unsubstantiated assertions about how premiums are priced. They should have to substantiate premium pricing across all forms of insurance. In the home and contents space it is essential.

The failure of industry to have any mechanism of review of the accuracy of premium calculations is of significant detriment to consumers. This failure also provides no guarantee that any household mitigation strategies or idiosyncratic household conditions are taken into account when determining premiums. Consequently, premium prices cannot be said to be "accurate" signaling of risk as there is no contestability or transparency in their calculation.

A consumer may reject the premium as an inaccurate reflection of their risk, and where there are few insurers in the market place (or they are all relying on the same incorrect information) a consumer may decide to self-insure or be forced to be uninsured not only for the risk of the hazard but for all claims (where they cannot get any level of cover).

If a robust dispute mechanism was in place creating greater transparency and contestability of premium pricing, Financial Rights expects the following benefits to arise:

- a) In some cases premiums may be reduced because of a flaw in the insurer's information or assumptions
- b) consumers may be persuaded they are at risk, and decide to incur the cost to insure;
- c) consumers may undertake personal mitigation strategies; or
- d) consumers may lobby local government for local mitigation strategies.

In the absence of this information, consumers are in the dark and may be making poor decisions. If they could have a premium pricing decision reviewed by an independent body, consumers may be more likely to believe the risk assessments on their properties.

Case study – Failure of contestability in North Queensland

Sally lives in North Cairns. Her property was built in the 1940's and is located in the White Zone outside the Storm Tide Zone as advised by her Local Council. Since buying the property and after Cyclone Yasi, Sally made some structural changes to the property and was advised by her builder that it was now "cyclone rated". She was insured for Storm, but not Storm Surge or Flood, and her premiums were \$5,000 per annum. She was happy with her policy in light of the property modifications. At renewal time, the insurer wrote to her and declined to renew her insurance policy on the basis her property was an "unacceptable risk".

Sally rang them and told them about the building works and that she was zoned in the White Zone. The insurer did not change its position, and continued to refuse to renew the

policy. Sally rang around other insurers, each time telling them at the point of sale about the works undertaken and that she was in the White Zone. No insurer would offer a policy of insurance to her. Eventually, she contacted a broker, who arranged insurance for her at a higher price, so she would not be left completely uninsured.

Financial Rights helped her dispute the insurer's refusal to renew, by requesting written reasons under s75 of the Insurance Contracts Act. Shortly after Financial Rights raised the written dispute, the insurer changed its mind and offered Sally a policy at the same price as it was the year before.

Sally was disheartened as Financial Rights had not done anything more than what she had previously done apart from quoting a section of the Act and using legal letterhead. She was still in completely in the dark about the reasons for their original decision to decline to cover her, or indeed why this was later reversed. She chose to remain with her new insurer out of dissatisfaction.

Recommendations

13. The Financial Rights Legal Centre recommends the following approaches to promote pricing contestability, disclosure and transparency:
- a) Amend s 75 of the *Insurance Contracts Act 1984* requiring insurers to provide written reasons for why premiums were increased on request in writing from a policy holder. These reasons should include any increased risk factor that the insurer has become aware of.
 - b) Alternatively, if legislative change is not feasible, the General Insurance Code of Practice should be amended to include a requirement for the insurer's IDR team to provide reasons for significant premium increases after a request in writing by the policy holder.
 - c) Change AFCA Complaint Resolution Scheme Rules to allow disputes about the level of a premium if there has been an unfavourable change to an insurance policy (or if the insured has recently undertaken mitigation strategies on their home which have not resulted in a reasonable reduction of premiums) and the insurer's IDR response has failed to include adequate reasons for the change.

Independent Assessment

Financial Rights supports the development of an independent assessment process. The biggest advantage of establishing an independent assessment process is that it will give insurers and reinsurance pool administrators the verification they need to reduce premiums, which will in turn incentivise mitigation action by policyholders. Again, policyholders will only be incentivised to undertake mitigation projects on their own properties if there is some certainty around a corresponding reduction in insurance premiums.

Consumers respond very positively to independent assessment and review mechanisms. Consumers will not always trust an insurer to give them an honest answer about their risk or the corresponding cost of indemnification. An independent process is often seen as much more reliable.

The disadvantage of an independent assessment scheme like this is that it would cost money. Would it be industry funded, Government funded, or funded by policyholders that want to use it? If the answer is the latter, this will not help with affordability issues, and it is not much different from a policyholders paying for a builder to come assess their property. Financial Rights recommends that an independent assessment process be at least partially funded by industry or the Government. We believe it could be run by the new National Recovery & Resilience Agency.

Recommendations

14. The Financial Rights Legal Centre supports:

- a) the development of an independent inspection process to determine the vulnerability of a property to extreme weather events;
 - b) an independent assessment process could be run by the new National Recovery & Resilience Agency.
-

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

Yes. Financial Rights strongly supports the pool providing discounts for properties that undertake mitigation. We also support providing other types of grants and subsidies to communities and property owners where effective mitigation projects have been identified. The National recovery & Resilience Agency would be well placed to help identify such projects and distribute funding.

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

Yes. If the Government is planning to have an exit date for the reinsurance pool, then mitigation works while the pool is in place will be critical to reducing cyclone risk in the region. Even in the absence of an exit date, the scheme should be designed to reduce risks and encourage sustainable development. We note that the Flood Re pool in the UK has a sunset clause and sees its role as assisting the market to transition to more affordable cover against floods before its exit date. Flood Re has called on the UK Government to give it the ability “*to reward those householders who proactively install flood resilience measures with discounted premiums on their home insurance policies, when they are ceded to the Scheme.*”²¹

²¹ Flood Re plans to make Britain more resilient to flooding (Webpage) <https://www.floodre.co.uk/flood-re-plans-to-make-britain-more-resilient-to-flooding/>

Recommendations

15. The pool should have an explicit mandate to encourage mitigation and it should provide discounts for properties that undertake 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?

Financial Rights does not support a time-based cut off. We are afraid this limitation would be very difficult to explain to consumers buying new homes. Developers would walk away with all of the profit for a new development while the homeowners are stuck with a 30 year investment that they cannot afford to insure.

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

Financial Rights does support a restriction in the pool's design which only allows it to apply to new builds that have been built to adequate standards and in suitable locations. If a consumer buys a new home or new office building for their small business and ensures that it meets all the standards of cyclone resilience, then it he or she should have access to the benefits of the reinsurance pool.

Recommendations

16. The pool should only allow new builds that have been built to adequate standards and in suitable locations. We do not support a time-based cut-off to exempt new builds from the pool.

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

Financial Rights supports the governments of Western Australia, the Northern Territory and Queensland abolishing stamp duties on home, contents and strata insurance products, or in the alternative reducing stamp duties for home, contents and strata insurance in higher risk areas with reference to the sum insured value, rather than the premium level, and directing a portion of stamp duty revenue on insurance products towards measures to improve affordability for low income consumers or to fund mitigation works.

Unfortunately we can't comment on how the design of the reinsurance pool will be able to encourage that result.

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

No comment.

22.2 Which policy options could be introduced alongside the pool?

No comment.

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?

No comment.

National solution to accessibility and affordability of insurance

Financial Rights supports the Government's decision to intervene in insurance markets in northern Australia in order to help Australians access affordable insurance. Those in northern Australia face uniquely extreme risks by virtue of the climate, environment and geography of northern Australia.

However, it should go without saying that the presence of high frequency natural disaster events is not uniquely limited to this region. The problems faced by those in northern Australia in gaining affordable insurance premiums are also experienced by Australians in other regions of the country. While cyclone, storm surges and floods are the key issues in northern Australia, high level flood risk is a significant issue to those in for example, the Hawkesbury-Nepean Valley, the Gold Coast and the Northern Rivers, and extreme bushfire risk remains central to the lives of those in an increasing number of areas across Australia.

Financial Rights raises this not to diminish the extreme and unique risks faced by those in northern Australia. Rather Financial Rights wishes to ensure that whichever design is finally supported by the Treasury Taskforce should be made available to all those Australians in those areas that face extreme risk. Given the constitutional issues raised by the Government's proposal, Financial Rights trusts that the Treasury Taskforce is aware that a broader, more national approach to the issue may be required.

Climate Change

Financial Rights notes that there is no reference to climate change in the Consultation paper. The science is clear, and the insurance industry has been the canary in the coalmine for some time when it comes to identifying the increasing risks posed by climate change in Australia.

It is therefore prudent to factor in climate change and the risks it poses for the environment, communities, industry and individual homeowners, when designing this intervention in the insurance market. This is particularly important with respect to consideration of the length and geographical breadth of any intervention. There is already evidence that cyclone risk will soon extend further south into New South Wales.

Recommendations

17. Government and tax-payer funded intervention in the insurance market to improve accessibility and affordability of insurance in areas of high risk for extreme weather events should be Australia-wide.
-

Other intervention strategies

While Financial Rights supports the Treasury Taskforce designing the best reinsurance pool possible, we are concerned that it may not be the most effective response to the challenges posed by cyclone risk, and that it does not address the broader issue of increasing exposure to extreme weather events more generally in other parts of the country. Other policy responses should also be considered.

The ACCC found in its final report that the likelihood of reinsurance pools significantly impacting premiums levels was uncertain and that the measures could not be targeted to those most in need. Further, it involved the significant transfer of risk from the insurance industry to governments. The ACCC favoured well-designed direct subsidies as having the greatest potential *“to relieve some of the acute affordability and cost of living pressures facing consumers in higher risk areas, at a lower cost and more effectively than other measures.”*²²

The cyclone reinsurance pool also fails to take into account problems posed by all the other climate change perils, such as storm, hail, flood, coastal erosion/sea level rise and bushfires. Our service has a number of examples of consumers having opted out of flood cover due to it being prohibitively expensive in areas that are not as yet impacted by cyclones, and many people have recently reported significant increases in their insurance costs due to bushfire risk.

A national data collection program on underinsurance should be developed as a matter of urgency. Trends in underinsurance should be tracked by the newly established National Recovery and Resilience Agency, especially in high risk regions. This would enable governments to take targeted action in those areas to address affordability with mitigation projects or direct subsidies or both. The effectiveness of the reinsurance pool in addressing insurance affordability and underinsurance should be regularly reviewed.

Financial Rights submits that direct subsidies on premiums to vulnerable residents in high risk areas have significant potential to assist people who face disproportionate risks because of the location of their property and should also be trialled in relation to other extreme weather risks

²² Australian Competition and Consumer Commission, *Northern Australia Insurance Inquiry, Final Report* (November 2020), recommendation 8.1, <https://www.accc.gov.au/focus-areas/inquiries-ongoing/northern-australia-insurance-inquiry/final-report>.

in appropriate areas. Direct subsidies can help to lower levels of underinsurance and non-insurance, which can lower costs to governments of providing post-event relief. They can also help support government objectives towards decentralisation and promote thriving regional communities. Such subsidies should be targeted, means and asset tested, and carefully designed to ensure they do not simply increase insurance premiums or facilitate further development of high risk areas. Property buy-backs should also be part of the adaptation mix.

Finally, Australian governments should take more decisive action to address climate change through reductions in greenhouse gas emissions. Many of the above risks are already locked in under current trends regardless of what action is taken now. More drastic action is required to prevent an increasing escalation of extreme weather events. Recovery and resilience are important, but prevention is critical.

Recommendations

18. Direct premium subsidies to vulnerable residents in high risk areas should also be trialled as the best way for Australia to assist citizens who face disproportionate risks because of their location.
-

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact [REDACTED]

Kind Regards,



Karen Cox
Chief Executive Officer
Financial Rights Legal Centre

[REDACTED]
[REDACTED]