

24 June 2021

Manager
Cyclone Reinsurance Pool Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: reinsurancepool@treasury.gov.au

Dear Sir or Madam

REINSURANCE POOL FOR CYCLONES AND RELATED FLOOD DAMAGE

Thank you for the opportunity to comment on the proposed key design features of a Reinsurance Pool for Cyclones and Related Flood Damage, as outlined in Treasury's Consultation Paper (May 2021), and an extended timeframe for submission (granted on 18 June 2021). The Shopping Centre Council of Australia (SCCA) is the national industry group for major shopping centre owners. Some of our members own and operate more than 40 assets in Northern Australia.

SCCA members are significant contributors to the Terrorism Reinsurance Scheme, administered by the Australian Reinsurance Pool Corporation (ARPC), and therefore have relevant perspective and experience to inform the development of the Cyclone Reinsurance Scheme.

As tenants within shopping centres may be covered by the Cyclone Reinsurance Scheme, and our membership may be required to pay higher insurance premiums or a levy to subsidise the scheme, the SCCA has an inherent interest in its design.

We respectfully raise the following matters for Treasury's consideration and would welcome an early opportunity to discuss these further.

Reinsurance pool coverage

Property insurance in Northern Australia is a significant cost borne by businesses. Accordingly, the SCCA generally supports Government's objective of improving the accessibility and affordability of property insurance.

Treasury highlights the complexity of capturing small business policies, with particular reference to shopping centres.

To provide clarification, shopping centre tenants are generally required to hold (and provide evidence of) insurance as a standard feature of retail leases, which themselves are regulated by various state and territory legislation. This typically takes the form of property and business interruption insurance, in addition to other coverage. These costs are directly paid by the tenant and are not recovered as a cost through individual leases.

Shopping centres do not take out coverage to include all individual tenants, with a view to passing on the costs. Building insurance (and other related) costs are met by landlords, who are typically indemnified through leasing arrangements. Landlords are liable to pay the lessee compensation if a premises or centre is damaged or destroyed or if the lease is ended as a result of damage or destruction.

Cyclone and related flood damage insurance would need to be factored into the premiums of products that retail tenants typically take out, as required by leasing arrangements across our membership. The introduction of a Cyclone Reinsurance Scheme within this context should be mindful of existing insurance arrangements with respect to shopping centres and their tenants.

Without further detail or modelling, the SCCA notes that the scheme presents as a means to impose a levy on larger businesses and insurance policyholders outside of Northern Australia, to fund the insurance premiums of homeowners and smaller businesses. This would contribute to the already considerable

insurance costs of our sector. Unlike with the Terrorism Reinsurance Scheme, our members would derive no direct benefit.

Such a scheme stands to benefit the insurance sector and a comparatively small group of policyholders, including some shopping centre tenants, whose insurance costs would, in effect, be part subsidised by their landlords, irrespective of the state-/territory-based retail leasing arrangements and the status quo.

The SCCA understands that the scheme will cover residential, strata and small business property insurance policies only and will therefore not address cost pressures faced by our members, who will not be eligible to participate or benefit. Rather, the scheme may be applicable to some of our members' tenants that qualify as a small business as defined for the purposes of accessing the scheme.

The SCCA agrees that a definition is warranted and should determine eligibility to the scheme. In terms of an applicable definition, our experience is that this varies significantly and that various definitions are broadening the scope of what really should constitute a small business, by encompassing larger and larger businesses (see table below).

Organisation/Legislation	Definition/Test to determine a 'small business'
Australian Bureau of Statistics (ABS)	An entity with 5-19 employees.
<i>Corporations Act 2001 (Cth)</i>	Satisfies at least two of the following: (a) consolidated revenue of <\$50 million, (b) value of the consolidated gross assets <\$25 million, and/or (c) <100 employees.
<i>Competition and Consumer Act 2010 (Cth)</i>	Considered on the basis of contracts issued: a) employing <20 employees <u>and</u> the upfront price payable under the contract does not exceed \$300,000, <u>or</u> b) if the contract has a duration of >12 months, the upfront price payable under the contract does not exceed \$1 million.
<i>Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth)</i>	A business: a) employing <100 employees, <u>or</u> b) <\$5 million in revenue p.a.
<i>Retail Shop Leases and Other Commercial Leases (COVID-19 Emergency Response) Regulation 2020 (Qld)</i>	A business: (a) carried on by a sole trader; or (b) employing <20 full-time, or full-time equivalent, employees.

Definitions that a) encompass businesses that require less staff but have high turnovers, or b) allow for a structure that disregards the principal/wider business, are fundamentally deficient. For the purposes of accessing the scheme, an appropriate definition should apply only to genuinely small businesses; for instance, that of the Australian Bureau of Statistics, which defines a small business as having 5-19 employees. A two-limb test would address these issues, for example:

- that the business has a national turnover of less than \$10 million, and
- that the business has between 5-19 employees.

Reinsurance product design and insurer participation

The SCCA notes that Treasury proposes that the '*pool would be intended to provide targeted reinsurance premium reductions at the individual property level based on each property's risk profile, where higher risk properties receive higher discounts*'.¹ The SCCA agrees that a tiered risk rating system should be implemented; however, this should not disperse or equalise risk and effect what should be proportionally higher savings for buildings that have design or other mitigation measures in place or are located in less risk prone areas.

The SCCA submits that qualifying small businesses in shopping centres should benefit from improved (or otherwise) risk ratings, which should be modelled on those applied by insurance companies. This would incentivise mitigation action undertaken by or affecting policyholders. By extension, any premiums paid by policyholders, such as our membership, should recognise mitigation measures and building design features that individual policyholders have in place.

The SCCA appreciates that Treasury will be aware of the findings of Australian Competition and Consumer Commission's (ACCC) Northern Australia Insurance Inquiry. In particular, the ACCC recommended direct subsidies over other measures considered (including reinsurance) as having '*the greatest potential to work in a targeted way 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*'.²

Treasury officials spoke to this at a recent Senate Estimates hearing of the Economics Legislation Committee, explaining that a preliminary analysis based on actuarial analysis of the market suggested a 10 percent reduction in premiums.³ Further, Treasury officials explained that this modelling (which was unavailable at Senate Estimates, and has not been available since) incorporates indicative costs passed on to other policyholders.

The SCCA is concerned that this level of detail has not been provided in the consultation paper as part of Treasury's initial consultation. It is important that we are able to comment on the proportion of costs shared (residential vs. business policyholders), whether this is determined by insured amount or insurer-calculated premiums etc.

The ACCC was clear in its view that a government reinsurance pool would not be *'well-suited to address affordability concerns in a targeted way'*.⁴ The Australian Prudential Regulation Authority and a majority of the insurance industry also questioned and opposed the introduction of a reinsurance pool, respectively.⁵ The SCCA is mindful of these contrasting views, which call into question the viability of a Cyclone Reinsurance Scheme. In contrast, the ACCC suggested the following, amongst other measures:

- *'direct subsidies based on both premium level and income eligibility requirements'*, and
- a *'portion of revenue from stamp duties on insurance products (however they are levied) should be directed [by state or territory governments] towards measures to improve affordability for low income consumers or to fund mitigation works.'*⁶

It is disappointing that Government has not heeded this advice and sought to address insurance affordability with a broader approach, or one that is supported by regulators and the insurance sector itself. Arguably, issues that are unique to Queensland, the Northern Territory and Western Australia should be addressed, at least in part, by Goods and Services Tax and stamp duty levied on insurance policies in these jurisdictions.

Reinsurance pool governance and monitoring

The SCCA agrees with Treasury that an initial (12 month) review followed by triennial reviews of the Cyclone Reinsurance Scheme would be appropriate.

The SCCA also reiterates concerns that it has held over some time with the Terrorism Reinsurance Scheme, whereby contributors to the scheme are not recognised as owners of the scheme, like a mutual insurance company. Contributors should be recognised as owners of any Cyclone Reinsurance Scheme to oversee aspects of the scheme including reserve levels, fees and payments to government.

The SCCA also recommends that the scheme should have an end date and a post-funding model for when the pool reaches an agreed reserve.

Links to risk reduction

The SCCA supports the view that insurance premiums be adjusted to reflect mitigation action undertaken by or affecting policyholders to encourage cyclone risk mitigation and that new builds only be allowed to participate if built to adequate standards.

Interactions with the ARPC's existing functions

If Government proceeds with the establishment of a Cyclone Reinsurance Scheme then it will be critical that the pool is guaranteed separately to the Terrorism Reinsurance Scheme, to ensure that no risk is shared and its establishment and ongoing costs are not co-funded by the existing scheme.

The SCCA looks forward to working with Treasury as its consultation progresses. Please do not hesitate to contact me on [REDACTED] as required.

Yours sincerely,

James Newton
Manager – Policy and Regulatory Affairs

¹ The Treasury, *Consultation paper: Reinsurance pool for cyclones and related flood damage*, May 2021, p. 12.

² Australian Competition and Consumer Commission (ACCC), *Final report: Northern Australia Insurance Inquiry*, November 2020, p. 194.

³ Commonwealth of Australia, *Senate Estimates*, Economics Legislation Committee, 1 June 2021, pp. 72-73.

⁴ Australian Prudential Regulation Authority, Submission: Northern Australia Insurance Inquiry, 6 September 2019, p. 6; ACCC, Final report: *Northern Australia Insurance Inquiry*, p. xvi.

⁵ *Ibid*, p. 58,

⁶ *Ibid*, pp. 194;59.