

Chapter 5

The committee's view and recommendations

5.1 This chapter presents the committee's view and recommendations on the key issues raised in this report:

- the need to improve transparency in the states and territories' reporting of their insurance and reinsurance arrangements;
- the need for the Commonwealth Grants Commission (CGC) to be more thorough in its collection of the states' and territories' natural disaster expenses to include insurance receipts;
- the claim that the current Natural Disaster Relief and Recovery Arrangements (NDRRA) act as a disincentive for the states and territories to adequately insure and reinsure their assets, with particular reference to Queensland's case; and
- the meaning of the term 'cost-effective' in assessing the adequacy of the states' and territories' insurance arrangements.

Improving transparency and consistency in insurance arrangements

5.2 Chapter 2 sketched the states' and territories' current insurance and reinsurance arrangements. It noted significant gaps in the public reporting of this data. At present, the states' captive insurance arrangements are reported in an ad hoc fashion. The reporting of reinsurance arrangements is similarly inadequate. The committee believes there is a need for standardised and transparent reporting of the states' and territories' insurance arrangements.

Recommendation 1

5.3 The committee recommends that the Commonwealth Government consult with state and territory governments to ensure that the states' and territories' captive insurance and reinsurance arrangements are reported transparently and on a comparable basis.

The Commonwealth Grants Commission and the 'all state average'

5.4 Chapters 3 and 4 noted that the CGC is currently seeking a clearer picture of which states are insured and whether they have included past insurance receipts in the data they provided to the Commission in the past. The committee is surprised that this information is not routinely passed to the CGC. Clearly, a state that pays reinsurance premiums should have this cost factored in to the expenses that the CGC takes into account in determining its gross state expenses data.

5.5 The committee encourages the CGC to ensure that all states and territories do incorporate their reinsurance policy costs in the expenses data provided to the CGC. This reaffirms the committee's emphasis in chapter 2 of this report that the states need to be more transparent in reporting their insurance arrangements.

Recommendation 2

5.6 The committee recommends that the Commonwealth Grants Commission ensures that as part of the current redesign of its data request, state and territory governments are required to include their past insurance and reinsurance receipts for natural disaster insurance premiums. These data must be taken into account by the Commission in determining the states' GST share.

The moral hazard problem

5.7 The committee recognises that under previous NDRRA Determinations, there was the opportunity for state and territory governments to overly rely on Commonwealth disaster relief payments to fund the rebuild of state infrastructure. This assistance could act as a disincentive for governments to have adequate capital or insurance to fund the replacement and restoration of infrastructure.

5.8 The committee concurs with Commonwealth Treasury that the NDRRA should not encourage the states and territories to under-insure their assets. Rather, the purpose of the NDRRA is—and should remain—to supplement the states' and territories' insurance policies. The objective of the states' captive insurers should be to protect the state's balance sheet with regard to losses incurred as a result of disasters. Reinsurance should support these arrangements.

5.9 In this context, it is proper that the states' insurance policies should be subject to an independent review. The committee welcomes the Commonwealth government's decision to amend the NDRRA to ensure that the state and territory governments have adequate insurance arrangements in place (see chapter 3). It is important that where a state has its arrangements reviewed and fails to meet a certain standard, the Commonwealth can dock the level of financial assistance to that state under the NDRRA.

5.10 The committee also supports the broader review of insurance arrangements headed by Mr Trowbridge into matters including the Commonwealth's role in providing disaster insurance or reinsurance to the private sector.

The case of Queensland

5.11 It is not clear to the committee that the Queensland government's failure to secure a reinsurance policy for its assets was an example of the 'moral hazard' problem. There does seem to be merit to the claim by the Queensland Government and the Commonwealth Treasury that Queensland's risk profile is different to that of other states. Not only is there a higher incidence of flood and cyclone events than in

other states, but its population and state assets are also more dispersed and its road network more extensive.

5.12 The committee notes the Queensland Government's claim that its 2004 reinsurance quote from the international insurance market did not represent value for money. The premium was \$6.4 million for \$500 million of coverage with an excess of \$20 million.

5.13 In this context, the committee is particularly interested in what the international market can offer the Queensland Government for the reinsurance of its assets (see recommendation 3). It is concerned that the QGIF does not have a reinsurance policy and has only returned to seek a quote from the international insurance market in the wake of the recent floods and cyclones and the federal government's announcements. It is important that there is independent scrutiny of the quote that the Queensland government receives from the market. This will allay concerns that Queensland is relying on NDRRA payments in preference to purchasing adequate insurance.

Roads

5.14 It has been claimed that the Queensland Government was offered natural disaster insurance including roads for \$50 million a year. The Queensland Government has denied that it was offered a deal on these terms and there has been no evidence provided from a third party suggesting the Queensland Government was offered a contract on these terms. The committee notes the Queensland Government's claim that in 2004 it could not secure a reinsurance policy for its extensive road network. It is also aware that Queensland is not alone among Australian states in not having a reinsurance policy for its roads.

5.15 The committee believes that the current Natural Disasters Insurance Review, headed by Mr Trowbridge, should specifically examine the ability of the international insurance market to offer adequate and affordable cover for the states' and territories' road networks. Again, the committee is particularly interested to learn the outcome of the Queensland Government's current approach to the global market to reinsure its road network.

Recommendation 3

5.16 The committee recommends that a particular focus of the Natural Disasters Insurance Review into the adequacy of current insurance arrangements should be on whether the international insurance market offers reinsurance for the states' and territories' road networks.

The meaning of 'cost effective'

5.17 The terms of reference for this inquiry direct the committee to consider 'the appropriateness of fiscal arrangements for natural disaster reconstruction efforts'. The committee supports the 2011 NDRRA Determination's emphasis on the states having

insurance arrangements that are 'cost effective for both the state and the Commonwealth'.¹ This principle of 'cost-effectiveness' does need to be defined, however.

5.18 The committee understands that the Commonwealth Treasury has had preliminary discussions with the Queensland Government on the meaning of the term as it relates to state governments' insurance arrangements.² Treasury must clarify its interpretation of what is a 'cost-effective' insurance policy and this meaning must be understood and used by all states and territories. This common basis for measurement should be based on an assessment of a state's risk exposure, the geographic spread of its assets, the level of insurance cover it seeks, the excess payable and the premium offered.

Recommendation 4

5.19 The committee recommends that the Commonwealth Treasury clarify what is meant by the term 'cost-effective' as it relates to the 2011 NDRRA Determination and the scrutiny of the states' and territories' insurance arrangements.

Senator David Bushby

Chair

1 Attorney-General's Department, *2011 NDRRA Determination*, p. 9.

2 Mr Neil Singleton, Queensland Insurance Commissioner, *Proof Committee Hansard*, 13 May 2011, p. 30.