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Cyclone and Related Flood Damage Reinsurance Pool - Submission

Prepared for Treasury
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Treasury
Langton Cres
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Via email: reinsurancepool@treasury.gov.au

Dear Treasury

Thank you for the opportunity to provide feedback to the proposed Cyclone & Flood Reinsurance pool legislation by Treasury.

The caravan park industry is potentially greatly impacted by this, and over the past several years has suffered from a lack of insurance providers in the sector, as well as chronic underinsurance. There is great optimism that a well-structured, well-resourced and regularly reviewed reinsurance pool could alleviate some of the issues in the sector.

However, the contrary is also possible, particular given the proposed low threshold which may lead to businesses structuring their insurance in such a way that their commercial, property and business interruption insurance is under the $5M proposed threshold. This may lead to exacerbating the underinsurance issue in the caravan park industry.

The caravan park sector is Australia's number one holiday accommodation type and provides some of the most iconic experiences around Australia to people from all walks of life.

Several insurers over recent years have left the caravan park market, meaning it is increasingly difficult to get insurance. In addition to this, some insurers have stopped providing cyclone coverage altogether in their policies. It is hoped that these insurers will be required to provide access to insurance that covers cyclones and flood related damages.

Issues around access to and affordability of insurance has been a significant barrier to business investment and stability in the caravan park sector for several years. It is pleasing to see that the government is taking these issues seriously and with tangible action.

However, this support needs to be sustainable and ongoing for a significant period of time. Hence the recommendation for the risk-sharing arrangement to be delayed by an additional two years to ensure that this pool is not a simple 'stop-gap' measure in the current hard-cycle.

Thank you again for the opportunity to comment on this legislation, and please do not hesitate to reach out if you require additional information.

Kind Regards

Stuart Lamont
Chief Executive Officer
Caravan Industry Association of Australia

About Caravan Industry Association of Australia

Caravan Industry Association of Australia is the peak national body for the caravanning and camping industry in Australia. Our organisation's vision is *"to lead and champion a safe, compliant and sustainable caravanning and camping industry"* in Australia, with all operational pillars – marketing; research; lobbying and advocacy; compliance, accreditation and training – working towards this vision.

Caravan Industry Association of Australia operates as a not-for-profit organisation with a membership base comprising the individual state caravanning and camping industry associations, who we work collaboratively with on matters concerning the caravanning and camping industry in Australia.

As the peak national body for the Australian caravanning and camping industry, Caravan Industry Association of Australia represents over 6,000 industry businesses across the entire supply chain. The caravanning and camping industry is significant in Australia as evidenced by the following:

- An annual economic contribution to the Australian economy of $23 billion;
- There are 6,000 businesses across the supply chain, including 2,000 caravan parks;
- The caravanning and camping industry has 53,000 direct employees in Australia;
- 50,000 jobs in Australia across 6,000 business, 90% being SMEs; and
- 770,000 recreational vehicles registered in Australia, 90% of these were manufactured in Australia.

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Background

In recent years, caravan park operators around Australia have increasingly reported that insurance providers are imposing exponentially higher premiums on businesses in lieu of the potential of a natural disaster, irrespective of what risk mitigation policies that may be in place.

In some cases, caravan park operators have also reported that they are unable to extend or purchase new coverage at all. There are an estimated 400 caravan parks that require cyclone insurance coverage. Caravan Industry Association of Australia is optimistic that this legislation is a step in the right direction towards combatting under-insurance and non-insurance amongst businesses, however the detail is vital for this to function as intended and around premium setting and the potential margin savings expected to be received by businesses.

While not in this scope, it is worthwhile noting that this legislation does nothing for parks who are experiencing difficulty gaining insurance for other reasons such as bushfires, remote location, and non-cyclone storm and flood damage. Secondly, the pool does not contemplate public liability insurance concerns. Although a separate issue it is a very important one for parks across Australia.

That being said, this draft legislation is a positive step for improving insurance conditions in some parts of Australia. Caravan Industry Association of Australia, after significant consultation with industry insurers, brokers, caravan parks and other peak sector bodies, provides the below recommendations for Treasury to help this legislation achieve its required objectives.

Summary of Recommendations

1) Increase of the threshold of 'Total Sum Insured' from $5M to adequately cover SMEs.
    - to at least $10M, but preferably $25M
2) Extend 48 hours of damage post weather event
    - to at least 96 hours, but preferably 168 hours (1 week from end of event).
3) No insurer should be able to receive an exemption to participate in the pool.
    - inclusion of Lloyd's underwriters in proposed legislation
4) Hail damage, during a cyclone period, be regarded as a loss.
5) A review to be conducted before the government withdraws support, with options for an ongoing review mechanism explored..
    - thereafter a formal review every three years
6) Risk sharing arrangement be delayed until July 1st 2027
7) The pool should have an explicit mandate to recognise and encourage mitigation (without fear of exceeding the $5M threshold) and look to peak industry bodies and their accreditation programs to assist with this.

Proposed Threshold & Definition of an SME

Underinsurance is already a chronic issue across the insurance industry with caravan parks not escaping this. While any threshold runs the risk of worsening this situation, a $5M threshold would create a conundrum for many caravan parks.

There is a significant risk that businesses deliberately structuring their insurance arrangements so that their sums insured remain below a threshold to access policies participating in the pool. This can occur through:

- splitting assets across companies and superannuation funds and creating two or more policies;
- deliberately under-estimating the replacement value of the property;
- electing to insure for indemnity value rather than replacement value;
- restricting the indemnity period of the business interruption cover; or
- electing not to insure some assets at all.

Worse still some parks may decide not to invest capital works at their park because the new assets will rise above the threshold. This effectively discourages businesses from growing or providing the services and facilities a maturing customer base demands.

In the caravan park sector, some businesses have a number of parks which are insured separately, there are also businesses that own multiple parks that are insured through a single policy and, under the current scenario, these businesses would not qualify for 'the pool'.

If this business had a park in a cyclone region it would make sense for them to spilt that park from the other parks, create a separate policy and potentially participate in the pool. As well as a lower premium for the cyclone affected park, the premium for the other parks may also decrease because the higher risk park is insured elsewhere. Obviously the larger clients could go one step further and create a new company and policy for each of their parks, it is unclear if this is an intended consequence of the Government's reforms.

In consultation with insurance brokers in the caravan park sector, more than 1 in 5 caravan parks in cyclone areas have a total sum insured of more than $5M, which would make them ineligible for this pool.

This proportion is growing regularly as land and building values increase, for example the price of cabins alone has increased by 20% over the past three years.

This $5 threshold would omit many small businesses and is not consistent with the Federal Government's own various definitions of small business used in the recent COVID-19 and bushfire support measures.

ASIC defines a 'small proprietary company' if it satisfies at least 2 of the following:

- the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than $50 million;
- the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $25 million; and/or
- the company and the entities it controls (if any) have fewer than 100 employees at the end of the financial year.

Australian Small Business and Family Enterprise Ombudsman (ASBFEO) defines a small business as any business with less than $10M in annual turnover (taken from ATO) or employs less than 20 people (taken from ABS).

Recommendation 1
Increase of the threshold of 'Total Sum Insured' from $5M to at least $10M, but preferably $25M to be in line with ASICs definition and cover SMEs

Ultimately, regardless of the threshold limit it will need to reviewed and adjusted annually to reflect building cost inflation, growth in business income and increases in professional and services fees including claims adjusters, contractors and so on.

Case Study

A Queensland caravan park received their renewal offer and were informed that despite the premium increasing, it would not cover the cabins at their property. After seeking further offers, their park is now paying 120% more in premiums while only receiving coverage for 80% should their park need to claim on their business insurance. To reduce the premium they needed to remove the glass coverage from their policy (as the excess is normally more than a claim) and have now been informed as a result that their remaining insurance policies will not cover windows and glass with no discounted premium – even if damaged by a cyclone or named storm.

Insurance Period

The proposed insurance period ending 48 hours after the cyclone ends is insufficient. Whilst winds may abate and the potential for storm damage is reduced, the potential for continued flood damage remains very high. For example, a park not directly impacted by the cyclone, could experience flooding, related to the cyclonic rain, downstream many days after the cyclone has ceased.

Case Study

One caravan park in North Queensland reports that four weeks after Cyclone Yasi their town received 750mm of rain because of a Tropical Low system. This resulted in significant flooding in town, including in their park as the water ways which would normally cope with a deluge of this quantity were compromised by the cyclone.

Recommendation 2
Extend 48 hours of damage post cyclone to <u>at least</u> 96 hours, but preferably 168 hours (1 week from end of event).

Insurer Participation in Reinsurance Pool

In recent years, several major providers of insurance for caravan parks have withdrawn from the market or have excluded cyclone coverage for all their parks – regardless of location. As such, there are parks in Victoria and southern NSW who have a cyclone exclusion imposed on their property insurance. It is hoped that these insurers lift their exclusions and provide a policy that qualifies for participation in the pool.

It is also noted that in Section 8A(1) of the legislation, participation in the pool is not mandatory for brokers and underwriting agencies who use Lloyd's for underwriting capacity.

While Lloyd's underwriters are traditionally used to insure larger sums, there is a strong possibility that brokers and local underwriting agencies, having exhausted the local risk appetite, will need to use Lloyd's security. This could result in a large proportion of eligible premium from parks being diverted to Lloyd's, as such, we do not see any advantage by not requiring Lloyd's underwriters to also participate in the pool.

Recommendation 3
No insurer be able to receive an exemption to participate in the pool, with clarity around premium thresholds

Section 8A(5) & (6) seem also problematic as it refers to insurers not being required to participate in the pool because they do not reach a premium threshold. This threshold is prescribed at $10M, however it is unclear if this is:

a) the total premium written by the insurer?; or

b) is the total premium written by the insurer related to cyclone risks?

If it is b) it is important that evidence disclosing how its property premium structure is derived and how much of that premium is related to cyclones. Again, if an insurer currently excludes cyclone cover (such as the example above) they receive no premium for cyclone risk. Does this mean that they can continue to exclude this risk and therefore be exempt from participation in the pool? This would defeat one of the primary purposes of the Pool's development – to bring in more insurers.

Flood and Hail Damages

Many caravan park policies exclude flood damage altogether. The inclusion of flood cover for participating policies may see the development of 'have' and 'have not' coverage for parks with cyclone areas getting flood cover and those in non-cyclone areas won't be offered or being unable to afford flood cover.

Hail is usually listed as a separate insured event in most insurance policies. The explanatory memorandum (Section 1.37 & 1.38) point to Section 8C of the draft bill. Whilst not an exhaustive list hail is not mentioned. It is important to ensure that hail, during a cyclone period, is contemplated as a loss. If it is expressly covered in a participating policy it should also be expressly listed in the draft bill.

Recommendation 4
Hail damage, during a cyclone period, be regarded as a loss and listed in final bill.

Review Process

An ongoing review process will be vital for the success of this legislation in ensuring the ongoing viability of business in cyclone prone regions. Increasingly reviews of insurance portfolios seem to be ongoing rather than cyclical. It is vital that a review should be conducted before the Government's participation is reduced. Thereafter we believe a review every three years would be reasonable.

Recommendation 5
A review to be conducted before the government withdraws support, with options for an ongoing review mechanism explored. Thereafter a review every three years is recommended.

Government Participation

The proposal for a risk sharing arrangement from 1 July 2025 is a serious issue in the proposed legislation that may mean that post-2025, the current state of insurance is reverted after a period of being 'propped up' by the government.

Currently under the legislation, large insurers have until 31 December 2023 to have their policies in the pool. Small insurers have until 31 December 2024. With the current proposed data of 1 July 2025, the pool will have only been operating at 'full capacity' for six months before the risk sharing arrangement is considered.

Caravan Industry Association of Australia proposes to move to a risk sharing arrangements on1 July 2027 and only then if there have been a number of cyclone events to test the robustness of the pool and Government guarantee.

Recommendation 6
Delay of move to risk sharing arrangements by two (2) years until 1 July 2027.

Further the fact sheet states the "pool will be funded by charging reinsurance premiums to insurers that are consistent with the expected claims and operating expenses for the pool so that it will:

- be cost-neutral to Government over the longer term;
- lower the reinsurance cost for most policies with medium-to-high exposure to cyclone risk;
- have minimal impact on policy premiums for lower cyclone-risk properties; and
- maintain incentives for risk reduction and offer discounts for properties that undertake mitigation.

More detail needs to be provided in this regard, as it currently seems the Government are looking to prop-up the insurance sector for a time and then revert back to status quo. If that is the case the insurers may provide coverage now and then reduce or remove cover when the support is withdrawn. The harder insurance cycle will be simply delayed.

Continuing to Encourage Risk Reduction

Risk reduction and mitigation remain paramount to businesses receiving insurance, and it is vital that government assists businesses in these practises.

With this pool only considering severe natural weather events, while building codes and land planning can be adjusted, little can be done for seaside and riverside parks with non-cyclone proof cabins. There is a balanced need for incentives to increase risk mitigation, improve their assets and remain below a current $5.0m threshold.

There is a strong role for industry associations to assist in this, particularly through improving accreditation programs and linking these in with insurance companies to ensure that it has a demonstrable impact on claims history and premium reductions through improved business practises.

Recommendation 7

The proposed reinsurance pool should have an explicit mandate to recognise and encourage mitigation and should look to peak industry bodies and their accreditation programs to assist with this.

Conclusion

While the proposed legislation for a reinsurance pool is welcomed by Caravan Industry Association of Australia, the proposed arrangements have the potential of exacerbating the existing underinsurance issue if there is not more detail provided in the final legislation.

Intensifying this is the relatively low threshold of $5M which has significant issues and will result in businesses not investing in improving their businesses and mitigating risks; as well as potentially giving businesses no option but to underinsure in order to be able to get insurance.

The proposed eligibility timeline of 48 hours post cyclone event, is not long enough, and would mean many potential damages caused by cyclonic events (including but not limited to flooding from cyclone rain, hail and storm surges) are not covered by this pool arrangement, particularly for regional Queensland.

The proposed transitional arrangements from Government participation to an industry regime also warrant review and will need to be tested by actual events, leading to actual claims and adjustments.

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