TOWNSVILLE
CHAMBER

Townsville Chamber *of* Commerce

# Reinsurance Pool

## Consultation Paper Answers

# Overview

The insurance industry is complex and constantly evolving. The failure of the insurance market for Property, Contents and Strata in Northern Australia has been clearly articulated and the announcement on the 4th of May 2021 sent a clear message that government intervention is required to not only make insurance affordable in Northern Australia, but also attainable. The Townsville Chamber of Commerce put forward four (4) recommendations in its 2021 Federal Budget submission.

1. **Expanding the Australian Reinsurance Pool Corporation remit to include Northern Australia and the natural events of cyclones and floods.**
2. **Obligation for insurers to provide insurance for all of Australia.**
3. **National Insurer – Baseline of insurance for all Australians.**
4. **Removing additional fees on premiums – Stamp Duty and GST.**

A combination of the above recommendations is critical to ensuring that an equalisation of insurance premiums across Australia is achieved. The announcement of the $10b reinsurance pool for cyclone and related flood damage (RPCFRD) is an excellent first step however, its design and sustainability will determine the government's effectiveness in addressing the market failure of the essential service that is affordable insurance in Northern Australia.

The Townsville Chamber of Commerce has spoken to industry experts and local representatives with a vested interest in developing Northern Australia. For the design of the RPCFRD to be successful, industry representatives from Northern Australia, and in particular, Northern Australian insurance brokers representation is critical. People with experience in having to find insurance products for people living in Northern Australia must be included in the consultation and design of the RPCFRD. Without people truly invested in the success of the RPCFRD, its effectiveness in addressing the market failure and removing impediments towards developing Northern Australia will be diminished.

The consultation paper released in May 2021 asked 23 questions about the design and structure of the RPCFRD. Some of the questions asked will ultimately be determined by market forces seeking competitive advantages. It is important when asking and addressing questions to assist with designing the reinsurance pool that the fundamental focus reverts to how the RPCFRD will place downward pressure on the cost of insurance premiums while encouraging the re-entry of more competition into the Northern Australia insurance market to ensure sustainability.

# Reinsurance Pool Coverage

1. **How should "cyclone" and "cyclone-related flooding" be defined for the purpose of defining the reinsurance pool's coverage?**

Duplicating and introducing new definitions for the purpose of the RPCFRD should be used with caution to avoid ambiguity and inconsistencies. The RPCFRD will not be accessed by policy holders directly and therefore standard legal definitions between insurers and insurance policies should continue to allow flexibility to ensure competitive advantages remain possible.

The insurance industry already has a definition for flood and can continue.

The Bureau of Meteorology (BOM) has a technical definition of a tropical cyclone that can be used for the RPCFRD.

*"a non-frontal low pressure system of synoptic scale developing over warm waters having organised convection and a maximum mean wind speed of 34 knots or greater extending more than half-way around near the centre and persisting for at least six hours"*

The existing definition of "flood" needs to be directly linked to the new definition of "cyclone". Creating a new definition of "cyclone related flooding" will create complexity. Insurance companies should have access to the RPCFRD for their first loss cover for "cyclone" and "flood" that are directly linked.

If a cyclone by definition becomes a rain depression causing "cyclone related flooding" in South Australia, the fundamental purpose of the RPCFRD and addressing the market failure in Northern Australia is eroded.

In line with the above, there is already a catastrophe declaration system used and recognised by the Insurance Council of Australia (ICA) and applied within the industry, any new definitions should be done in conjunction with and consistent with pre-existing systems within the industry.

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

Storm surge events should be covered by the pool and should be aligned with the industry catastrophe systems as stated above, there should be no definition of "cyclone related flooding".

3. **Is it desirable for the use of standard definitions of 'cyclone' and 'cyclone related flooding' to be required in policies covered by the pool?**

No, the catastrophe system is already in place and the response to definitions are detailed in Questions 1 and 2.

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?**

The pool should provide reinsurance for property damage to buildings and contents. This captures property damage to homes and businesses and removes complexities and difficulties that would otherwise arise where buildings and contents have mixed uses such as strata complexes.

There will only be difficulties if there is an attempt to create narrow definitions. The lack of insurance and the unavailability of insurance in Northern Australia is the problem needed to be addressed by the RPCFRD. Creating narrow definitions will erode the effectiveness of the pool and its objectives.

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

Yes, this already happens in the marketplace. By providing a reinsurance pool for the property (building and contents) component, insurers can create competitive products for insureds needing to cover risks tailored to their individual circumstances.

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

Yes, this already happens in the marketplace. By providing a reinsurance pool for the property (building and contents) component, insurers can create competitive products for insureds needing to cover risks tailored to their individual circumstances.

**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. By removing narrow definitions in the criteria, these perceived difficulties can be removed. The pool should provide reinsurance for property damage to buildings and contents. This captures property damage to homes and businesses and removes complexities and difficulties that would otherwise arise where buildings and contents have mixed uses such as strata-title complexes. There will only be difficulties if there is an attempt to create narrow definitions to apply. The lack of insurance and the unavailability of insurance in Northern Australia is the problem needed to be addressed by the RPCFRD. Creating narrow definitions will erode the effectiveness of the pool and its objectives.

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

Small business should not be defined by the RPCFRD. The purpose of the reinsurance pool is to place downward pressure on the cost of premiums in Northern Australia and encourage new insurers to enter the market. The RPCFRD should cover all property and contents regardless of the individual or entity identified as the "insured" on policies between insurers and policy holders.

The government should not become involved in the type of insurance product that insurers can offer to policy holders. Exclusions should only be defined between the insurer and the policy holder not the RPCFRD and the insurer. The RPCFRD should only cover the very clear and precise market failure – property damage (buildings and contents) triggered by the declared catastrophe – "cyclone" and "flood" that are directly linked.

If a definition for small business is used there are several issues that arise. Many small businesses rent or lease commercial space from larger businesses. If insurance is not available for properties to be developed or owned by a "large business" that might rent or lease property to smaller businesses, developing Northern Australia will not occur because the market failure of insurance has not been addressed.

If larger businesses are excluded from the reinsurance pool and experience premium rises then the existing costs of insurance will continue to be passed on to smaller businesses and the pool will fail to address the problem of unaffordable or unattainable insurance. The unavailability of insurance will also remain for larger businesses.

The other major issue with creating a definition for small business and attempting to assist a defined as part of the design of the RPCFRD is creating another reason for businesses not to grow and create jobs. If a small business is scaling, employing more staff, and creating more economic activity, the business may become too large and be no longer able to access the RPCFRD. We could also see businesses that win large contracts move in and out of the RPCFRD as work fluctuates creating major issues if a claim is made. This will also hinder their ability to tender and price contracts efficiently.

Creating definitions like 'small business' would undermine the principle of the RPCFRD and not address the intended purpose of the RPCFRD and is unnecessary if targeted at property damage (building and contents) for a declared catastrophe event in Northern Australia.

**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?**

All property damage should be included regardless of the insured's entity as an individual, business or Body Corporate established under strata title legislation. Assessing the size of an individual insured to determine exclusion from the pool will create significant difficulties and is contrary to the fundamental purposes and objectives for designing 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?**

In general terms, this is understood to be commercial in confidence so the Townsville Chamber of Commerce cannot give any guidance.

There is already a pre-existing structure in place for a reinsurance pool with ARPC – the Terrorism Reinsurance Pool. The approach used by the ARPC to assess and measure terrorism risk and individual policy level data could assist with queries regarding how cyclone related risk premiums should be calculated or pricing models replicated for the new pool. The approach used by the ARPC could be extended where possible.

**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?**

In general terms this is commercial in confidence so the Townsville Chamber of Commerce cannot give any guidance.

There is already a pre-existing structure in place for a reinsurance pool with ARPC – the Terrorism Reinsurance Pool. The approach used by the ARPC should be replicated or extended where possible.

**12. How much risk exposure should primary insurers retain?**

It is imperative that the pool operate similar to the Terrorism Reinsurance Pool. Insurers must have access to the RPCFRD for their First loss cover retention. This is critical to reintroduce competition to the marketplace. Insurers may then negotiate for access to other reinsurers as required by the individual insurance company's requirements based on products offered to insureds and market exposure.

**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?**

It needs to be left to the existing claims model, Insurer to Policy Holder

**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?**

The RPCFRD will be required to provide the first loss cover for insurers. This is the same as the Terrorism Reinsurance Pool structure already in place and its remit must be expanded and replicated for property damage caused by "cyclone" and "flood".

Considerations should be given to what an appropriate level of cover would be on a first loss basis. For example, if an insurer offers $1m property damage cover, what percentage will RPCFRD be providing as the first loss reinsurer. This will require government actuarial input as well as insurance industry input and modelling to confirm what ultimate outcomes could be achieved (cost reductions) as a result of this ceding (risk transfer) from private markets to the pool.

Reference should be made to New Zealand's EQC.

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

A common start date as 1 July 2022 is appropriate. You need to have a start date. There is a side of caution however as insurance companies and underwriters often negotiate three to four (3-4) year underwriting agreements and some insurers may be at a disadvantage during the early stages of the introduction of the government backed reinsurance pool. This however should not delay the introduction as the basic principle is to introduce competition and potentially new insurers into the marketplace to bring the costs of premiums down. This should be at the forefront of any discussion and decision-making process.

# 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?**

There is already a pre-existing structure in place with ARPC in relation to Terrorism Reinsurance Pool and that review structure can be replicated for the RPCFRD.

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

No. Unless there is a planned date as to when development of Northern Australia will have been achieved or cyclones and flood are no longer a risk for Northern Australia. Instead of an end date, review dates are important. These should be aligned with the review structure as timelines will vary and levels of risks, assessments of risks and appetite for risks, mitigation and management of risks will take time. The reinsurance pool should stay in place until a sustainable model is in place to ensure insurance premiums in Northern Australia are available and will for the foreseeable and sustainable future remain affordable and in line with the rest of Australia. Introducing an end date does not give confidence for insurers to re-enter the market or new insurers to seek competitive advantages and gain market share with a long-term view and strategy to make a new affordable product available to insureds in Northern Australia.

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

The mechanism required to ensure pass-through of premium savings to policyholders is healthy private industry competition in the market.

**18.1. Explicit price monitoring of insurance premiums?**

Yes, and there are examples of this in the economy. For example, the Reserve Bank of Australia (RBA) monitors interest rates and how that is passed on to consumers and adopted in the marketplace.

**18.2. Additional requirements to disclose the cost of reinsurance to policy holders?**

No. There are disclosure obligations on insurers and a suitable review and public access to public documents provides sufficient mechanisms for the existing and proposed reinsurance pools in Australia.

**18.3. Any additional mechanisms that may be appropriate?**

A mechanism for viability must be considered. How will the RPCFRD remain financially viable into the future? The current Reinsurance Pool for Terrorism established in 2003 charges a levy on Commercial Property and Business

Interruption policies at a rate of between 2.6% to 16% depending on the location of the property and business insured.

This is done via a three (3) tired system, A, B and C. Tier A is for areas with a population of over 1 million people and a rate of 16% is charged; Tier B is for areas with a population between 100 000 and 1 million people and a rate of 5.3% is charged; Tier C is for all other areas and is charged at 2.6% on the premiums. This model has proven effective for the sustainability and longevity of the fund. It also aligns with the true meaning of insurance where everyone contributes a little so if a few are impacted then they will have cover. This levy model for the whole of Australia must be replicated where all of Australia pays a little for the sustainability of the RPCFRD to achieve the government agenda to develop Northern Australia.

# Links to Risk Reduction

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

Mitigation is considered a separate discussion from the one involving the design of the RPCFRD.

Risk based pricing already exists for many insurers, including to some extent, mitigation. However, the discounts given for mitigation carried out by the policyholder are minimal and are eroded by annual premium increases. For mitigation to have a major effect the timelines are long, and the major effects will be driven more from planning and the building approval processes rather than penalising policy holders in Northern Australia where a market failure has been identified, notwithstanding attempts to address the issue using mitigation incentives in the past. Risk based pricing is a matter for the industry and is a separate discussion to that involving the design of the RPCFRD.

**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?**

Policy holders are not buying directly from the RPCFRD so the RPCFRD should not be involved in pricing discounts to policy holders. Attempting to influence insurers to direct the behavioural changes of insureds by using the RPCFRD does not align and will be contrary to the fundamental purpose and objectives of the RPCFRD, that is seeking to reduce the cost of premiums and making insurance affordable and attainable in Northern Australia. Property based assessment and mitigation should not be part of the design of the reinsurance pool.

For mitigation to have any major effect on premium prices, the timelines are long, and the major effects will be driven more from planning and approval processes and is considered a separate discussion to one involving the design of the RPCFRD.

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

There is an opportunity for surplus funds collected by the RPCFRD to be reinvested into mitigation programs. This should only be done once a sustainable and affordable model is in place and the pool is viable and sufficient funds are available to ensure the pool's viability is not jeopardised or the real purpose of the pool is compromised.

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

The risky behaviour that should be discouraged is behaviour of insurers as the pool is accessed by insurers not insureds. The ICA and Code of Practice for insurers must be complied with as a minimum criterion for access to the pool.

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

No. This question assumes the RPCFRD can be accessed directly by insureds. The pool should cover property damage (building and contents) where the claim relates to property damage caused by 'cyclone' and 'flood' when the events are linked. To develop Northern Australia, new builds should be encouraged. The use or further development of old builds should also be encouraged, but this is a separate discussion to the design of the RPCFRD.

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

No. This question assumes the pool can be accessed directly by insureds. The pool should cover property damage (building and contents) for policies entered into by insurers and insureds where the property is located in Northern Australia. To develop Northern Australia, new builds should be encouraged and use, or further development of old builds should be encouraged, but this is a separate discussion to the design for the reinsurance pool.

**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?**

The removal of state-based Stamp Duty being charged on insurance premiums.

**22.2. Which policy options could be introduced alongside the pool?**

The Queensland State Government has very prescriptive legislation in relation to the types of insurance required for strata developments. Prescription in the type and level of insurance included in legislation should be reviewed and align to encourage and allow competitive pricing for premiums in Northern Australia.

# Interactions with ARPC's Existing Functions

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

The ARPC is well established and has developed a sustainable model that has been in operation for over 18 years. Using the sound reporting and management and operational structures already in place, the reinsurance pool for cyclone and related flood damage should be an extension of or should be modelled on or be used as a base for the design for the new pool. The major aspects that require replication is the levy model created for sustainability and the first loss cover provided by the ARPC for Terrorism.