



Senate Standing Committee on Economics
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CANBERRA ACT 2600

Submitted Via Email

7 March 2022

To whom it may concern

Treasury Laws Amendment (Cyclone and Flood Damage Reinsurance Pool) Bill 2022

The Insurance Council of Australia (Insurance Council) welcomes the opportunity from the Senate Standing Committee on Economics (the Committee) to provide a submission to its inquiry into the *Treasury Laws Amendment (Cyclone and Flood Damage Reinsurance Pool) Bill 2022* (the Bill).

The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95 percent of private sector general insurers. A foundational component of the Australian economy, the general insurance industry employs approximately 60,000 people, generates gross written premium of \$59.1 billion per annum and on average pays out \$148.7 million in claims each working day (\$38.8 billion per year).

In May 2021, the Government announced that it would establish a cost-neutral reinsurance pool for cyclone and cyclone-related flood risk (the reinsurance pool). The Insurance Council and industry representatives have welcomed the opportunity to work with Treasury on the design of the scheme.

As we have outlined in our previous public commentary, further detail from the Australian Reinsurance Pool Corporation (ARPC) on pricing arrangements is required before insurers will be able to calculate the impact on premium costs, noting the Government's intention to provide the greatest savings to those with the greatest need.

Insurers have remained committed to northern Australia, despite commercial difficulties. The Australian Competition and Consumer Commission (ACCC) Final Report of the *Northern Australian Insurance Inquiry* (the ACCC Final Report) found that "over the 12-year period to 2018-19, insurers in northern Australia have experienced an estimated aggregate gross loss, across home, contents and strata insurance products of approximately \$856 million in real terms".¹

¹ ACCC, *Northern Australia Insurance Inquiry: Final Report* ([link](#))



More detail on our policy positions can be found in our submissions to earlier inquiries and in our policy platform, *Building a More Resilient Australia*.² For brevity, this submission does not repeat our detailed earlier comments, but rather highlights four key points:

- 1) The reinsurance pool is one part of a solution. Driving sustainable premium relief in northern Australia will require long-term coordinated attention across key policy areas, as outlined in *Building a More Resilient Australia*:
 - A significant increase in measures that better protect Australians from the impacts of extreme weather;
 - Changes to land use planning to ensure homes are not built on areas likely to flood;
 - Changes to building codes to make future property more resilient to cyclone and cyclone-related flood;
 - The removal of state taxes and charges on insurance products to remove this unnecessary expense; and
 - A comprehensive strategy and community programs to improve and maintain resilience in older houses and building stock.
- 2) Premium savings from the reinsurance pool are contingent on several factors, including the reinsurance premiums to be charged by the ARPC which are not known at this time, the outcomes of insurers' renegotiation of existing commercial reinsurance treaties and other ongoing operational, compliance and frictional costs for insurers;
- 3) Ongoing dialogue and monitoring will be needed to ensure that Australians understand how the reinsurance pool is working, resulting premium reductions (or potential increases) and the impact of complementary Government policies aimed at reducing risk for those living in cyclone prone areas; and
- 4) Reiterating a point in our previous submission, Insurance Council members request consideration of a wider time period in relation to cyclone-related flooding. Cyclone related flooding has a greater impact on affordability than cyclone. While we appreciate the Government's intention to confine the Pool coverage to floods occurring within 48 hours, it may do little to address affordability for those facing affordability challenges. Consideration should be given to the Pool covering claims for cyclone and related flood damage arising during a cyclone event up to 7 days after the cyclone ends.

One Part of a Solution

Higher premiums in the northern Australia market reflect greater levels of natural peril risk. The nature of this challenge calls for a multi-faceted policy response, of which the reinsurance pool is one component. To ensure sustainable premium reductions, the reinsurance pool will need to be supported by complementary policy initiatives in areas such as mitigation and resilience, building codes and state taxation.

² Insurance Council, *Treasury Submission: Consultation – Reinsurance Pool for Cyclones and Related Flood Damage* ([link](#)), and; Insurance Council, *Treasury Submission: Draft Legislation for Reinsurance Pool for Cyclones and Related Flood Damage* ([link](#))



Building a More Resilient Australia outlines twelve policy areas that we have identified as requiring reform, modernisation or investment.³

Australian homes, businesses and communities can only be made more resilient to worsening weather with a doubling of federal funding to \$200 million a year matched by the states and territories.⁴ The Insurance Council has called for all Australian Governments to collectively lift funding to \$400 million a year or \$2 billion over the next five years.

Building a More Resilient Australia outlines six measures to make at-risk communities and homes more resilient to flood, cyclone and bushfire that are estimated to save Government and households at least \$19 billion to 2050.

The Insurance Council is also calling for a review of land use planning arrangements to ensure no more homes are built in areas with a high risk of extreme weather, and for national building codes to be strengthened. Too many homes are in the direct line of flood, fire and cyclone, or at risk from actions of the sea, because at the time of planning and approval not enough account was given to the natural peril risk.

Likewise, instilling resilience through our building codes and standards is a critical component of mitigating the risks arising from extreme weather events for households and small businesses.

Finally, states and territories should be incentivised to abolish duties, levies and taxes on insurance products, which only increase the cost of premiums and discourage adequate levels of cover. The tax system should encourage not hinder insurance coverage. Depending on the state or territory, government taxes and charges can add up to 20 to 40 per cent on top of the cost of the premium which can result in underinsurance or non-insurance.

Savings from the Reinsurance Pool

Below, we have provided some broad comments on how the reinsurance pool will interact with existing commercial reinsurance treaties, and how these could drive any ultimate premium savings. The ARPC is yet to announce pricing arrangements. In their absence, we are not able to provide specific comments on the precise quantum of savings that could be expected. Potential savings will come to light after renegotiation of existing commercial reinsurance treaties. Further detailed consideration will need to be given to the extent of implementation and ongoing costs (eg. new systems, pricing algorithms and staff training), noting that insurers have been provided transition periods to join the reinsurance pool, with larger insurers having until 31 December 2023 to enter the pool, while smaller insurers have until 31 December 2024.

Expected premium savings should be understood in commercial context. Insurers already have reinsurance treaties in place, often with global reinsurers. Such treaties are typically taken out on a “whole of book” basis, meaning that Australian insurers are quoted a reinsurance price for all risks within their portfolio. As the reinsurance pool would cover one particular risk, insurers will need to negotiate specific carve-outs to avoid paying twice for the same risk and may lose diversification benefit in doing so.

³ Insurance Council, *Building a More Resilient Australia* ([link](#))

⁴ Productivity Commission, *Natural Disaster Funding: Final Report* ([link](#)) Recommendation 3.5



Premium reductions will therefore be driven by the ability of insurers to capture savings through commercial re-negotiations. There may not be a direct pass-through of theoretical savings. For example, a global reinsurer may have been offering discounted rates on the cyclone risk component of the reinsurance treaty to secure the overall business, or they may simply have a different (lower) view of the value of cyclone risk being ceded to the ARPC. In that circumstance, the insurer may not be able to realise the full theoretical savings. The precise quantum of premium savings will begin to be seen when insurers are able to enter the reinsurance pool, in line with the transition period.

With respect to risk sharing, we understand there will be a Ministerial decision with input from the insurance industry to changing the 100% risk sharing after the first 3 years. The level of risk retained by insurers will also have an impact on their reinsurance treaties and the savings achieved by the pool. Discussions around risk sharing percentage should commence as early as possible into the pool's operation so that insurers can begin to prepare for these changes.

A further factor is the definition of cyclone and related flood risk. The Draft Regulations and Bill provide that the coverage period extends for 48-hours after the Bureau of Meteorology declares that a cyclone has formally ended.⁵ Events that occurred outside this time would not be covered by the reinsurance pool, whether or not they are linked to the cyclone. For example, riverine flooding can manifest weeks after a cyclone as excess water in a river system can take time to flow through. We note the potential impact on customers of the 48-hour timeframe may also warrant consideration of appropriate awareness initiatives as claims made will need to indicate the timeframe of damage to facilitate appropriate allocation to the pool.

The Insurance Council understands that the 48-hour period is designed to limit the geographical application of the reinsurance pool. We also recognise that a line needs to be drawn somewhere. Nonetheless, insurers will need to purchase reinsurance for cyclone-related flood damage that falls outside this period. In practice, there are likely to be questions about whether damage falls inside or outside of the 48-hour period and within what geographical distance⁶ which may require additional claims management practices and therefore frictional costs (for example, hydrologist and other expert reports may be required).⁷ This will impact the potential premium savings that can be passed through to customers.

Both the upfront costs of setting up systems and the ongoing annual costs of complying with the reinsurance pool will be large. These costs are not quantifiable at this stage, particularly as industry does not know how the ACCC will undertake its price monitoring function. This will likely depend on the circumstances of each insurer:

⁵ *Treasury Laws Amendment (Cyclone and Flood Damage Reinsurance Pool) Bill 2022* 8C, 8F; *Terrorism Insurance Amendment (Cyclone and Related Flood Damage Reinsurance Pool) Regulations 2022* 3A

⁶ This reflects that the BOM provides confirmations of timeframes and not location. For example, the downgrade of TC Oswald occurred at 10pm on 21 January 2013. 48 hours later would put the geographic location somewhere between Cooktown and Lucinda. Under the current proposal there would need to be a determination as to which towns between those points are included.

⁷ Please note that this relates to reinsurance arrangements between the ARPC and insurers.



- Each brand and product may be impacted differently to the extent they sit on different front-end systems and price engines. All of these different systems may possibly need differing solutions, and different products on the same system will also need different solutions;
- Reinsurance and claims systems may need to be upgraded, and entirely new systems builds could be needed. The granularity required to manage the Pool contract is a lot higher than for existing commercial reinsurance contracts; and
- There is uncertainty around what the ACCC will expect to see, which could require further system changes which have not yet been accounted for.

The accompanying Regulation Impact Statement developed estimates implementation costs of \$440,000. As the Office of Best Practice Regulation noted in its certification letter, these regulatory costs have not been tested with affected stakeholders.⁸ Based on our initial feedback, we are concerned that the estimated implementation costs are unrealistically low. As discussed above, to utilise the potential savings that may be available through the reinsurance pool, insurers will need to invest in new systems, pricing algorithms and staff training. There will also be ongoing operational, compliance and frictional costs, as well as costs to comply with ACCC price monitoring. We suggest that further engagement with industry and deeper consideration by the ACCC is needed to develop more realistic implementation figures.

In summary, there will be implementation and ongoing costs for industry as well as Government with both the ARPC collecting the data through the pool and the ACCC responsible for price monitoring to ensure flow through of benefits to customers. While the full detail is yet to be seen, we reiterate the need to ensure that these costs do not erode any cost savings possible through the pool.

Ongoing Dialogue and Monitoring

The above sections have highlighted implications for the expected benefits of the reinsurance pool and outlined how complementary policy initiatives are needed to support premium affordability over the longer-term. Given the complexity and multi-faceted nature of the issues under consideration, ongoing dialogue and monitoring will be critical to ensuring that the policy outcomes are met. While these matters will be considered in the proposed triennial review, ongoing focus from the start is needed to maximise chances of success.

It is critical that key agencies work together effectively, most significantly the Treasury, APRC and the National Recovery and Resilience Agency (NRRA). It is equally important to ensure that other stakeholders are included, such as the insurance industry, consumers, and state governments.

The aim of this dialogue should be two-fold: first, to ensure that complementary policies across multiple jurisdictions are understood and appropriately aligned towards agreed goals. Second, to track the cumulative impacts of those policies and adjust where necessary.

In addition, the Insurance Council will continue to work with the ACCC, NRRA and ARPC. In line with the recent Ministerial Direction, the ACCC will commence price monitoring of relevant insurance policies. As outlined above, pass-throughs to consumers will depend on complex

⁸ Office of Best Practice Regulation, *Regulation Impact Statement – Second-Pass Final Assessment – Cyclone and Related Flooding Reinsurance Pool* ([link](#))



commercial factors, including renegotiation of existing treaties. The Insurance Council has welcomed the opportunity to assist the ACCC in this exercise.

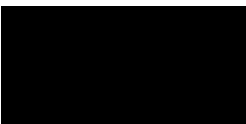
The NRRA is closely linked to the success of this project. Once the reinsurance pool is operational, the NRRA will begin to collect data on natural hazards, which will help inform ongoing funding priorities. The Insurance Council has already engaged with the NRRA to assist prioritisation of resilience projects, alongside the development of industry priorities.

Finally, the industry will continue to work with the ARPC on implementation. The proposed reinsurance pool differs from its current role in several critical respects. Most significantly, insurance claims for cyclone and cyclone-related flood damage are vastly more common than claims for terrorism. Participation in the cyclone reinsurance pool is also mandatory for insurers unlike the terrorism reinsurance pool. The ARPC will need to adapt to promptly process a larger number of claims compared to those arising from terrorism. The insurance industry also looks forward to working with the ARPC regarding how it will adapt reinsurance premiums to account for resilience works.

Next Steps

The Insurance Council trusts that our comments have been of assistance. If you have any questions or comments about our submission please contact Aparna Reddy, General Manager, Policy – Regulatory Affairs, on [REDACTED]

Regards



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