

Treasury Consultation - Reinsurance pool for cyclones and related flood damage

Submission by Legal Aid Queensland

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Legal Aid Queensland (LAQ) welcomes the opportunity to provide a submission in response to the Treasury Consultation on the Reinsurance pool for cyclones and related flood damage.

LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the *Legal Aid Queensland Act 1997*, LAQ is established for the purpose of “giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way” and is required to give this “legal assistance at a reasonable cost to the community and on an equitable basis throughout the State”. Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ’s services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ always seeks to offer policy input that is constructive and is based on the extensive experience of LAQ’s lawyers in the day to day application of the law in courts and tribunals. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

LAQ’s Civil Justice Services Unit lawyers provide advice and representation in relation to mortgage stress, housing repossession, banking and financial issues, financial hardship, debt, contracts, loans, telecommunications, unsolicited consumer agreements and insurance, including insurance issues following cyclones in North Queensland.

Reinsurance pool coverage

1. How should ‘cyclone’ and ‘cyclone-related flooding’ be defined for the purposes of defining the reinsurance pool’s coverage?

There should be a standard legal definition of “cyclone” and “cyclone related flooding” that applies across all insurance contracts. We support using the Bureau of Meteorology definition of cyclone because it is concise, objective and provides certainty. If a cyclone is not declared, the vast majority of insurance policies will provide consumers with protection under the policies coverage for storm.

With respect to the definition of cyclone related flooding, for this definition to be effective, it must incorporate the existing standard legal definition of flooding that applies in insurance contracts. Since that definition has been introduced LAQ has seen a significant reduction in the number of flood related insurance definition disputes following natural disasters. For consistency and certainty this definition must be incorporated.

An appropriate definition would be flooding (using the current standard definition) where a cyclone has been declared and the effects of the cyclone are felt on land. A cyclone does not have to necessarily cross the coast for the protection offered by cyclone related flooding to be triggered.

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

Storm surge is a natural consequence of cyclones in North Queensland and causes significant damage to property. It is a risk that many consumers in North Queensland find it difficult to protect against because it is excluded from many standard insurance policies.

LAQ supports the inclusion of storm surge in a definition of cyclone related funding because it will provide additional protection to consumers from cyclone risks and certainty to consumers that they are protected from all cyclone risks.

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?

LAQ supports the use of standard definitions of cyclone and cyclone related flooding across the insurance industry.

Standard definitions would:

- (a) Provide greater certainty for consumers about their coverage.
- (b) Provide greater certainty for consumers about the likelihood of their claims being paid.
- (c) Allow policies to be more easily compared and assessed for value by consumers.
- (d) Improve community understanding of insurance policies.

Requiring standard definitions to be used in policies that want the benefit of the pool will:

1. Give certainty to the pool about the scope of policies falling within the pool.
2. Allow the pool to more easily identify its exposure in the event of a cyclone.
3. Improve consumer understanding and outcomes by encouraging industry to develop appropriate standard definitions.

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?

LAQ supports the view that all home building, contents and residential strata policies should be eligible to be covered by the reinsurance pool. We do not foresee any difficulties arising from including these policies in the reinsurance pool.

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

LAQ has no submissions to make in response to this question.

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

LAQ has no submissions to make in response to this question.

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?

There is a risk that including mixed-use strata title policies in the reinsurance pool could lead to some larger businesses potentially benefiting from the pool. However, we submit that as mixed

use residential and business premises are becoming more and more common and one of the key purposes of introducing the pool is to make insurance in Northern Australia more affordable for consumers and small business, any detriment from some larger businesses gaining a benefit from the scheme is outweighed by the benefits the pool provides to consumers and small business.

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

Whilst LAQ does not generally represent small business, LAQ does assist farmers with farm debt mediations under the *Farm Business Debt Mediation Act (QLD) Act 2017*.

It is important that a reinsurance pool includes insurance for farmers for

- their properties including
 - their residences and any other buildings contained on farm property;
 - damage to infrastructure including dams, terracing and contour bunding, large earth ring tanks and fencing;
 - damage to pumps and or windmills and or irrigation equipment and infrastructure; and
 - Hot houses and similar types of structures and hail netting
- stock and crop losses
- damage and loss of farming equipment

Many large insurers ceased offering rural pack insurance years ago. LAQ is unsure why this has occurred.

Historically, farmers have not had insurance cover for damage to fences; or earthworks, dams, terracing and contour banks. The reinsurance pool needs to cover those items particularly where natural disaster grants made after a natural disaster declaration is made may not assist with these losses.

Currently stock is generally not insured unless for very valuable animals such as a race horse or stud bulls or stallions as the premiums are very expensive.

Some organisations are currently trying to introduce multi-peril insurance for crops but are receiving resistance from sections within the industry.

It is important that these potential losses are recognised and protected as part of the pool.

LAQ supports there being a standardised definition of small business across all insurance legislation. LAQ supports the proposed definition of the Small Business and Family Enterprise Ombudsman which is "a business with less than \$10 million in turnover and fewer than 100 employees."

The current definition of "small business" in *the Insurance Contract Act 1984 (Cth)* that has a turnover of less than \$1 million and 5 or less full-time equivalent workers would exclude many farmers. Many operations of farmers would be excluded on this definition even where the operation may only be run by one farmer with or without a small number of permanent employees.

There is another reason why the definition proposed by the Small Business and Family Enterprise Ombudsman is attractive. If a narrow definition of "small business" is adopted such as that in the Insurance Contracts Act, it does not take into account the significant fluctuation in farm income and number of employees over time.

Farmers could be excluded one year because of their turnover in that year whereas the income over the next 10 years might not meet the threshold. Similarly, farmers may have a significant number of staff for short periods of the year (around harvest) and for the rest of the year very low numbers of permanent staff.

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?

We are not aware of any difficulties that may arise as a result of including small business in the pool.

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?

LAQ has no submissions to make in response to this 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?

LAQ supports the pool using a tiered risk rating system as a means of providing targeted premium reductions. We submit that the risk-based system should have the following characteristics:

- (a) Assess an individual property's risk based on its characteristics;
- (b) Should not assess the risk at a community level;
- (c) Provide significant premium reductions for individual properties at the highest risk.
- (d) Provide further discounts if mitigation work is undertaken;
- (e) Uses a risk assessment that is comparable to risk ratings used by insurer's on properties.

12. How much risk exposure should primary insurers retain?

The key focus of establishing and structuring a reinsurance pool should be on making a substantive difference to the level of insurance premiums so that consumers can reasonably afford the premiums. The amount of risk exposure retained by an insurer should give effect to this focus of reducing premiums.

13. Would implementing a reinsurance pool have any effect on the claim's management process, and how could this be addressed in the reinsurance pool's design?

There is no reason why implementing a reinsurance pool should affect how insurance claims are managed. LAQ submits that the current process where insurers assess claims and are bound by legally enforceable claims management standards should continue. Any changes to the current

claims' management process risk a poorer claims experience and poorer outcomes for consumers.

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?

It is important to remember that not all insurers participate in the Northern Australia insurance market and many insurers have a limited exposure. From LAQ's perspective, part of the attraction of a reinsurance pool is that it may encourage insurers to become greater participants in the market because the risk is shared between the insurer and the pool.

If the pool is structured appropriately, there would be no need to make the pool mandatory because it would deliver benefits to the communities of which the insurers are a part.

If the pool was made mandatory, then it is appropriate that hazard maps be used to determine the threshold of cyclone risk for insurers to cede policies to the pool.

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

LAQ supports the view that a short transition period is appropriate. A long transition period would unnecessarily delay the consumer benefits and protection offered by the reinsurance pool.

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?

LAQ supports an interim review of the pool being completed 12 months after its commencement and the pool being reviewed every 3 years after the interim review.

The interim review will opportunity to review the early operation of the scheme while the 3 yearly review allows a timely and regular review of the operation of the pool. The 3 yearly review is also consistent with the timing of reviews conducted of the terrorism reinsurance scheme.

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

LAQ supports the reinsurance pool having a planned exit date because it encourages mitigation measures to be developed and enacted as a means of addressing insurance affordability.

We note that as climate change continues to intensify and affect Australia and in particular Northern Australia there are likely to be further insurance affordability challenges that arise which may necessitate the end date for the reinsurance pool being extended.

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?

LAQ supports the introduction of an insurance price monitor as a mechanism for ensuring that reinsurance premium savings are passed through to policyholders.

In LAQ's submission having an insurance price monitor will:

- (a) Provide a check and balance on reinsurer and insurance;
- (b) Provide openness and transparency to policy holders and the public about

- (i) the savings being realised from reinsurance and
 - (ii) the fact reinsurance savings are being passed on;
- (c) Encourage the adoption of risk mitigation strategies as a means of reducing insurance premiums.
- Any price monitor should be a Public Sector Monitor because:
- 1. Public Sector Monitors are more objective and less prone to capture by the Industry.
 - 2. Public Sector Monitors are able to compel relevant information to be provided to them if it is not provided willingly.

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

We support requiring the cost of reinsurance to be disclosed to policy holders because it:

- (a) Improves openness and transparency to policyholders; and
- (b) May encourage the adoption of risk mitigation strategies.

18.3 Any additional mechanisms that may be appropriate?

LAQ has no submissions to make in response to this question.

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 are not aware the extent to which insurers price discounts into insurance policies for mitigation action that is taken by or affecting policy holders. However, LAQ strongly supports insurers rewarding policyholders through reduced premiums when the risk to their property is reduced.

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

The introduction of a reinsurance pool, on its own, will not solve insurance affordability issues in Northern Australia. It must be used as one of a suite of measures designed to reduce and mitigate insurance risk and allow consumers to be able to protect themselves in the event of a cyclone in Northern Australia.

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

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

We support the reinsurance pool providing discounts for properties that undertake mitigation; and having a specific mandate to encourage mitigation as part of a wholistic approach to address the issue of insurance affordability in North Queensland. The reinsurance pool is one measure of a number of measures (including mitigation) that should be used to address provide long term solutions to insurance affordability in North Queensland.

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?

We support the view that the pool should not encourage risky behaviour such as building new homes in unsuitable areas or which are not of an adequate standard to respond to events. LAQ supports a collaborative approach to land use planning that involves the pool and State and Local Government. LAQ supports that view that:

- (a) It is appropriate for existing properties that were built or under construction prior to the pool being established; and
- (b) any new properties can only benefit from the pool if they meet building codes and land use planning standards that mitigate against cyclone and flood risk.

It is also important the pool engages directly with state and local governments to ensure that planning and land use standards adequately protect and mitigate properties against the risk of cyclone and related flood damage.

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?

The most important things that State, territory and local governments can do to assist insurance affordability in North Queensland are:

- Continuing to invest in mitigation works that will reduce the risk and effects of cyclone damage and related flooding.
- Taxes that apply to insurance are reduced in areas like Northern Australia.
- Improving building codes and land use planning regimes to ensure that:
 - (i) new properties are built to the highest possible standard to protect against cyclone damage;
 - (ii) New housing estates are not built in high risk areas.

Initiatives that may encourage further action by States and territories include:

- (a) Settings in the pool that only allow access to the pool when new properties meet cyclone compliance building codes and land use planning schemes.
- (b) Building into the pool premium reductions for properties in areas where mitigation works are completed by States or Territories.

We support the funding legal aid commissions community legal centres to provide advice and assistance to consumers following natural disasters. In LAQ's experience of assisting consumers following natural disasters consumers obtain better outcomes and are more satisfied from the insurance claims process when they have expert insurance assistance from LAQ and other similar organisations around the country.

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?

LAQ has no submissions to make in response to this question.