Joint Select Committee on Northern Australia: Cyclone Reinsurance Pool

Public Hearing 25 November 2022

Additional Questions on Notice received from Committee 16 December 2022

1. Are you aware of a decline in the number of insurers willing to cover cyclone insurance (or cover new risks related to cyclone insurance), particularly as the deadline to join the pool draws closer?

   Answer:

   ARPC is consulting closely with approximately 14 insurers, including those insurers different insurance brands. These insurers have insurance exposure in Northern Australia. ARPC has not been informed by any of these insurers of a decline in being willing to cover cyclone insurance or new risks related to cyclone insurance. All these insurers have project teams that are working towards joining the cyclone pool.

2. How does the pool's coverage relate to excess – and is it anticipated that the existence of the pool will lead to decreased excess amounts?

   Answer:
   The pool covers all eligible cyclone-related losses above the policyholder excess. Policyholders will continue to cover claims costs up to the excess amount.

   The pool premium formula adjusts the premium an insurer pays to the pool based on the policyholder excess. Policyholders with a higher excess will attract a lower pool premium (all else equal) than policyholders with a lower excess.

   Therefore, it is not anticipated that the existence of the pool will materially change the excess amounts taken up by policyholders in the short term.

   It is possible that the lower costs of the cyclone reinsurance pool, and the transfer of cyclone risk from insurers to the pool could result in insurers reducing very high excesses over time, or consumers deciding to reduce their excesses over time. Consumers with very high excesses could consider seeking alternative quotes from other insurers once those insurers have joined the cyclone pool.

3. Will cyclone reinsurance may be more expensive through the pool than in the private market for some insurers?

   Answer:

   ARPC has published in its modelling reports that some consumers will have a higher cyclone reinsurance cost. However, insurers are not obliged in the legislation to pass through higher costs for those consumers. Higher reinsurance costs for some consumers can occur due to:

   - The insurer not charging for the cyclone or cyclone related flood risk.
   - The insurer providing caps on premiums, for example such as loyalty discounts.
   - Or the insurer having a different view of the modelled risk to the cyclone pool.

ARPC is working with insurers to provide guidance on smoothing out such increases across their customer base.

The cyclone pool targets premium savings to medium and high-risk areas, with low-risk areas having comparable premiums to the private market. The proportion of consumers with modelled premium savings are:

- For home insurance policies 85% of consumers in Northern Australia have modelled premium savings. This includes 95% of customers in medium risk areas and 100% of customers in high-risk areas having modelled premium savings.
- For small medium enterprise SME policies 97% of consumers in Northern Australia have modelled premium savings.

For any specific insurer the pool premium may differ from that being paid to private reinsurers. This is an inevitable consequence of replacing competitive private market pricing with a uniform public cyclone reinsurance pool premium rate.

Insurers that have material exposure in high-risk regions are expected to see pool premiums lower than private market costs and will be able to achieve material savings to high-risk customers.

4. How does the ARPC's modelling take into account the possibility that insurers may still need to take out cyclone reinsurance for cyclone-related events that extend beyond 48 hours after a cyclone has been downgraded?

   Answer:
   ARPC expects that all material cyclone-related losses due to wind damage, flash flooding and storm surge will occur within the pool coverage period (cyclone declaration for the duration of the cyclone plus a further 48 hours after cyclone downgrade). Therefore, it is not expected that additional reinsurance will be required for these perils.
   However, there may be riverine flooding that continues beyond the pool coverage period, and the modelling suggests the majority of this would occur outside of Northern Australia.
   To support the determination of the pool premium rates, ARPC commissioned two expert reports on riverine flooding that estimated:

   - The proportion of all riverine flooding that is cyclone-related
   - For cyclone-related flooding, what proportions of losses occurs within 48 hours after the cyclone downgrade

   The pool only charges insurers for expected costs due to cyclone-related flooding within the coverage period. Therefore, the costs of any private market reinsurance purchased by insurers should not overlap with premiums being paid to the pool and not materially impact the ability of the pool to generate savings in high-risk regions.

   For transparency and to encourage alignment with the private insurance market, ARPC has published these flood modelling reports on its website - https://arpc.gov.au/wp-content/uploads/2022/10/2022.07.30-Publication-ARPC-CRP-Flood-Analysis-Report-30-June-2022.pdf.

5. What incentives for risk mitigation has the ARPC included for insurers to date?

a. When does the ARPC anticipate providing financial incentives for risk mitigation to small business and strata, and what will be the nature of those incentives?

Answer:
For Home, Small Business and Strata policies the pool premium formula provides discounts for:

- properties that have been elevated off ground level to reduce flood and storm surge vulnerability
- have been constructed in recent years where additional buildings standards apply
- have a roof construction material that is expected to be more resilient to cyclone damage
- have a building construction material that is expected to be more resilient to cyclone damage

Additionally for Home policies, the pool premium formula provides discounts for properties that have:

- been built prior to 2012 and have either braced or retrofitted their roller doors (compliant with AS 4505:2012)
- window protection installed on all windows
- been built prior to 1982 and have upgraded their roof tie-downs
- been built prior to 1982 and have completed a full roof replacement to current standards

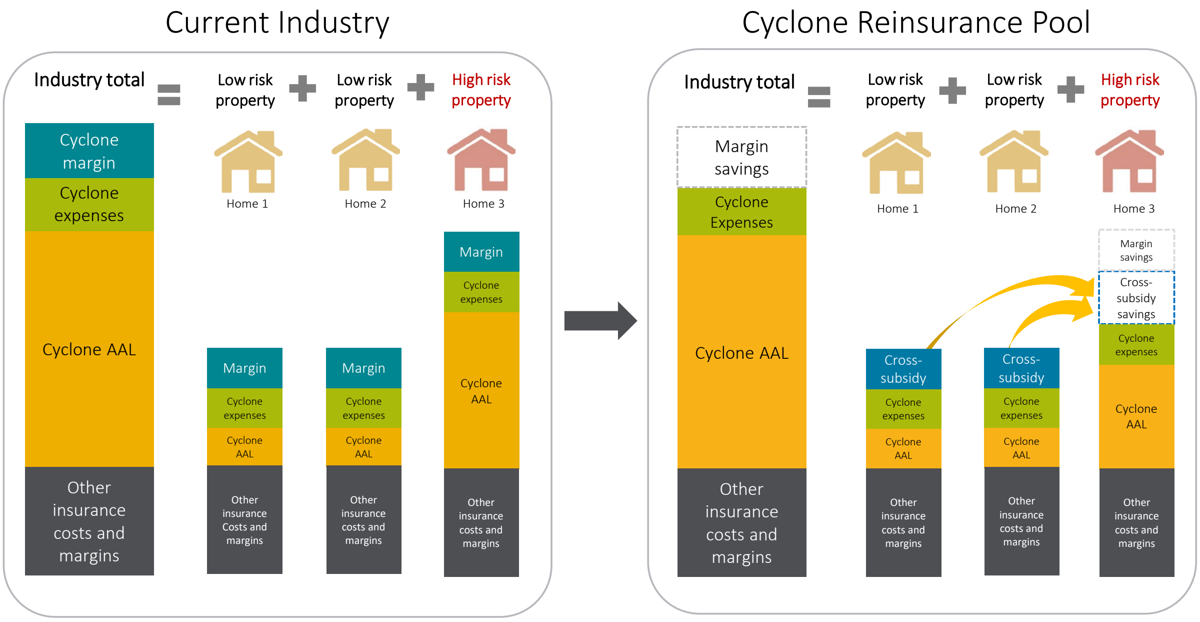
These discounts were developed to encourage risk mitigation and have been focused on the initiatives that have been proven to have the greatest impact in reducing cyclone vulnerability.

ARPC has commenced engagement with and will continue to work with cyclone vulnerability experts in 2023 to determine additional risk mitigation incentives for small business and strata properties. These incentives will likely be of similar nature to the incentives provided for home policies but will focus on the initiatives that have the greatest impact in reducing cyclone vulnerability for small business and strata properties.

6. If joining the ARPC was not compulsory, what impact would this have on:
   a. The total funds in the pool;
   b. The cost of premiums, for both insurers joining the pool and policy holders; and
   c. The requirement for the pool to be cost-neutral in the long term?

Answer:

If joining the pool was not compulsory, the ability of the pool to generate savings for properties in medium and high-risk regions would reduce significantly. The pool has been designed to generate savings for medium and high-risk regions by reallocating margin savings from low-risk regions. This is illustrated in the figure below:



Source: Figure 1.2 of Finity Report "Cyclone Reinsurance Pool – Summary of the Actuarial Premium Rate Assessment"

If joining the pool was not compulsory, insurers who write business predominantly in low-risk regions would be less likely to join the pool as the pool is not designed to provide premium savings to policyholders in these regions. Without these policies in the pool, the margin savings that the pool would be able to allocate to medium and high-risk regions would be materially reduced.

In response to the specific impacts:

a) The total funds in the pool will reduce. It is not possible to predict with accuracy to what extent insurers would elect to not join the pool if it was not compulsory, but it is likely there would be a significant reduction in the total funds collected.

b) Premium rates for policyholders in medium and high-risk regions would be expected to increase relative to the current pool premium rates. This is due to a smaller number of low-risk policies in the pool that generate margin savings. Premium rates for policyholders in low and nil-risk regions would not be expected to change materially. The impact on insurers would depend on the mix of business that that each insurer writes.

c) The premium rates could still be designed to be cost neutral over the long term, but to achieve this, premium rates in medium and high-risk regions would need to increase relative to current pool premiums.

7. If coverage was extended from 48 hours after a cyclone is declared to have ended to 7 days, what impact would this have on:
   a. The total funds in the pool;
   b. The cost of premiums, for both insurers joining the pool and policy holders; and
   c. The number of policy holders covered, particularly those further south (e.g., in Sydney), bearing in mind that many policy holders further south may not have cyclone insurance?

Answer:
Currently the pool covers all cyclone and related losses from the declaration of a cyclone event up until 48 hours after the downgrade of the event. For some events (that last 5+ days), the pool coverage will be greater than 7 days.

ARPC expects that all material cyclone-related losses due to wind damage, flash flooding and storm surge will occur within the current pool coverage period (48 hours after cyclone downgrade).

There may be riverine flooding that continues beyond the pool coverage period, and the modelling suggests the majority of this would occur outside of Northern Australia.

a) The ARPC would likely need to increase premium rates to allow for the change in coverage. As stated in the response to Q4, the current pool premium rates do not allow for any claims costs beyond the current coverage period. Higher premium rates would lead to an increase in the total funds collected by the pool.

b) Pool premium rates for insurers writing risks in Southern Queensland, New South Wales and Southwestern Australia would be expected to increase to allow for the increased exposure to cyclone-related riverine flood claims in these regions. However, this should be offset by reductions in private market reinsurance costs for insurers and the net impact should not be material. Shifting claims costs from the private market to the pool may have some benefits in removing margins from the system but the extent to which this will occur in practice is highly uncertain.

   Similarly, the impact on policyholder premiums is unlikely to be material as the re-allocation of reinsurance costs between private market reinsurance and the pool should approximately offset. Additional analysis will be required by ARPC to estimate the exact impact to policyholder from the change in coverage period.

   Insurers will however need to do additional work to allow for any changes to pool coverage and also to estimate the impact of the revised pool premium rates on their portfolio. Therefore, there is a risk that adjusting the coverage at this time may delay insurer's joining the pool.

c) The pool currently provides national coverage and will cover cyclone and related losses that occur within the coverage period anywhere in Australia. In South Australia, Tasmania, Victoria, ACT, and the majority of NSW however, the risk of cyclone-related losses is so low as to be considered negligible and ARPC does not charge insurers any premium for this coverage.

   Similarly, insurance policies in all regions of Australia generally will cover cyclone losses if they occur (e.g., in Sydney). However, because the risk is so low in southern regions, insurers will not charge policyholders any premium for this coverage.

   The number of policyholders that are covered for cyclone risk would not change. However, the number of policies that are charged a pool premium by ARPC is expected to increase. ARPC has not undertaken any modelling of costs outside of the legislated coverage.