

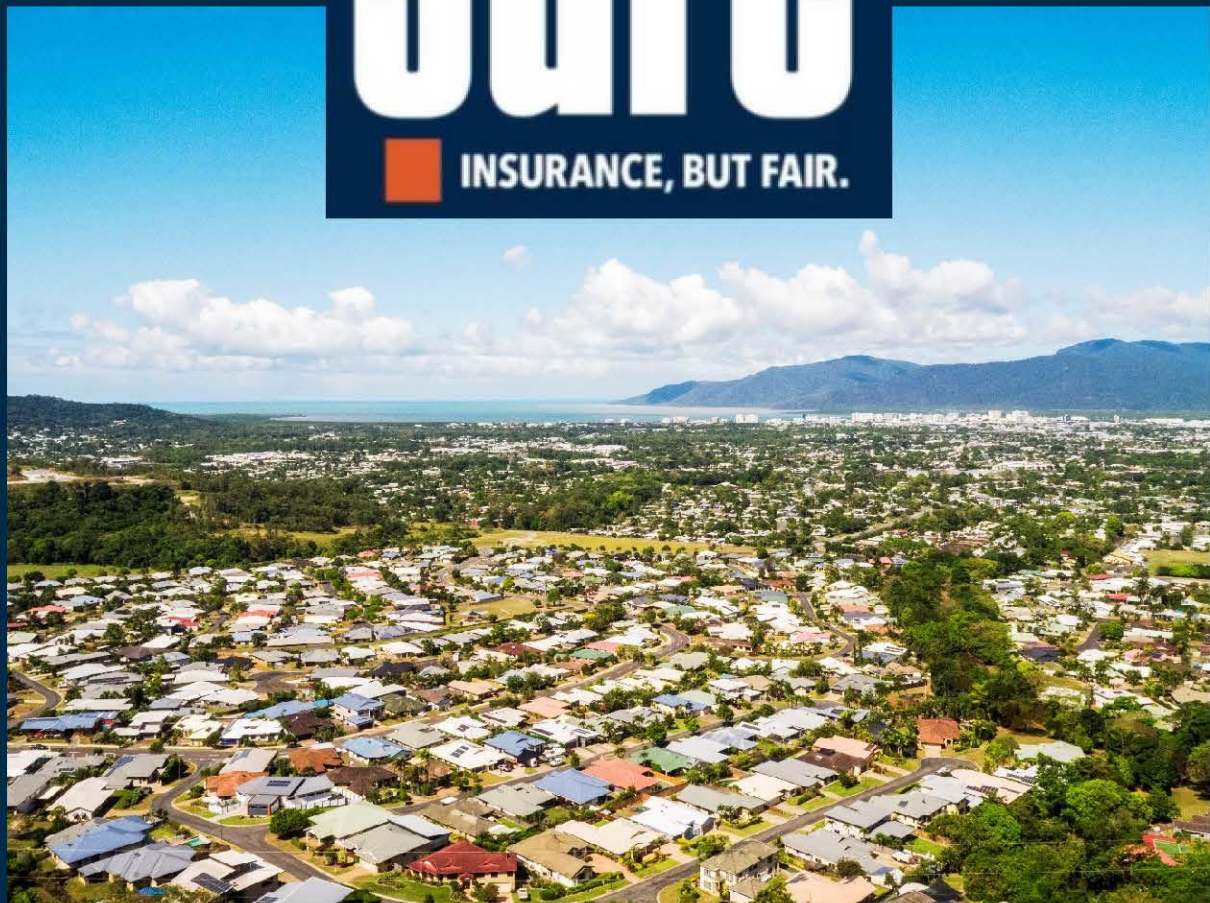
# Reinsurance pool for cyclones and related flood damage

Exposure Draft Legislation Response  
December 2021

# SURE



INSURANCE, BUT FAIR.



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## FOREWORD

In Sure Insurance's first submission in response to the Reinsurance Pool consultation process we proposed 4 key issues.

In the Foreword of that submission which, for the sake of relevance, we have reproduced below in italics and after perusing the draft exposure legislation, we feel it remains critically relevant to Sure's position and that of our policyholders.

*Sure Insurance is committed to ensuring that those policyholders most affected by the cost of insurance in Regional Queensland and beyond are afforded every opportunity to lower the price of their insurance. Equally, we are committed to ensuring that as many home and unit owners are able to insure as possible to reduce the post event burden on the community and deliver a level of security and certainty to people.*

*The introduction of the proposed Government Reinsurance Pool (Pool) is one part of a package of solutions to reduce the price of insurance which should, individually and collectively, be aimed at reducing the future cost of insurance.*

*As such, Sure Insurance submits that there are some key issues and principles that we would highlight and that are expanded upon in this submission -*

- 1. The "No disadvantage test".** *No policyholder should be worse off if their insurer cedes to the Pool. This applies to the level of premium, policy coverage, policy conditions and other relationship benefits with their insurer.*
- 2. A focus on those policyholders who need the most support.**
- 3. Dovetailed simplicity.** *The Pool design should not be unnecessarily complex for policyholders, insurers, and reinsurers. Ensuring that unintended outcomes and gaps are avoided is crucial.*
- 4. A successful and enduring delivery of the Government's commitment and investment for home and unit owners.**

*Sure Insurance stands ready to contribute whatever assistance it is able to contribute to the success of the Reinsurance Pool for Cyclones and Related Flood Damage.*

# 1 SUMMARY OF FEEDBACK

We have structured the Sure Insurance response in a format to directly address Sure's initial feedback following our review of the draft exposure legislation, associated explanatory documents and the meeting with Treasury convened 06/12/2021.

Should any aspect need further clarification or is worthy of expansion to fully understand the Sure position then we are ready to assist.

In summary, the key issues below can be summarised as;

## KEY ISSUE #1 – THE NO DISADVANTAGE TEST

- The potential for the policyholder no disadvantage test to be breached appears to be material based on our analysis of the proposed Pool structure.

The key reasons for this are –

- An ongoing requirement to purchase Cyclone reinsurance to deal with Pool 'Gaps' in cover. Such reinsurance cover will not be able to be purchased at a proportional discount.
- 'Gaps' in PDS cover between current cover and the Pool cover contribute to this.
- Loss of policyholder discount and capping structures means that price rises are more likely and arise from the Pool price being more expensive than the previous insurer price.

We have detailed this further in Section 2.

## KEY ISSUE #2 – INTERNAL REINSURANCE

- Analysis by Sure's analytics partners covering the last three major cyclones affecting North Queensland, ***Cyclone Yasi, Oswald & Debbie, indicate that around 40% of the combined incurred claims cost of these events would have not been covered by the proposed Pool*** – in the proposed Pool model this means that the cost would be borne by insurers. These scenarios are in addition to previous major events such as the 2019 Townsville Floods not being covered in any respect of the proposed Pool. This illustrates the necessity of 'Gap reinsurance' cover being required.

We have detailed this aspect and the implications further in Section 3.

Sure Insurance remains committed to the delivery of affordable household and residential strata insurance products across regional north and far north Queensland.

We remain equally committed to supporting and assisting this and other Federal Government initiatives that will assist Sure Insurance in the delivery of these affordable essential types of insurance.

Do not hesitate to contact Sure Insurance should any additional information be required regarding this and previous submissions provided to the Federal Treasury-Led Reinsurance Pool Taskforce.

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## 2 KEY ISSUE #1 – THE NO DISADVANTAGE TEST

In reviewing the draft information, the key issue that we have raised previously, and will continue to raise, is the issue of price and product disadvantages to policyholders arising from mandatory insurer participation.

We note that we have previously discussed with government Members the issue of mandatory participation and the likely effect on policyholders. We had received verbal assurance, via their consultations with the Minister, that the Pool would not be based on mandatory participation. We confirmed this advice in a letter to Minister Sukkar on 25/08/2021.

We note from the draft documentation that these assurances have not transpired.

Sure has made its position clear that a mandatory scheme design has potentially serious pricing disadvantages to policyholders should they receive price increases as a result of the Pool pricing being higher than the particular insurer policy level price. Some of the direct issues as to why we believe this is a likely outcome of the pool are set out below.

Sure confirms its position that if more than minimal numbers of policyholders face price increases, then such an outcome presents reputational issues for the Pool and by association insurers incorporating the Pool into their policies. Sure has no realistic option in these cases other than to communicate pricing differentials and also to respond to policyholder price complaints confirming that the Sure price was less and that the increase has come about as result of the mandatory nature of the Pool.

The same situation will occur in respect of the PDS 'Gaps' identified below.

That either or both of these scenarios could be considered acceptable given the government publicity of the Pool benefits is hard to understand.

### 3 KEY ISSUE #2 - INTERNAL REINSURANCE

- On the current available information it is clear that Sure and Sure's underwriting partners will still need to purchase Reinsurance protection for the 'Gap' between what is currently covered under the Sure PDS and what the Pool will cover.
- We have confirmed that the current functionality of existing Catastrophe models does not allow the granular separation of loss components to fully price and identify the classification of what is a Pool loss and what is an Insurer loss in an event situation. A myriad of scenarios clearly exist and will need to be identified, modelled and priced to allow renegotiation of existing and future reinsurance cover to ensure that the appropriate cover is obtained and to ensure that the pricing of such cover is incorporated into retained loss cover.
- The concern with the clear need to still purchase reinsurance cover is that the pricing of such residual or 'Gap cover' will be proportionally more expensive than before. While there may be a view that insurers will need to be stronger in their negotiations, the genuine market reality is that reinsurers have pricing models that incorporate more sophistication and minimum/capital pricing than a simple 'proportionate' pricing model. The cost and availability of capital and reinsurer allocation preferences mean that such a directly proportionate outcome is not realistic. The practical end result is that the cost at a policyholder level will be the sum of the Pool price and the residual insurer price and this outcome may erode the anti spates policyholder benefits.
- The nature of these 'Gaps' have not yet been able to be fully modelled however some initial observations of the 'Gaps' include –
  - **Event Time Definition** – The proposed methodology of the start and end time of an event to be covered by the Pool is understood. Analysis by Sure's analytics partners covering the last three major cyclones affecting North Queensland, ***Cyclone Yasi, Oswald & Debbie, indicate that around 40% of the combined incurred claims cost of these events would have not been covered by the proposed Pool*** – in the proposed Pool model this means that the cost would be borne by insurers. These scenarios are in addition to previous major events such as the 2019 Townsville Floods not being covered in any respect of the proposed Pool. This illustrates the necessity of 'Gap reinsurance' cover being required.

The real-world reinsurance market dynamics means that the cost of this cover will not be materially different to the reinsurance cover being currently purchased and will need to be included in the cost of policyholders premiums – in **addition** to and on top of the proposed Pool premium. In other words, the discount for the residual or 'Gap' reinsurance cover is expected to be minimal and certainly not in proportion to reduction in reinsurance cover being purchased.

## 4 POLICYHOLDER PRICING & GEOGRAPHIC DEFINITIONS

### PRICING

- We note comments in Sure's meeting with Treasury on 6 December 2021, that Pool pricing will occur at an individual address level and that a cross subsidisation model is envisaged where high and medium risks will receive a greater level of discount versus low risk policies which will receive little to no reductions.
- Sure seeks to understand the methodology, risk level, rating factors and classification system that will be used to determine what constitutes each of these layers of risk. In particular we would like to understand how the pricing for low risk policies will be approached. We understand from discussion with Treasury that these low risk policies will receive some pricing impacts (increases) to assist with pricing reductions in the medium to high risk categories.
- We note that in setting the address level Pool premium, that there is no distinction between different insurer components and coverage of PDS cover and original policy excesses. Our understanding is that these different coverage and excess levels between insurers and policies will not be considered as differentiating factors in the Pool premium calculation. We are unable to understand how this will work in a risk cost sense where different levels of cover will produce materially different claims cost outcomes. One illustrative example is where one policy has a sum insured limit and another has a replacement cost limit – these two scenarios will most likely produce vastly different claims costs outcomes in a total loss situation. The same applies to a policy with an excess of \$500 versus one with say \$20,000 and potentially up to \$75,000 on Strata policies.
- We note that discounts for recognised site level policyholder risk mitigation is planned for introduction after the initial roll out of the scheme. In the initial phases this aspect increases the likelihood of the Pool premium failing the aforementioned no disadvantage test. Exacerbating this will be the policyholder level loss of a range of discounts on the cyclone component of the premium – examples include auto club loyalty discount, combined policy discount, multi policy discounts and other loyalty discounts and so on. In addition to these discounts, there exist many scenarios across different insurers where policyholders premiums are "capped" due to a range of factors but usually on the length of time that the policy has been held with the insurer. All of these scenarios, individually and collectively, increase the risk of the no disadvantage test being breached and reputational issues for the Pool as a possible outcome.
- Should there exist material 'Gaps' between Pool and original PDS cover, then it would be Sure's intention to ensure that the policyholders remain covered by Sure in addition to the Pool coverage. The example below of the Pool Sum Insured definition refers to this. In this scenario there will be another policyholder impost in addition to the Pool price - again impacting the no disadvantage test.
- Finally, we refer to Section 6 below covering the premium impact of the need to still purchase Pool 'Gap' reinsurance cover. This effectively creates the need for the customer to pay the Pool price plus the insurer price to ensure the continuity of cover to that provided previously under the PDS.

### GEOGRAPHIC

- We understand that the Pool design is based on an Australia wide application where eligible Cyclone risk exists at each individual site location. We would request clarification of the scope of this application. We would also request clarification of the pricing structures for these locations as soon as this is practical.

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## 5 PRODUCT & PDS DESIGN

- The proposed sum insured loss limit is disadvantageous for Sure policyholders. The Sure PDS has benefits that are in addition to the sum insured NOT included within the sum insured. Examples include Removal of Debris and Architects Fees which are paid in addition to the sum insured. The PDS is designed this way to provide a higher level of benefit to the Policyholder particularly in a Catastrophe Event and/or Total Loss situation. We urge a rethink of this aspect to ensure that policyholders are not disadvantaged.
- We reiterate the effects of loss policy level discount structures mentioned in Section 2 above.
- In summary, the current Sure PDS covers the policyholder for Cyclone, Flood and Storm Surge with no time limits and within the coverage set out in the PDS. The proposed Pool creates 'Gaps' in cover between the current PDS extent and the Pool coverage – necessitating the creation of 'Gap cover' to ensure continuity and which results in additional premium costs.



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## 6 CLAIMS

- We note the advice that individual insurers will manage the claims payable by the Pool for a fee.
- A definition of claims service standards is required to ensure that the service provided to policyholders is supportive and consistent with the Pool objectives.
- The management of claims costs will be an important scheme success measurement by policyholders.