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**Response to the ‘Reinsurance pool for cyclones and related flood damage’ consultation
paper May 2021**

Validity to comment

I am a Professor of Strategic Management at the University of Queensland Business School, Australia, and also at City, University of London, UK. I am an expert in global insurance and reinsurance markets, as evidenced by my industry reports, Masterclasses, academic papers, media appearances and my widely-acclaimed 2015 book on changes in the global reinsurance industry, entitled “Making a Market for Acts of God” with Oxford University Press. My current research examines how governments and insurance markets can work together to address the growing threat of disaster. My research on this topic has informed disaster response policy in different countries. For example, my 2018 report on this topic is cited in the appendix of the Australian Terrorism Insurance Act Review, 2018, in February 2021 I gave evidence, based on my research, to a United Kingdom House of Lords Select Committee on Risk Assessment and Risk Planning, and I am a member of the Organization for Economic Cooperation and Development (OECD) High-Level Advisory Board for Financial Management of Catastrophic Risk. You can download my reports and find out more about my research on my website: [REDACTED]

In this response I address only those questions where my global research on public-private risk pools provides me with specific insights into the topic.

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?

Reviews of 3 to 5 years are optimum because they provide a long enough period for changes in policy to be implemented and the effects to be evaluated between reviews. At the same time, a 3-5-year period is not too long to be effective for updating the objectives of the pool. The review goals might examine

1. The extent to which risk is being shared between policyholders, the private insurance and reinsurance market, the pool, and the government: e.g. reviewing and refining incentives for risk mitigation by policyholders, and incentives for private market involvement where appropriate.
2. The effectiveness of cover for different property types: e.g. commercial, residential, mixed-use and for different structural features of buildings.
3. The effectiveness of cover for different risk zones including redrawing the boundaries of those risk zones according to data on the evolving nature of the peril: e.g. reviewing cyclone effects in different zones, such as increasing or unexpected severity of cyclones in hitherto unaffected zones, and other secondary effects of cyclones such as wind damage, excess rainfall, flooding and storm surge and their effects on different zones.
4. The data being gather by the pool on the above factors, and the use of these data to manage pricing and affordability for different policyholders, properties, and risk zones
5. Risk mitigation progress by various third parties (e.g. federal, state, and local government investment in resilient infrastructure and defenses, home improvements

by policyholders, and changes in planning permissions) and their effects upon the above 4 key review goals.

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

Exit dates are dependent on resolving the problems for which the reinsurance pool was established. Hence any exit date will be arbitrary without a clear plan for addressing contingent factors, such as the extent of investment in risk mitigation by multiple stakeholders at different levels, the effectiveness of that risk mitigation, and movement of policyholders in properties that prove to be unsustainable in light of the changing nature of the peril. Clear sight of and planning for these contingent factors will be difficult to establish in advance of the reinsurance pool's establishment. Indeed, as per my answer to question 16 on review periods, one purpose of the reinsurance pool may be an opportunity to gather data on these contingent factors in order to develop a comprehensive plan. Therefore, providing there is a regular review period, there is no particular reason to establish an exit date. Rather, the reviews can establish the extent to which contingencies are being, or can be, managed to the extent that a pool would no longer be needed.

Links to risk reduction

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?

Where it is possible for the pool to identify risk mitigating measures, discounts to policyholders could be provided. These might be difficult to price accurately, depending on the extent to which precise structural features can be linked to specific reductions in risk of loss or damage. Nonetheless, a discount may be a valuable behavioural 'nudge' towards the general principle of encouraging policyholders to share in their own risk through implementing risk mitigation measures and should therefore be encouraged.

The pool could have a mandate to encourage mitigation and this would be valuable in relation to the discussion of questions 16 and 17 on reviews and potential exit. However, the mandate will need to be linked to some levers of influence over mitigation – such as the above discounts, but also potentially, the ability to provide some financial support such as grants for refitting houses to increase their resilience to cyclone and its secondary effects, such as flooding.

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?

Exemptions to new builds and only allowing new builds built to particular standards in suitable locations will ensure that those properties not built with cyclone and flood mitigation in mind are not covered. However, the unintended consequences of this action will be that policyholders in these properties bear the brunt of poor planning and inadequate structural regulations. As policyholders have little control over these regulations, and some will have already bought houses that, under items 21.1 and 21.2 would be uninsurable, this would constitute a financial burden that is beyond their means to mitigate. Therefore, alongside any such actions, it is important that an education campaign take place. Such a campaign might identify houses built after specific cut-off dates, or not built to appropriate standards, specify that they are not insurable under the pool, and clearly label the implications of that exclusion in terms of the probability of loss and the costs to the property-owner. Essentially, the aim

should be to disincentivise purchase of such properties. This will increase incentives on those approving planning permission (as per question 22 below) and monitoring building codes to ensure that properties are built to appropriate standards in appropriate locations in order to increase saleability.

Over and above this, given that knowledge about the effects of cyclone and flood, and about the specific risk mitigation features likely to reduce loss will be generated from the work of the reinsurance pool over time – see answers to 16 and 17 – it would be helpful if the pool had a structured way to provide its data to support the updating of planning codes and regulations over time.

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?*

Please see my answers to 21, in which the education campaign and clear identification of properties not built to adequate standards or in suitable locations would, most likely, be integrated into and incentivise state and territory planning regulations. In addition, with reference to my answer to question 20, states and territories might support the distribution and/or matching of grants to policyholders to carry out specific mitigation measures.

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?*

It would make sense in terms of efficiency gains to incorporate the two perils under a single pool structure. These would include operational efficiencies and relationship efficiencies as the existing pool is already experienced in working with a) largely the same private market insurance and reinsurance companies as part of the risk transfer chain for terrorism; b) government bodies; and c) modelling companies and scientists in generating suitable modelling data to keep track of the evolution of the peril and of mitigation measures. The establishment of a pool is a costly and also politically-fraught exercise. Therefore, establishing a separate pool would add to these costs and tensions without providing clarity over the benefits of two different pools. Multi-peril pools have been proven to be very effective in a number of countries, such as France, Spain and Switzerland, among others. In addition, existing pools have been proven to be suitable vehicles to take on new and emerging risks, as for example, with the inclusion of wildfire under the auspices of the California Earthquake Authority.

That said, the cyclone pool would focus upon residential property primarily, whereas the terrorism pool deals with commercial properties. This might necessitate a more granular approach to modelling, and the pool would also need to be more responsive to claims management. Hence, the existing pool would need to have its capabilities expanded and there needs to be consideration of how that pool would work with the insurance industry in underwriting policies and paying claims.