The Senate

Economics
References Committee

The asset insurance arrangements of
Australian state governments

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Chapter 1

Introduction

Background

1.1 In late December 2010 and early January 2011, significant flooding occurred in many areas of Queensland leaving three-quarters of the state declared a disaster zone.[1] National Accounts data released six months later partly attributed the 1.2 per cent fall in Australia's Gross Domestic Product to the impact of the Queensland floods.

1.2 In late January 2011, the Commonwealth Government estimated it will need to invest $5.6 billion in rebuilding flood-affected regions, with the vast majority to be spent on rebuilding essential infrastructure.[2] The Prime Minister, the Hon. Julia Gillard MP, noted that the Commonwealth had had discussions with the Queensland Government, adding:

> ...preliminary estimates of the infrastructure repair costs under existing arrangements for the Natural Disaster Relief and Recovery Arrangements (NDRRA) are around $5 billion, of which the Australian Government will provide close to three quarters (around $3.9 billion).[3]

The flood levy

1.3 To assist in covering these costs, the Prime Minister announced that a progressive flood levy for the 2011–12 income year will be introduced 'to assist affected communities recover from the recent floods and rebuild essential infrastructure'.[4] The Commonwealth Government anticipates that budget spending cuts and reprioritisation will deliver two-thirds of the $5.6 billion cost to the Commonwealth purse, with the remaining cost financed by the temporary levy.[5]

1.4 The flood levy will apply to all taxpayers whose taxable income is more than $50 000 in the financial year from 1 July 2011 to 30 June 2012. Taxpayers earning

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1 Queensland Government, *Queensland floods*, http://www.qld.gov.au/floods/ (accessed 20 May 2011).

2 The Hon. Julia Gillard MP, Prime Minister, *Media Release*, 27 January 2011, http://www.pm.gov.au/press-office/rebuilding-after-floods (accessed 20 May 2011).

3 The Hon. Julia Gillard MP, Prime Minister, *Media Release*, 27 January 2011.

4 Treasury, *Flood levy*, http://www.treasury.gov.au/contentitem.asp?NavId=022&ContentID=1949 (accessed 20 May 2011).

5 The Hon. Julia Gillard, Prime Minister, *Media Release*, 27 January 2011.

between $50 000 and $100 000 will pay a levy equal to 0.5 per cent of their taxable income in excess of $50 000, while those earning over $100 000 will pay 0.5 per cent of taxable income in excess of $50 000 and one per cent of taxable income in excess of $100 000.[6] The Parliament passed the flood levy legislation on 22 March 2011; Royal Assent was given on 12 April 2011.

1.5 In the months after the floods, there has been some questioning of the Queensland Government's decision not to seek a reinsurance policy for its assets on the international market. Some have argued that had the Queensland Government sought adequate reinsurance, the costs now borne largely by the Commonwealth Government would have been significantly less. In this context, there has been some criticism that Queensland's under-insurance was deliberate, safe in the knowledge that the Commonwealth would fund a significant proportion of recovery costs under the Natural Disaster Relief and Recovery Arrangements (NDRRA).

1.6 In February 2011, the House of Representatives Standing Committee on Economics held an inquiry into the provisions of the flood levy bills. During the committee's public hearing on 16 February, the Queensland Under Treasurer Mr Gerard Bradley, indicated to the committee that the Queensland Government did not seek reinsurance because of the cost sharing arrangements between the Commonwealth and the States.[7]

1.7 In March 2011, the Senate Economics Legislation Committee reported on the provisions of the flood levy bills. The committee described the levy as 'an equitable and reasonable response for the government to have taken to fund the reconstruction effort that will be required as a result of the summer of natural disasters'.[8] A dissenting report from Coalition Senators rejected the passage of the bills, arguing that instead of adding to the list of new taxes, 'significant budget savings remain available to the government to assist in the cost of rebuilding'.[9] The majority report did note that:

> In light of the many natural disasters that have occurred in a relatively short space of time in both Australia and the Asia-Pacific region the committee believes it would be prudent to examine the adequacy of its preparedness for future reconstruction efforts following a natural disaster, and its impact on the economy. [10]

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6 Treasury, 'Rebuilding after the floods', http://www.treasury.gov.au/floodrebuild/content/faq.asp (accessed 20 May 2011).

7 House of Representatives Standing Committee on Economics, *Proof Committee Hansard*, 16 February 2011, p. 24.

8 Senate Economics Legislation Committee, *Tax Law Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011*, March 2011, p. 19.

9 Senate Economics Legislation Committee, *Tax Law Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011*, March 2011, p. 23.

10 Senate Economics Legislation Committee, *Tax Law Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011*, March 2011, p. 20.

The referral

1.8 On 3 March 2011, the Senate referred for inquiry issues relating to the insurance of state government assets to the Senate Economics References Committee for report by 2 May 2011.

1.9 The referral is based on a Notice of Motion from independent Senator Nick Xenophon. The Notice directs the committee to examine:

- the provisions of the Tax Laws Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011 and the Income Tax Rates Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011;
- current insurance and reinsurance arrangements of the States and Territories of their assets and infrastructure; and
- the appropriateness of fiscal arrangements for natural disaster reconstruction efforts.

1.10 In terms of the current insurance and reinsurance arrangements of the states and territories, the inquiry established that the Senate call on the Queensland Government to provide to the committee:

> ...any correspondence, and any related documents, between the Queensland Government and any insurance advisers, insurance brokers, reinsurance brokers, insurers and reinsurers in relation to providing services or insurance products, or offers or proposals of insurance or reinsurance of Queensland Government assets, from 1 January 2000.

1.11 The referral also directed the committee to seek correspondence and any related documents from any relevant individual, corporation or other private entity in relation to these matters.

Conduct of the inquiry

1.12 This inquiry has involved requests for correspondence and the explanation of procedural issues relating to the powers of the Senate to compel the production of documents.

1.13 On 12 April 2011, the committee wrote to the Chief Executive Officer of AON Benfield Asia Pacific, Mr Robert D'Souza, and the Chairman of AON Corporation, Mr Steven Nevett, to request correspondence relating to Queensland's natural disaster insurance arrangements. These letters noted that while the committee's preference was for this information to be made public, it would accept a request for confidentiality.

1.14 On 18 April 2011, AON Benfield's Corporate Counsel, Ms Natasha Saltirova, contacted the committee by telephone inquiring into the Senate's powers to compel the production of documents from a corporation, in light of commercial-in-confidence considerations that a corporation may have in disclosing this information. The committee replied to Ms Saltirova by e-mail, making the following points:

- the terms of reference for this inquiry state that the committee 'seeks' from any relevant corporation correspondence between the Queensland Government and any insurance advisers. In other words, the committee is requesting this information;
- committees have the option of receiving documents confidentially and taking evidence from witnesses 'in camera'. This option enables a committee to inform itself fully on an issue in a way which it would not be able to do in public, and at the same time minimise any risk arising from publication;
- Senate standing committees do have the power to order the production of documents. A person failing to comply with a lawful order of a committee to this effect may be found in contempt of the Senate. In accordance with section 7 of the *Parliamentary Privileges Act 1987*, there is a penalty of up to six months' imprisonment or a fine not exceeding $25,000 for a corporation. The Senate has the power to deal with the consequences of a failure to comply with an order for the production of documents, rather than the committee. That noted, this power is seldom used. Privilege Resolution 1 requires committees to proceed by way of invitation in the first instance, unless the committee has specifically determined that particular circumstances warrant otherwise, and committees almost invariably invite witnesses to give evidence voluntarily; and
- a refusal to provide information on the basis of it being 'commercial-in-confidence' is sustainable only if it is clearly established that the public disclosure of the information would damage the commercial interests of the party concerned. In other words, a claim of commercial confidentiality from a corporation should be supported by evidence of the commercial harm which may result from disclosure.

1.15 The committee received a letter dated 19 April 2011 from Ms Saltirova noting that AON Benfield is legally obliged to maintain the confidentiality and privacy of its clients. The letter noted that it is the 'more appropriate avenue' for the Senate to obtain correspondence from the Queensland Government directly. It noted that in the interim, the company will consult with the Queensland Government to get their consent for the corporation to provide correspondence to the committee.

1.16 On 20 April 2011, in the absence of material received from either the Queensland government or Aon Benfield, the committee tabled an interim report requesting an extension of time to report until 30 June 2011. The report noted that 'it is crucial that the committee receives and analyses documentation from the Queensland Government and other parties on the state government's arrangements or offers to insure state assets'.

The Clerk's advice

1.17 On 20 April 2011, the committee wrote to the Clerk of the Senate, Dr Rosemary Laing, requesting procedural advice on whether there are any restrictions on the Senate requesting information from a state government and from a third party in relation to its dealings with a state government.

1.18 On 28 April, the Clerk responded to the committee's query. She noted that:

> There is no question that, in respect of relevant individuals, corporations, or private entities, the committee has the power to call them as witnesses and require them to produce documents. It has the power to question them about their dealings with state governments, an issue which is central to the terms of reference. Any refusal to comply with the order of the committee may be reported to the Senate and dealt with as a potential contempt.[11]

1.19 The Clerk's advice added that:

> The terms of reference...include a request to the Queensland Government to provide the...material. This has been framed as a request in recognition of the possible limitations on the Senate's powers in these circumstances and in accordance with long-standing Senate practice in such matters. The committee has been directed to seek the same information from two sources. Although one aspect of the terms of reference (regarding the insurers and reinsurers) is enforceable, the other (regarding the Queensland Government) is not. This suggests that the committee would be justified in having regard to "Melbourne Corporation" considerations in determining whether it should require the insurers and reinsurers to produce the material if the Queensland Government does not respond favourably.[12]

The Queensland government's correspondence

1.20 In the event, the Queensland Government did provide the committee with nearly 800 pages of confidential correspondence. This was received on 21 April 2011.

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11 Dr Rosemary Laing, *Procedural advice to Senate Economics References Committee*, 28 April 2011.

12 Dr Rosemary Laing, *Procedural advice to Senate Economics References Committee*, 28 April 2011. The Melbourne Corporation doctrine or principle arose from the decision of the High Court in *The Lord Mayor, Councillors and Citizens of the City of Melbourne v The Commonwealth and Another (1947) 74 CLR 31*. In this case, the Court held that section 48 of the *Banking Act 1945* was not a valid exercise of the Commonwealth's legislative power because an implied limitation could be derived from the federal nature of the Constitution (requiring the continued existence of separate governments exercising independent functions). The doctrine was refined in subsequent decisions by the Court to encompass a prohibition of: (1) discrimination which involves placing special burdens or disabilities on the states; and (2) laws of general application which operate to destroy or curtail the continued existence of the states or their capacity to function as governments (although in the Austin case it was reasoned that the doctrine could consist of one 'limb' instead of two—see *Austin v Commonwealth* (2003) 195 ALR 321).

On 10 May 2011, the committee was provided with a confidential précis of this by Mr John Tsouroutis. Mr Tsouroutis, who was employed on contract by Senator Xenophon, was formerly the Head of the Northern Territory Government's Territory Insurance Office (TIO). The committee authorised Mr Tsououtis to examine the documents. It thanks him for his summary and analysis of the correspondence.

Public hearing

1.21 The committee held a public hearing on 13 May 2011 in Canberra. It took evidence from Commonwealth Treasury officials, the Secretary of the Commonwealth Grants Commission, the Executive Director of the Victorian Managed Insurance Authority, Miss Rachel Carter from the School of Law at La Trobe University and the Queensland Government Insurance Commission and the General Manager of the Queensland Government Insurance Fund. The committee thanks these witnesses for their evidence.

1.22 The Queensland government officials took several questions on notice at the public hearing. These related to the insurance of roads, the details of the state government's approach to the international insurance market in 2003–04 and the various aspects of the documentation provided to the committee on 21 April. In anticipation of the Queensland government's response to these questions, the committee made a decision shortly before the scheduled tabling date of 30 June 2011 that it would seek a further extension of time to report until 29 July 2011. On 30 June, it tabled a second interim report making this request.

The IRMG report

1.23 On 1 July 2011, the committee received further documentation from the state government in response to these questions. It provided the committee with a commissioned report by the International Risk Management Group (IRMG), dated November 2000. The purpose of the report was to determine the feasibility of establishing a centralised insurance scheme that would provide property and liability insurance coverage to state government Departments. The Queensland government requested that this document be kept confidential.

1.24 On 28 July 2011, the committee wrote to the Queensland Government Insurance Fund requesting its permission to cite from the IRMG report. On 9 August 2011, the committee received a response from the Queensland Minister for Finance and the Arts, the Hon. Rachel Nolan. The letter noted that as the Queensland government is currently out to market seeking a quote to insure its assets against future natural disasters, 'the IRMG report remain commercial-in-confidence'.[13]

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13 The Hon. Rachel Nolan, *Letter to committee*, 9 August 2011.

1.25 On 17 August 2011, the committee again wrote to the Queensland Government requesting further documentation relating to the 2000 IRMG report. Minister Nolan replied that there are 'no further documents relating to this request'.[14]

Requirement to hold hearings in Queensland

1.26 The Notice of Motion establishing this inquiry instructed the committee to hold at least three days of public hearings in Queensland. However, the committee received only three submissions from Queensland-based submitters. Moreover, it felt it could address the terms of reference—focused as they are on decisions made over a period of time relating to the insurance of state assets—without holding a public hearing in Queensland. The committee felt that of these submitters, only the state government warranted an invitation to appear before the committee to give evidence. Had the terms of reference focussed on issues relating to the physical and social impact of the floods, the committee would have travelled to Queensland.

1.27 The committee sought the advice of the Clerk of the Senate about this matter. The Clerk responded:

> Rather than artificially spreading the available evidence over three days, the committee should consider making the best use of its time and resources and providing an explanation to the Senate accordingly.[15]

Answers to questions on notice

1.28 The committee thanks the Commonwealth Grants Commission and the Victorian Managed Insurance Authority for their prompt responses to questions on notice from the public hearing. The responses from the Commonwealth Treasury and the Queensland Government were received after the committee's revised tabling date of 30 June 2011.

Structure of the report

1.29 This report has five chapters:

- Chapter 2 outlines the committee's understanding of the states' self insurance and external insurance policies. Above all, it notes the absence of a uniform approach to obtaining insurance and the lack of transparency in these arrangements.
- Chapter 3 focuses on the arrangements for the States and Territories to access Commonwealth funding through the Natural Disaster Relief and Recovery Arrangements. Specifically, it provides an overview of how the level of state government assistance is calculated through the 2011 NDRRA Determination

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14 The Hon. Rachel Nolan, *Letter to committee*, 31 August 2011.

15 Dr Rosemary Laing, Clerk of the Senate, *Procedural advice to Mr John Hawkins, Secretary to the Senate Economics References Committee*, 25 March 2011.

and the impact of the States' disaster relief expenses and NDRRA payments on the States' share of revenue from the Goods and Services Tax. The chapter also notes the current review of the NDRRA and a broader inquiry into insurance arrangements.

- Chapter 4 presents the views on the Queensland Government's insurance arrangements.
- Chapter 5 concludes with the committee's view on the Queensland Government's past insurance arrangements and comments on the merit of possible reforms to the NDRRA.

Chapter 2

The Australian states' current insurance and reinsurance arrangements

2.1 The terms of reference for this inquiry direct the committee to examine—among other matters—the current insurance and reinsurance arrangements of the states and territories of their assets and infrastructure. This chapter considers these matters.

Captive insurance and reinsurance

2.2 All Australian states and territories have a captive insurer, which are state agencies established with the specific objective of financing risks to state government assets from public and products liability and special industrial risks (including disasters). Covered agencies pay premiums to the captive insurer, which then pays to replace public assets when needed.

2.3 Reinsurance is insurance that is purchased by an organisation to transfer the risk of claims where its own balance sheet is unable to meet potential claims. Reinsurance is therefore a risk sharing arrangement, whereby the insurer obtains cover from a third party (the reinsurer) for part of the credit risks that it has guaranteed, in exchange for the payment of a premium.

State governments' captive insurance and reinsurance arrangements

2.4 In the first instance, the committee notes the lack of transparency in states' reinsurance arrangements. The committee has not received, nor has it found, a publicly available list of the Australian states' and territories' reinsurance arrangements. As this chapter attests, the state governments' websites and annual reports are of varying quality. And, as subsequent chapters of this report note, even the Commonwealth Grants Commission—which adjusts states' GST share on the assumption that all states have the same spending policies in regard to natural disaster relief[1]—seems to be without a clear picture of these insurance costs.[2]

2.5 Most Australian state governments have reinsurance for their assets paid through premiums to international insurance companies. Queensland appears to be the only mainland state that does not have external reinsurance arrangements.[3]

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1 Commonwealth Grants Commission, *Submission 1*, p. 1.

2 Mr John Spasojevic, Secretary, Commonwealth Grants Commission, *Proof Committee Hansard*, 13 May 2011, p. 14.

3 Mr John Tsouroutis, *Correspondence to the committee*, 6 May 2011, p. 1.

2.6 Among the states that do have external reinsurance arrangements, the level of cover varies. The committee is aware that Victoria has reinsurance for its roads, for example.

Queensland

2.7 The Queensland Government Insurance Fund (QGIF) is the Queensland Government's captive insurer. The QGIF commenced operation on 1 July 2001 and is a managed fund within the general government sector. Agencies pay premiums to QGIF, claims are met from it, and reserves are built up to meet the cost of insurable liabilities.[4]

2.8 As mentioned, the Queensland Government does not purchase reinsurance for QGIF on the global market. Instead, the state government is heavily reliant on funding its natural disaster relief costs through arrangements with the Commonwealth. The Queensland Government's website states that the purchase of reinsurance as appropriate to the management of major and catastrophic risks 'is an ongoing consideration'.[5]

2.9 The committee found it difficult to identify the QGIF's current financial position. There is very little detail on the Fund's activities in Queensland Treasury's Annual Reports or on the QGIF website.

2.10 The committee has seen a note sent from the Queensland Treasury to the Queensland Treasurer on 21 January 2011. The note was obtained by *The Australian* newspaper on 11 April 2011 under the State's *Right to Information Act 2009*. It shows that the QGIF's premium revenue for 2010–2011 was $113 million, comprising health litigation ($57 million), general liability (28.4 million) and property ($24.1 million). Queensland Treasury's 2009–10 Annual Report lists the QGIF's claims and concessions at $110 million.[6]

2.11 In his précis for the committee on the Queensland Government's correspondence (see chapter 1), Mr Tsouroutis noted that as of 30 June 2010, the QGIF had $685.5 million in outstanding insurance liabilities. In February 2011, the Queensland Treasurer stated that the Fund has more than $700 million in reserves. Mr Tsouroutis concluded that:

> In the absence of reinsurance, it appears that the QGIF had negligible net reserves to meet any significant net claims such as those which arose from

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4 Queensland Government Insurance Fund, http://www.qgif.qld.gov.au/contents/operational_structure.shtml (accessed 18 April 2011).

5 Queensland Government Insurance Fund, http://www.qgif.qld.gov.au/contents/operational_structure.shtml (accessed 18 April 2011).

6 Queensland Treasury, *Annual Report 2009–10*, p. 93. http://www.treasury.qld.gov.au/knowledge/docs/annual-reports/2009-10/pdf/docs/complete-treasury-annual-report-2009-10.pdf (accessed 23 June 2011).

> the 2011 natural disasters, after allowing for its current fund reserves which essentially only covered its current outstanding liabilities, prior to the 2011 natural disasters.[7]

Victoria

2.12 The Victorian Government underwrites the state's exposures through its captive insurer, the Victorian Managed Insurance Authority (VMIA). The VMIA's insurance covers major government assets and infrastructure, the public healthcare system and community service organisations. The Chief Executive Officer of the VMIA, Mr Stephen Marshall, explained to the committee that the Authority's objective is to protect its balance sheet and the state's balance sheet with regard to losses incurred as a result of disasters.[8]

2.13 The VMIA's portfolio represents just over $108 billion in insured assets, with annual premium revenue in 2009–2010 of nearly $175 million.[9] The same financial year, the Authority paid an annual insurance premium of $36.2 million, leaving net premium revenue of $138.8 million.[10]

Table 2.1: Victorian Managed Insurance Authority's reinsurance

	2010 ($'000)
Premium revenue	*$174,935*
Outward reinsurance premium expense	*$36,179*
Net premium revenue	*$138,756*

Source: *VMIA Annual Report 2010*, p. 12.

2.14 The VMIA has a policy of purchasing reinsurance to limit the State's financial exposure to recovery from natural disasters. In 2009–2010, this included $1.45 billion for industrial special risks. The VMIA informed the committee that in 2010–2011, the state has industrial special risk insurance for $2.05 billion worth of assets within the state.[11] The VMIA retains the first $50 million for each event and reinsures the remainder in the local and overseas insurance markets.[12]

2.15 In addition to special industrial risks, the VMIA also has public and products liability insurance which includes cover for the state's bridges and roads. Again, the

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7 Mr John Tsouroutis, *Correspondence to committee*, 6 May 2011, p. 3.

8 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 25.

9 VMIA, *Annual Report 2010*, p. 6.

10 VMIA *Annual Report 2010*, p. 12.

11 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 22.

12 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 22.

VMIA retains the first $50 million for each event and reinsures a further $700 million on the local and overseas reinsurance markets.[13]

2.16 In evidence to the committee, Mr Marshall explained the process for insuring the state's roads as follows:

> VicRoads identify what the replacement value is per kilometre of road, whether it be a single road, single lane, dual highway and the like. VicRoads actually do have quite a robust asset replacement value—I think it is in excess of $20 billion. As I mentioned before, we rely on their valuations in regard to the kilometre of road depending on each of those constructions.[14]

2.17 The Victorian Government is reportedly in talks with the insurer Swiss Re to expand its external insurance coverage. These discussions were initiated by the state government in response to the Black Saturday bushfires.[15] Mr Marshall told the committee that losses of state assets from the 2010 bushfires were 'somewhere between $50 million and $60 million', paid for by the VMIA, 'with very marginal reinsurance recoveries'.[16]

South Australia

2.18 One of the roles of the South Australian Government Financing Authority (SAFA) is as a captive insurer for the Government of South Australia. The 2009–2010 SAFA Annual Report states that although the South Australian Government is fundamentally a self-insurer of most of its own risks, 'it has been considered appropriate and desirable that the state's finances be protected against the financial consequences of a catastrophic event'.[17] The SAFA Annual Report notes that under the Catastrophic Reinsurance program, the items in Table 2.2 are insured at the corresponding levels.

Table 2.2: South Australian Government's insurance and reinsurance 2009–2010

	2009–10 ($m)
Premium revenue	35
Reinsurance expense	7
Net claims	10.3

Source: *SAICORP Annual Report 2009–10*

13 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 22.

14 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 26. Roads at a local government level are insured through the Municipal Association of Victoria.

15 'Victorian Government in insurance talks with Swiss', www.insurancenews.com.au , 4 April 2011.

16 Mr Stephen Marshall, *Proof Committee Hansard*, 13 May 2011, p. 27.

17 South Australian Government Financing Authority, *Annual report 2009–2010,* p. 17.

New South Wales

2.19 The committee has not received information during this inquiry on the insurance and reinsurance arrangements of New South Wales (NSW) Government assets. It is aware that the state's captive insurer is the Treasury Managed Fund (TMF), which provides a full range of insurance covers and services for all participating Agencies.[18] The TMF's website describes its overall purpose as 'to provide structure and services that will assist Agencies in reducing the impact of risk exposures and maximise resources available to support their core business'.[19] The TMF is itself administered by the NSW Self Insurance Corporation (SICorp).

2.20 There is little information on the SICorp website about reinsurance arrangements. It does note that the TMF is protected by 'a comprehensive reinsurance program' and that the TMF has a reinsurance contract with Aon Benfield (Australia) Limited from 1 October 2009 to 30 September 2013.[20]

Western Australia

2.21 The Western Australian Government's self insurer is the Riskcover Fund. The Fund is underwritten by the Crown and is managed by the Insurance Commission of Western Australia on behalf of the state government. As part of RiskCover's commercial claims management service, a whole of State response is provided in respect of Western Australian government risks, to catastrophic losses such as cyclones, bush fires and floods.[21]

2.22 The Riskcover Fund's Statement of Comprehensive Income for the financial year ending 30 June 2010 listed outward reinsurance premium expense at $14.1 million.[22] Again, publicly available data on reinsurance arrangements is difficult to find.

Tasmania

2.23 The Tasmanian Risk Management Fund is the Tasmanian Government's self-insurance fund through which various agencies are covered for personal injury, legal liability, property and travel. The Fund operates on a cost-recovery basis with all

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18 New South Wales Government, 'Treasury Managed Fund', http://www.treasury.nsw.gov.au/insure/tmf (accessed 20 June 2011).

19 New South Wales Government, 'Treasury Managed Fund', website.

20 Treasury Managed Fund, 'Contracts and Tenders', https://riskinsite.nsw.gov.au/portal/server.pt/community/treasury_managed_fund/268/contract___tenders/1288 (accessed 23 June 2011).

21 Riskcover Fund, *2010 Riskcover Fund report*, p. 2.

22 Riskcover Fund, *2010 Riskcover Fund report*, p. 19 http://www.riskcover.wa.gov.au/publications/rc/fund_report/fund_report_10.pdf (accessed 23 June 2010).

participating agencies paying annual contributions to meet claim costs up to $5 million, administrative expenses, and where applicable, insurance premiums and reinsurance costs. The level of agencies' contributions is determined by an independent actuary and reflects their risk exposure, claims experience and nominated excess amounts.[23]

2.24 In setting agency contributions, the Fund aims to achieve: the collection of sufficient moneys each year to fund claims costs and alleviate the financial impact of large unexpected events; equity for user agencies with minimal cross-subsidisation; stability in contributions over time; and incentives for risk management, through recognition of claims experience. The Fund's finances are managed through the Tasmanian State Service Risk Management Account in the Special Deposits and Trust Fund.[24]

Concluding comment

2.25 The committee notes the lack of detailed, publicly available information on the states' and territories' current insurance and reinsurance arrangements. With the exception of Victoria, the collation and publication of this information among the mainland state governments is particularly poor. Chapter 5 makes a recommendation to address this problem.

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23 Tasmanian Department of Treasury and Finance, Tasmanian Risk Management Fund, *Annual Report 2009–2010*, p. 7 http://www.tenders.tas.gov.au/domino/dtf/dtf.nsf/a6c28ced64705388ca256f0700810896/a62275d1cc3569b0ca2577e50082288b/$FILE/TRMF-2009-10-AR.pdf

24 Tasmanian Department of Treasury and Finance, Tasmanian Risk Management Fund, *Annual Report 2009–2010*, p. 7 http://www.tenders.tas.gov.au/domino/dtf/dtf.nsf/a6c28ced64705388ca256f0700810896/a62275d1cc3569b0ca2577e50082288b/$FILE/TRMF-2009-10-AR.pdf

Chapter 3

The Natural Disaster Relief and Recovery Arrangements and the states' GST share

3.1 The terms of reference for this inquiry direct the committee to examine the appropriateness of fiscal arrangements for natural disaster reconstruction efforts. The remaining chapters of the report consider these issues in the context of:

- the Commonwealth's policy of disaster relief assistance to the states and proposals to tighten eligibility for this assistance;
- the Commonwealth Grants Commission's adjustment of GST shares based on the states' net expenses on disaster relief; and
- claims that Queensland's failure to reinsure its assets represents a 'moral hazard' given the generosity of the Commonwealth's disaster relief payments.

The Natural Disaster Relief and Recovery Arrangements (NDRRA)

3.2 This chapter provides an overview of the Commonwealth Government's arrangements to subsidise states' and territories' recovery costs through the Natural Disaster Relief and Recovery Arrangements (NDRRA). The NDRRA is a program of Commonwealth government financial assistance to the states in the form of partial reimbursement of the states' actual expenditure on disaster relief, recovery payments and infrastructure restoration. As the introduction to the 2011 NDRRA Determination notes:

> Natural disasters often result in large-scale expenditure by state governments in the form of disaster relief and recovery payments and infrastructure restoration. To assist with this burden, the Commonwealth has made arrangements to provide financial assistance to the states in some circumstances. Usually the assistance is in the form of partial reimbursement of actual expenditure.
>
> The Commonwealth's assistance is intended to be directed to state measures that complement other strategies in relation to natural disasters, such as insurance and disaster mitigation planning and implementation.[1]

3.3 Paragraph 4.1 of the 2011 NDRRA Determination states:

> In carrying out, or contributing to the cost of, eligible measures, the state must act consistently with the general policy that:

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1 Attorney-General's Department, *2011 NDRRA Determination*, http://www.ema.gov.au/www/emaweb/rwpattach.nsf/VAP/(689F2CCBD6DC263C912FB74B15BE8285)~NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf/$file/NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf (accessed 20 June 2011).

> a) its assistance is not to supplant, or operate as a disincentive for, self-help by way of either insurance or appropriate strategies of disaster mitigation.[2]

3.4 The Attorney-General's Department administers the NDRRA policy to ensure that the states' arrangements are adequate. Following these checks, Treasury transfers the money to the states.[3] As Treasury explained to the committee:

> The way the system normally works is that the states and territories do recovery and relief activities. They then have some administrative processes they go through which include their state auditors, as I understand it, to certify that the things that they have paid for are eligible under the NDRRA, and they then send in information to the Attorney-General's Department that says, 'Here's what we've spent; here's what we've spent it on,' and we then say, 'Above certain thresholds we pay half then three-quarters of those amounts and pass it on to you or you the states.'[4]

3.5 The severity of recent natural disasters in Australia has raised questions about the purpose and the incentives within the NDRRA. Treasury noted that while reliance on NDRRA payments for this and future years will be at historically high levels, the principle of the NDRRA remains that the assistance is there to supplement the states' expenditures:

> In the last 15 years there has only really been one year where there has been more than $200 million paid out under the NDRRA, and it is going to be many times that over this year and probably the next few years.[5]
>
> ...
>
> We think it [the NDRRA] is there as a mechanism to help relieve significant financial burdens placed on states, it is not there to relieve all financial burdens and it is not there to replace other sensible things that should be done to either minimise damage in the first place or meet costs after things have been damaged.[6]

3.6 Some of the recent public debate has queried whether the NDRRA payments by the Commonwealth has led some states to underinsure their assets. Treasury responded:

> That is one of the issues that is being considered by the disaster insurance review, I think, under that, and I suspect we will have a look at that same question as the states put in their assessments under the new NDRRA requirements. I don't think we have enough information, or have had

2 Attorney-General's Department, *2011 NDRRA Determination*, p. 7.

3 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 3.

4 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 10.

5 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 7.

6 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 7.

enough information in Treasury to date to make an assessment of whether we would believe that to be true.[7]

How is the level of state government assistance calculated?

3.7 The 2011 NRRDA Determination sets out how the level of state government assistance is to be determined. The level of federal assistance in a financial year is based on the state's actual expenditure (or what is expected to be spent within six months) on eligible disasters. This expenditure includes non monetary assistance.

Thresholds

3.8 If Commonwealth assistance is payable on this basis, the rate of assistance is worked out on the basis of the state's two thresholds for that financial year and the amount of its expenditure in that year on all eligible disasters.[8] The states pick up the full amount of the cost up to a first threshold. Above that threshold and up to a second threshold, the cost is shared, and above the second threshold, the cost is again shared, but the proportion that the Commonwealth picks up is greater than between thresholds one and two. The first threshold is .225 per cent of the state's total general government sector revenue and grants in the financial year two years prior to the relevant financial year. The second threshold is equal to the state's first threshold multiplied by 1.75.

Table 3.1: NDRRA State and Territory Expenditure Thresholds

	State revenue	*.225	1st threshold	*1.75	2nd threshold
NSW	$53,206,000,000		$119,713,500		$209,498,625
Vic	$39,283,000,000		$88,386,750		$154,676,813
Qld	$37,008,000,000		$83,268,000		$145,719,000
WA	$19,399,000,000		$43,647,750		$76,383,563
SA	$13,531,000,000		$30,444,750		$53,278,313
Tas	$4,286,000,000		$9,643,500		$16,876,125
NT	$4,187,000,000		$9,420,750		$16,486,313
ACT	$3,420,000,000		$7,695,000		$13,466,250

Source: Natural Disaster Relief and Recovery Arrangements, 'State and Territory Expenditure Thresholds', 2010–11 http://www.ag.gov.au/www/emaweb/rwpattach.nsf/VAP/(9A5D88DBA63D32A661E6369859739356)~EMA+-+RR+-+NDRRA+-+2010-11+NDRRA+State++Territory+Threshold.PDF/$file/EMA+-+RR+-+NDRRA+-+2010-11+NDRRA+State++Territory+Threshold.PDF

Categories of expenditure

3.9 There are three categories of expenditure: A, B and C. Category A is a form of emergency assistance that is given to individuals to alleviate their personal hardship or distress arising as a direct result of a natural disaster. Category B is the restoration

7 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 9.

8 Attorney-General's Department, *2011 NDRRA Determination*, p. 12.

or replacement of certain essential public assets damaged as a direct result of a natural disaster. Category C is a community recovery package designed to support a holistic approach to the recovery of regions, communities or sectors severely affected by a natural disaster. It comprises a community recovery fund and recovery grants for primary producers and small businesses.[9]

How the system works in practice

3.10 Based on the 2011 NDRRA Determination (see Table 3.1), the thresholds for Queensland are $83.3 million and $145.7 million. Where the Queensland Government's expenditure has not exceeded the first threshold of $83.3 million, the Commonwealth reimburses Queensland on a dollar for dollar basis. However, this only applies to categories A and C measures, not B.

3.11 Where the Queensland Government's expenditure has exceeded the first threshold of $83.3 million but is less than the second threshold of $145.7 million, the Commonwealth reimburses Queensland again on a dollar for dollar basis for all three categories.

3.12 Where the Queensland Government's expenditure exceeds the second threshold of $145.7 million, the Commonwealth picks up 75 per cent of the tab for all three categories.

Table 3.2: Payment conditions for the categories of expenditure

	Categories
Up to 1st threshold	AC
Between 1st and 2nd threshold	ABC
Over 2nd threshold	ABC

Source: Based on 2011 NDRRA Determination, p. 4.

3.13 In the case of the Queensland floods, given the extent of damage, the Commonwealth will be funding 75 per cent of almost all of the damage to essential infrastructure. As the House committee report noted: 'In effect, the Commonwealth has become the insurer for state governments for extreme natural disasters'.[10]

States' natural disaster expenditure and their GST share

3.14 The Commonwealth Grants Commission (CGC) assumes for simplicity that because states and territories operate under a common administrative and policy

9 Attorney-General's Department, *2011 NDRRA Determination*, pp. 2–4.

10 House of Representatives Standing Committee, Inquiry into the *Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011* and the *Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011*, February 2011, p. 7.

framework, they have the same spending policies in relation to natural disaster relief. Its assessment of states' GST requirements recognises states' actual expenditure on disaster relief, net of payments from the Commonwealth. Accordingly, the burden on State budgets of dealing with the non-Commonwealth funded costs of dealing with recovery from natural disasters is shared between the states through the GST allocation process.[11]

3.15 In its submission to this inquiry, the CGC noted that it ensures that neither the Commonwealth NDRRA funding received by a State nor its related expenditure affects its GST share.[12] State spending on natural disasters in excess of that funded by the Commonwealth through the NDRRA is taken into account in determining a State's GST share. The CGC ensures that a state's spending on natural disaster relief above the state average is partly funded by a reduction in other states' GST shares.

3.16 In other words, to the extent that an individual state spends in excess of the average spent by all states on natural disaster relief, its GST share is increased. The CGC gives the example based on Table 3.3 (below). Queensland's GST share would be increased by $15.39 per person because its net spend of $32.83 is more than the all-state average spend of $17.32.

Table 3.3: Impact of natural disaster relief expenses and NDRRA payments for 2006–07 to 2008–09 on the GST distribution, (2010 Review)

Annual average	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Gross state expenses ($m)	105.5	168	291.3	17.9	0.4	3.7	0.0	17.3	604.4
NDRRA revenue ($m)	2.6	73.4	151.8	0.0	0.0	0.2	0.0	6.9	234.9
Net expenses ($m)	102.9	94.9	139.5	17.9	0.4	3.5	0.0	10.4	369.5
Net expenses (%)	14.81	17.73	32.83	8.40	0.28	7.08	0.00	47.79	17.32
Impact on GST (%)	-2.62	0.52	15.39	-9.01	-17.08	-10.33	-17.36	30.17	3.55

Source: Commonwealth Grants Commission, *Submission 1*, p. 2.

The all-state average

3.17 The CGC told the committee that it adopts an average of expenditure across all states because it assumes that all states have the same spending policies in regard to natural disaster relief given they all operate under the NDRRA. However, the Secretary of the Commission, Mr John Spasojevic, told the committee that in the case of the recent Queensland floods:

11 Commonwealth Grants Commission, *Submission 1*, p. 1; Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 12.

12 Commonwealth Grants Commission, *Submission 1*, p. 1.

> ...the commission will have to assure itself that the numbers that we are seeing provided by the states do represent an average policy. If not, the commission will have to think about how it adjusts those numbers to make sure they are comparable.[13]

3.18 It does appear that at least some state governments do not incorporate their insurance premiums for natural disasters into the data they provide to the CGC. In an answer provided to the committee in response to a CGC questionnaire in April this year, the South Australian Government noted that these were not included in the CGC's data request for the 2011 Update. Further, the SAFA's payments to state government entities for insurable losses are not recorded in the data provided to the CGC.[14]

3.19 The South Australian Government has also indicated that its NDRRA data:

> ...will be significantly amended for the 2012 Update as we have recently completed a whole-of-government collation of NDRRA eligible expenditure (for lodgement with the Commonwealth) for the 2006–07, 2007–08, 2008–09 and 2009–10 financial years. The process for collating our NDRRA data has been prolonged due to the need to obtain supporting source documents (eg invoices) and the requirement to have the data audited.[15]

The Commonwealth Grants Commission's data request

3.20 The Secretary of the CGC told the committee that in the past, the Commission relied on gross state expenses data being reported on a consistent basis. It is now 'discovering' that some states do and do not have insurance, 'which is leading us to work again with the states to ensure that data comes to us is done on a comparable basis'.[16] As he told the committee:

> ...doubts have been raised by people making claims that they are insured or not insured, so we are now sitting down and saying, 'Can we just get a clear picture of whether you are insured or not and whether you have included in the past receipts from insurance or not in the data that you have provided to us.'[17]

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13 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 12.

14 South Australian Government, *Response to CGC questionnaire* of 7 April 2011. Information provided to the committee by the Commonwealth Grants Commission on 27 May 2011 in response to a Question on Notice.

15 South Australian Government, *Response to CGC questionnaire* of 7 April 2011. Information provided to the committee by the Commonwealth Grants Commission on 27 May 2011 in response to a Question on Notice.

16 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 15.

17 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 14.

3.21 The committee has been provided a copy of the CGC's data request for the 2011 Update. The document is a request for information from the states and territories regarding their net expenses on natural disaster relief. The document states: 'it is essential that you provide both revenue and expenses accurately since the Commission needs to determine net expenses for its (GST) assessments'.[18] However, the committee is concerned that the CGC's data request does not specifically include reinsurance premiums as an itemised expense. In the committee's view, the states and territories should include their past insurance recepts in the data that they provide to the CGC (see chapter 5).

Amending the NDRRA

3.22 On 3 March 2011, the same day the Senate referred this inquiry, the Federal Government announced that it will amend the NDRRA with the effect that the amount of funding states and territories will be entitled to following a natural disaster will be contingent on their own insurance arrangements. Under the new arrangements:

- states and territories will not be eligible to receive the maximum level of Commonwealth support unless they undergo regular assessments of their insurance arrangements by an independent specialist, such as the state Auditor-General;
- the first independent assessment must be published by 30 September 2011 with further independent assessments at intervals no greater than three years apart and following any significant change in the state's insurance arrangements. The state is required to publish the outcome of the independent assessment;
- these reports will be assessed by the Department of Finance;
- they will then be considered by the Attorney-General, who may make recommendations to the states or territories in regards to their insurance or mitigation strategies; and
- if a state or territory has failed to take appropriate action within a reasonable time, then the amount that state or territory would be reimbursed under the NDRRA may be reduced.[19]

3.23 The Government believes that the proposed changes will help ensure all state and territory governments have adequate capital or insurance to fund the replacement and restoration of infrastructure following a catastrophe.[20]

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18 Commonwealth Grants Commission, *Data request for 2011 Update*, p. 1.

19 The Hon. Julia Gillard MP, 'Flood levy to pass, natural disaster relief and recovery arrangements strengthened', 3 March 2011, http://parlinfo/parlInfo/download/media/pressrel/614623/upload_binary/614623.pdf;fileType=application/pdf#search=%22'natural%20disaster%20relief%20and%20recovery%20arrangements'%22 (accessed 9 May 2011).

3.24 Part 4 of the 2011 NDRRA Determination sets out the general conditions for Commonwealth assistance. These conditions include that the state must have reasonably adequate capital or access to capital to fund liabilities or infrastructure losses, including through, but not limited to:

- commercial insurance/reinsurance;
- any state COAG reinsurance fund or pool; and
- state department premium contributions (i.e. internal state funds).[21]

3.25 In terms of the Commonwealth's review of the state's independent assessment, the 2011 NDRRA Determination lists the following imperatives:

- that a state has a responsibility to put in place insurance arrangements which are cost effective for both the state and the Commonwealth;
- that the financial exposure borne by taxpayers (at both levels of government) under this Determination should be minimised; and
- that the onus is on a state to explore a range of insurance options in the market place and assess available options on a cost benefit basis.[22]

3.26 In terms of the first of these principles, the Queensland Government told the committee:

> With respect to the current process, we have commenced discussions through heads of Treasury in terms of the arrangements going forward post the Attorney-General announcing those changes. I believe that this is all part of understanding how we determine what are cost-effective arrangements. I am not aware that in the past there has been any requirement on the Queensland government to address its insurance arrangements with this sort of consideration in mind.[23]

3.27 In terms of the third principle (above), chapter 2 noted that the Queensland Government is currently actively seeking a 'cost-effective' reinsurance policy from the international market.[24]

3.28 Each of the Commonwealth's reviews of the states' insurance arrangements will include an examination of matters such as:

- the nature of any insurance / reinsurance sought and offered;
- the amounts of any premiums and excesses;

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20 The Hon. Julia Gillard, 'Flood levy to pass, natural disaster relief and recovery arrangements strengthened', 3 March 2011.

21 Attorney-General's Department, *2011 NDRRA Determination*, p. 8.

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

23 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, p. 41.

24 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, p. 31.

- the events and extent of assets covered;
- the amount covered per event;
- maximum possible loss;
- reinstatement terms;
- claims experience; and
- any related matters.

3.29 NDRRA Guideline No. 5 notes that the Commonwealth Attorney-General will request that the Department of Finance and Deregulation review the independent assessments submitted by the states to:

- establish benchmarks for the appropriateness of each States' insurance arrangements;
- assess the appropriateness of states' insurance arrangements; and
- make recommendations as to differential thresholds or differential rates of assistance that should apply under the Determination depending on the appropriateness of individual state's insurance arrangements.

3.30 The Determination adds that if a state fails to take appropriate action within a reasonable timeframe in response to a review's recommendations on the state's insurance, the amount of Commonwealth assistance will be reduced in accordance with the three principles above.[25]

3.31 In terms of the requirement that the first independent assessment of the states' insurance arrangements must be published by 30 September 2011, Treasury made the following comment:

> The Treasury, the Department of Finance and Deregulation and the Attorney-General's Department have had initial discussions with the states around these arrangements and how they are going. I guess it is probably fair to characterise that they think the 30 September time frame is a challenging one, but we are working with the states to see what can be done by that time frame. And we are looking at the information that people at the department of finance who will be making an assessment would need to be able to make their assessment of the states' reports, and basically working out all of the practical arrangements that need to be done to meet that time frame.[26]

25 Natural Disaster Relief and Recovery Arrangements, *Attorney-General's Department*, p. 9.

26 Mr Damien White, *Proof Committee Hansard*, 13 May 2011, p. 3.

Broader review of disaster insurance arrangements

3.32 On 4 March 2011, Assistant Treasurer the Hon. Bill Shorten MP announced an independent review into disaster insurance in Australia—the Natural Disasters Insurance Review. The Minister's media release emphasised that:

> [T]he Australian Government is concerned that appropriate national measures are in place to foster more complete sharing of risk and equitable sharing of the cost of damage and loss resulting from floods and other natural disasters.[27]

3.33 The review will consider insurance arrangements for individuals and businesses for damage and loss associated with flood and other natural disasters. It will be chaired by Mr John Trowbridge, with Mr John Berrill and Mr Jim Minto as members and will report to the Commonwealth by the end of 2011. Treasury told the committee that the review panel is being assisted by the Australian Government Actuary, Mr Peter Martin, and is supported by a secretariat within Treasury. The review is undertaking wide-ranging consultations and intends to publicly release an issues paper in late May. The final report will be provided to the Assistant Treasurer by 30 September 2011.

3.34 The review will consider a number of specific issues, including:

- the extent of, and reasons for, non-insurance and underinsurance for flood and other natural disasters in Australia;
- the ability of private insurance markets to offer adequate and affordable insurance cover for individuals, small businesses and governments for flood and other natural disasters;
- factors that may impede the private insurance market in offering such cover;
- measures that could improve the ability of the private insurance market to offer such cover and the take-up of such cover by individuals, small businesses and governments;
- whether there is a case for subsidising insurance premiums for individuals and small businesses in the areas of highest risk facing the highest premiums;
- whether there is a role for the Commonwealth Government in providing disaster insurance or reinsurance to the private sector, through mechanisms such as a national disaster insurance program, and, if so, what are the best options;
- the impact or likely impact of any Commonwealth Government intervention in disaster insurance on the private insurance market; and
- the relationship between disaster mitigation measures taken by State and local governments against flood risks, and the impact of such measures, or the lack

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27 The Hon. Bill Shorten MP, 'National Disasters Insurance Review', *Media release no. 39*, 3 March 2011.

of them, on the availability and affordability of flood and other disaster insurance.[28]

3.35 The panel has also been asked to examine the likely impacts of intervention on the private insurance market and whether a relationship exists between disaster mitigation measures and the availability and affordability of insurance. Specifically, the terms of reference ask the panel to consider whether the existing Commonwealth and state arrangements for dealing with natural disaster recovery and resilience should be supplemented by the establishment of a natural disaster fund to support the rebuilding of public infrastructure in the aftermath of events such as the recent floods.[29]

Concluding comment

3.36 The committee welcomes the government's announcement that the current NDRRA will be reviewed with a view to tightening eligibility for Commonwealth payments. The committee notes that the financial incentives in these arrangements will now be tied more closely to compliance of each State and Territory with adequate insurance provisions.

3.37 The committee also believes the Natural Disasters Insurance Review is timely. It is particularly interested in the capacity of the private insurance market to offer a cost-effective and comprehensive reinsurance program for the states' and territories' assets.

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28 The Hon. Bill Shorten, 'National Disasters Insurance Review', *Media release no. 39*, 3 March 2011, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/039.htm&pageID=003&min=brs&Year=&DocType= (accessed 10 May 2011).

29 Natural Disasters Insurance Review, *Terms of Reference*, http://www.treasurer.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/039/039.pdf (accessed 23 June 2011).

Chapter 4

Views on Queensland's insurance arrangements

4.1 This chapter looks at the views of the Commonwealth Treasury, the Queensland Treasury and the Insurance Council of Australia on the adequacy of Queensland's current insurance arrangements. It concludes by noting the Queensland state government's plans to reinsure its assets through the international market.

Treasury's view of Queensland's insurance arrangements

4.2 In February 2011, the House of Representative Economics Committee took evidence from Treasury on the flood levy bills.[1] Treasury was asked whether it would have been less expensive for the Commonwealth had the Queensland Government insured its public infrastructure. It responded:

> ...the better question is: would it be more expensive for the economy and for the population at large if different insurance arrangements had been in place in Queensland? I do not think that any of us know the answer to that question, because we do not know how expensive those insurance arrangements would have been and therefore the impost on Queensland taxpayers.[2]

4.3 In evidence to this inquiry, Treasury indicated that Queensland has a higher risk profile than the other states. It noted that:

> The history of payments under the NDRRA to the various states and territories would suggest that there are substantially different risk profiles among the states. Queensland has gotten the larger share of money under the NDRRA...[T]he history of the NDRRA suggests that roads are the cause of most damage, events like floods are much more damaging to roads than fires and even cyclones, and those sort of things, which may suggest that Queensland has a different risk profile than other states.[3]

The Queensland Government's view

4.4 As chapter 1 noted, the committee received a considerable amount of material from the Queensland Government relating to its insurance arrangements. Accompanying these documents was a cover letter from the Queensland Minister for

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1 Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011

2 Mr Nigel Ray, Executive Director, Fiscal Group, Department of the Treasury, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 9.

3 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 7.

Finance, the Hon. Rachel Nolan MP. In her letter, the Minister made the following points:

- the documents do not show that the Queensland Government was offered natural disaster reinsurance including roads for $50 million a year;
- the Commonwealth Government has never asked the State to seek external insurance;
- the Commonwealth has not previously requested a local government to adopt external insurance, despite local governments also relying on NDRRA cost sharing arrangements;
- the Commonwealth Government does not have external insurance for its 75 per cent liability under NDRRA arrangements; and
- on 21 February 2011, the Queensland Government announced that it would again go to the international market for quotes to reinsure state assets.[4]

4.5 In 2004, the Queensland Government sought a quote on reinsuring the QGIF from the international insurance market. This exercise was conducted by Queensland Treasury through its insurance advisors Aon. The terms on which insurance was available at the time was for the property of the state, excluding its roads. Insurance of up to $500 million in damages was available, with a $20 million excess payable on each event for a $6.4 million premium.[5]

4.6 However, Minister Nolan notes in a letter to the committee that these property assets account for only $150 million of the $5.8 billion estimated in costs from the recent natural disasters in Queensland. Accordingly, the Minister argues that it does not follow that an external insurance policy would have prevented the billions of dollars in costs now being borne by the state and federal governments. [6]

4.7 During the House of Representatives committee hearing, the Queensland Under Treasurer, Mr Gerard Bradley, was asked why the state government did not have insurance for Cape York. He noted that the state government had considered buying reinsurance from the QGIF but it considered that the offer did not represent value for money for the state. He added:

> We sought reinsurance advice from our broking advisers and we did take that to the international insurance industry. But the costing of that and the risk provisions that they proposed did not represent value for money for the

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4 The Hon. Rachel Nolan, Queensland Minister for Finance and the Arts, *Letter to the committee,* 18 April 2011, p. 2.

5 The Hon. Rachel Nolan, *Letter to the committee*, 18 April 2011, p. 2.

6 The Hon. Rachel Nolan, *Letter to the committee*, 18 April 2011, p. 2.

> state in terms of the deductions for events and the exposures they were willing to cover. They did not, for example, cover natural disaster.[7]

4.8 However, the Queensland Under Treasurer told the committee that the state government did not seek a premium in relation to natural disaster events. He added that other considerations need to be taken into account such as the total risk sharing arrangements. Moreover, he argued that the nature of Queensland's assets—such as road infrastructure—is different and the incidence of natural disasters is more frequent than in other states.[8]

4.9 Mr Bradley was asked why the Queensland Government had not sought insurance given the greater frequency of natural disaster events in the state. He responded that the sharing arrangements between the Commonwealth and the States have worked well over a long period of time.[9] He explained that the precise ratio of Commonwealth to state contribution varies from year to year and that thresholds apply to how the events are shared.

4.10 The Queensland Under Treasurer told the House committee that the Queensland Government does have in place 'appropriate insurance' through its captive insurer. He also observed that there are insurances in place for certain assets that have been impacted by the floods that do not qualify for NDRRA arrangements.[10]

4.11 It was also clarified that Queensland's captive insurer only covers government budget funded agencies, so outside of that each of their public utilities and commercial entities would make their own decisions in relation to the insurance arrangements they would put in place and many of them would seek external insurance to cover events. Mr Bradley gave the example of Stadiums Queensland which has insurance that covers the damage to Suncorp Stadium and to the tennis centre. Another example is Queensland Motorways, which has insurance coverage for the Gateway Bridge in Brisbane.[11]

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7 Mr Bradley, Queensland Under Treasurer, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 20.

8 Mr Bradley, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 23.

9 Mr Bradley, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 24.

10 Mr Bradley, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 20.

11 Mr Bradley, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 20.

Roads

4.12 A key issue for the committee's questioning on Queensland's insurance arrangements was why the state does not have a reinsurance policy for its extensive road network. The Queensland Under Treasurer has noted that 80 per cent of the cost of the Queensland floods relates to roads.[12] Any damage to Queensland's roads in a natural disaster is covered by the NDRRA.[13]

4.13 The Queensland Government has stated to both this inquiry and the House of Representatives committee inquiry that when it sought a reinsurance quote in 2004, this did not include cover for its roads. Mr Neil Singleton, the Queensland Government's Insurance Commissioner, was specifically asked whether the state sought a quote for roads. He responded:

> Since the formation of QGIF [in 2001] and prior I do not believe there has ever been a focus on insuring the road network. From an insurance perspective, it is regarded as a complex issue to insure. The focus has been on the main property and liability program rather than on roads per se.
>
> ...
>
> The proposal that was put forward was a property insurance program, excluding roads. The decisions taken were on that particular program, but the program was never intended to cover the full road network and no quotes were prepared and no information was gathered for the roads; it was only for the property that that program was costed.[14]

4.14 Mr Singleton told the committee that an exercise is currently being undertaken by the State Department of Transport and Main Roads to calculate the value of Queensland's 33 000 kilometres of road system.[15] He noted that this exercise is being conducted with a view to seeking insurance from the market.

The Insurance Council's view

4.15 During the House of Representatives committee hearing in February, the Insurance Council of Australia was asked for its view on the Queensland Government's decision not to take out a reinsurance policy for its public assets. Mr Karl Sullivan of the Council told the committee:

> ...to draw a parallel, if we created a situation in the private market where it became apparent that you did not need to insure your property and your

12 Mr Gerard Bradley, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 20.

13 Mr Neil Singleton, Queensland Insurance Commissioner, *Proof Committee Hansard*, 13 May 2011, p. 38.

14 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, pp 33–34.

15 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, p. 40.

> assets because there would essentially be a community bailout if a situation occurred then that would not be a positive outcome for Australia. You have to go into the economics and the feasibility of that type of cover.[16]

4.16 Mr Sullivan also suggested that there are insurance products available that would cover the public costs currently faced by the state of Queensland:

> There are examples internationally in far more disaster prone areas—for example, in parts of the Caribbean and in Alabama in the US—where they have taken out these products to fund their own recovery efforts. In many cases those would not fund 100 per cent of a recovery effort. That would be a matter of how much appetite for risk the state has, how much they want to push out to global reinsurers. There are certainly products available. They are highly configurable, and you can accept as much or as little of the risk as you like.[17]

4.17 The Insurance Council was asked: 'Is this basically an issue where, because the Commonwealth is picking up the tab, the state government has not bothered purchasing the product?' Mr Sullivan responded:

> In some respects you could argue that the arrangements under which that is done is an insurance policy for individual states. Our position is that perhaps this presents an opportunity to look for a better mix that encourages state governments to rely less on other governments and less on the particular arrangements.[18]

Queensland's current approach to the market

4.18 On 21 February 2011, the Queensland Treasurer, the Hon. Andrew Fraser MP and the Queensland Minister for Finance, the Hon. Rachel Nolan MP, announced that the Government would go to the international market for quotes to reinsure Queensland's state assets. In her letter to the committee, Minister Nolan stated that as part of these efforts, the Queensland Government has engaged advisors Aon to conduct an 'international market sounding exercise' and has budgeted up to $1 million for the task. The Minister anticipates the exercise will be complete in time to meet the Commonwealth's September request.[19]

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16 Mr Karl Sullivan, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 49.

17 Mr Karl Sullivan, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 49.

18 Mr Karl Sullivan, *Proof Committee Hansard*, House of Representatives Standing Committee on Economics, 16 February 2011, p. 47.

19 The Hon. Andrew Fraser MP and the Hon. Rachel Nolan MP, 'Statement on reinsurance', *Ministerial Media Statements*, 21 February 2011 http://www.cabinet.qld.gov.au/mms/StatementDisplaySingle.aspx?id=73685 (accessed 10 May 2011).

4.19 These plans were explained to the committee in more detail by the Queensland Insurance Commissioner, Mr Neil Singleton. He noted that his current priority with the QGIF is to:

> ...prepare our reinsurance program and gain Treasury and Queensland government endorsement for program options and then work with our insurance advisers on how best to promote the program to the reinsurance market in order to get the most cost-effective insurance solution. The program will cover property, which is buildings and the like; casualty or public liability; and roads. We have distinguished roads from other property assets, given the very different nature of the risk and our desire to avoid complicating the placement of the property program itself.
>
> We have recently completed data capture and will shortly complete the data analysis phase of our project and, over coming weeks, we have workshops which will focus heavily on insurance for our road network and which will also confirm the risk tolerance and liability limits which effectively will determine the range of policy coverages for which we will seek indicative pricing from the market. If cost-effective solutions are available, our intention is to have the program implemented in September this year. Our plan is to visit overseas reinsurers in July and our advisers believe we will have indicative premium quotations available in August for us to make a determination. These time frames are indicative, as we cannot control how reinsurers may respond to our proposals.[20]

4.20 In their statement on 21 February 2011, Ministers Fraser and Nolan suggested there are exceptional circumstances for Queensland as it seeks reinsurance for natural disasters, including its road network:

> Getting reinsurance coverage for Queensland is an entirely different proposition than it is for any other state. Our state is prone to natural disasters, and the decentralised nature of our population means we have many government buildings and major roads spread across vast areas.[21]

Concluding comment

4.21 While these may well be exceptional circumstances, the committee strongly supports the Queensland Government's approach to the international insurance market. Given the scale of recent disasters, and the extent of Commonwealth assistance to the State, it is important that the Queensland Government gives careful consideration to the offers it receives from the market. The considerations are discussed further in the following chapter.

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20 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2001, p. 30.

21 The Hon. Andrew Fraser and the Hon. Rachel Nolan, 'Statement on reinsurance', *Ministerial Media Statements*, 21 February 2011 http://www.cabinet.qld.gov.au/mms/StatementDisplaySingle.aspx?id=73685 (accessed 10 May 2011).

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.

Minority report by Independent Senator Nick Xenophon

1.1 The natural disasters in Queensland earlier this year have brought into sharp focus both the disaster insurance arrangements of the state and territory governments and the system through which the Commonwealth directs disaster relief payments to the states. These issues were magnified given that the Queensland government is the only major state government without a reinsurance policy for its assets. As *The Australian* reported in March this year:

> Unlike NSW, Victoria, South Australia and Western Australia—whose governments pay millions of dollars in premiums a year to international insurance companies to protect their infrastructure—Queensland relies on a deal struck with the Commonwealth to pick up 75 per cent of the recovery costs after a catastrophe.[1]

1.2 Even more concerning is that the Queensland government has in the past been offered quotes to reinsure its assets, but declined. In 2000, it received an indicative quote; in 2003–04, a formal quote; and in 2009, there was a review of the state's arrangements but no approach to market. Only now, after the floods and Cyclone Yasi, has the Queensland government returned to the international reinsurance market to seek a quote.

Requests for documentation

1.3 A key aspect of this inquiry has been the committee's request that the Queensland government provide:

> ...any correspondence, and any related documents, between the Queensland Government and any insurance advisers, insurance brokers, reinsurance brokers, insurers and reinsurers in relation to providing services or insurance products, or offers or proposals of insurance or reinsurance of Queensland Government assets, from 1 January 2000.

1.4 The Queensland government has provided information to the committee in two tranches. First, it provided the committee with several hundred pages of documentation described as 'all non cabinet-in-confidence reinsurance records retained from the requested period'.[2] The Queensland Government requested that this information be kept confidential.

1.5 Within this documentation, there was an excessive amount of information on aviation reinsurance which is of little or no significance to the broader issue of the

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1 Lauren Wilson, 'State goes it alone in shunning insurance', *The Australian*, 2 March 2011.

2 The Hon. Rachel Nolan, Letter to Chair of the Senate Economics References Committee, 9 August 2011.

state's catastrophe insurance and funding arrangements. The documents did note that in 2003–2004, the Queensland government was offered a reinsurance quote. However, this was not purchased.

1.6 Second, and on request, the Queensland government provided a copy of a November 2000 International Risk Management Group (IRMG) report. IRMG was commissioned to provide a feasibility study to assist the Queensland Treasury to provide a centralised insurance scheme to provide property and liability coverage to state government departments. Again, the state government requested that this document be kept confidential. It rejected the committee's request to make the report public stating:

> [G]iven that the Queensland Government is currently out to market seeking a quote to insure its assets against future natural disasters, the IRMG report remains commercial-in-confidence and it would not be appropriate for it to be quoted in a direct manner.[3]

This is despite the report being more than a decade old and only providing indications of what insurance should have cost, rather than actual quotes.

1.7 The committee was also advised that the IRMG report had been provided "in good faith" and Minister for Finance and the Arts, the Hon. Rachel Nolan, suggested that I was "not content with 11 years worth of records".[4]

1.8 In a letter to the Chair dated 16 August 2011[5], I further contended that it seemed there were two critical documents that were missing from the material that had been provided to the Inquiry by the Queensland government.

1.9 A document prepared by risk managers for Queensland Treasury made reference to 'critical tasks requiring completion' including a 'critical task' to "Finalise Reinsurance coverage for all risks" by 31 May 2001.

1.10 Presumably there ought to be documents relating to the critical tasks referred to, as well as Minutes of meetings by the Queensland Government Insurance Fund Advisory Board in considering this.

1.11 The Chair again contacted the Queensland government to request the release of any relevant documents published during this timeframe, however was advised on 31 August 2011 by the Hon. Rachel Nolan that "there [were] no further documents relating to this request."[6] It seems extraordinary that the request for the documents

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3 The Hon. Rachel Nolan, Letter to Chair of the Senate Economics References Committee, 9 August 2011.

4 Ibid

5 Senator Nick Xenophon, Letter to Chair of the Senate Economics References Committee, 16 August 2011

6 The Hon. Rachel Nolan, Letter to Chair of the Senate Economics References Committee, 31 August 2011.

sought in 1.10 was met with this response. It may well be that the issue of what documents exist will only be satisfactorily resolved following FOI requests of the Queensland government.

1.12 I contend that the refusal of the Queensland government's to release these documents has limited the committee's abilities to exhaustively assess this issue, and one has to question the real impetus behind its refusal to release information that is over ten years old and does not contain actual quotes for insurance.

1.13 I remain of the belief that in 2000, the Queensland government was offered natural disaster insurance that included roads for a premium of less than $50 million. It is disappointing that the Queensland government has not been forthcoming with this information. Had the Queensland government acted prudentially and reasonably at the time, there would not have been the need for significant Natural Disaster Relief and Recovery Arrangements (NDRRA) payments that taxpayers now face.

The 2003–2004 reinsurance quote

1.14 As noted above, the Queensland government received a reinsurance quote in 2003–2004. The Minister for Finance and the Arts, the Hon. Rachel Nolan, described this policy as the equivalent of an offer to insure a $500 000 house for $6400 per year, with no claim being possible without a $20 000 excess.[7] However, private insurers and other state governments have been able to purchase reinsurance of $3 to $5 billion. Further, the $20 million excess is not significant because this is typically what a private property insurance fund would meet from its reserves, with claims above this amount being met by the reinsurers.

1.15 The key question, however, is whether the Queensland government could afford *not* to have reinsurance. In the absence of its own reinsurance scheme, the state government has for many years relied on the NDRRA. All other states and territories have their own reinsurance arrangements. I would argue that one $500 million uninsured catastrophe represents 78 years of insurance premiums at 6.4 million per annum and peace of mind.

The NDRRA

1.16 I contend that the Queensland government's rejection of several reinsurance offers over more than a decade reflects the 'moral hazard' problem identified in the majority report. The Queensland government has had no incentive to insure its assets adequately given the generosity of Commonwealth payments under the NDRRA. However, a key principle of the comprehensively re-drafted 2011 NDRRA (as a consequence of negotiations I had with the Commonwealth government) is that it

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7 The Hon. Rachel Nolan, Letter to Chair of the Senate Economics References Committee, 18 April 2011.

should not supplant the states' own reinsurance. If it can be shown that the Queensland government did not adequately insure on the basis of reliance on the NDRRA, then it could be in contravention of the NDRRA guidelines for funding. The 2011 NDRRA guidelines have an extensive framework of transparency and accountability that was lacking in the 2007 guidelines.[8]

1.17 In the absence of reinsurance, it appears that the Queensland Government Insurance Fund (QGIF) had negligible net reserves to meet any significant new claims such as those that arose during the 2011 disasters. This is after allowing for QGIF's current fund reserves, which essentially only covered its current outstanding liabilities prior to the 2011 disasters. Even if the Queensland government was relying on 75 per cent assistance from the NDRRA, the remaining $2 billion it requires to self fund cannot be sourced from its own self-insurance fund given that it has negligible reserves.

1.18 Again, the question must be asked: Why is Queensland the only major state government without reinsurance as its own self insurance fund is clearly underfunded and unable to pay any major disaster claims from its own reserves.

Current inquiries and future arrangements

1.19 The majority report noted that the current Natural Disasters Insurance Review, headed by Mr John Trowbridge. This is an important review into matters including, but not restricted to, the NDRRA. In terms of the NDRRA, the Review's Issues Paper noted that:

> ...the existence of a self-insured fund or captive insurer into which premiums are paid each year represents a level of pre-funding for claims or losses, including losses from natural disasters. Reinsurance taken out by those funds is similarly a form of pre-funding. On this basis, NDRRA recoveries calculated net of reinsurance recoveries can be thought of as a penalty on those States that choose to take out insurance for large losses.[9]

The Review is correct to question whether there are benefits to the States in equity and effectiveness if the NDRRA funding formula were to apply to expenditure gross of reinsurance recoveries rather than net of reinsurance recoveries.

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8 The 2007 NDRRA Determination can be found here: http://www.ag.gov.au/www/emaweb/rwpattach.nsf/VAP/(084A3429FD57AC0744737F8EA134BACB)~NDRRA+Determination+2007.pdf/$file/NDRRA+Determination+2007.pdf The 2011 NDRRA Determination can be found at: http://www.ema.gov.au/www/emaweb/rwpattach.nsf/VAP/(689F2CCBD6DC263C912FB74B15BE8285)~NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf/$file/NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf

9 Natural Disasters Insurance Review, *Issues Paper*, June 2011, p. 65.

1.20 Further, as the majority report notes, there does need to be some definition of the term 'cost-effective' in the context of the states' insurance policies and NDRRA payments. I agree with the majority report that a common understanding of the term 'cost effective' 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.

The current approach to the market

1.21 Queensland's current approach to the international insurance market must seek a quote to reinsure the state's road network. The Queensland Government's claim that in 2004 it could not secure a reinsurance policy for its extensive road network is questionable. Reinsurance for road infrastructure is available on the international market and should be seriously considered by the Queensland government.

1.22 Moreover, it is important that the Queensland government's quote is properly scrutinised by the Commonwealth government. Australian taxpayers will significantly subsidise the rebuilding of Queensland's public infrastructure through the NDRRA. The quantum of this subsidy can be attributed not only to the scale of the natural disaster but to the state government's failure to reinsure its assets. On this basis, it is critical to protect the integrity of the NDRRA that the states and territories adopt standardised and transparent reporting of their insurance arrangements.

Senator Nick Xenophon
Senator for South Australia

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Commonwealth Grants Commission
2	Rachel Carter
3	Name Withheld
4	Stable Population Party of Australia
5	Sheila Newman

Additional Information Received

- Received from VMIA Risk Management and Insurance on 16 June 2011; answers to Questions on Notice taken at a public hearing in Canberra on 13 May 2011.
- Received from the Treasury on 19 July 2011; answers to Questions on Notice taken at a public hearing in Canberra on 13 May 2011.
- Correspondence received from Mr John Trowbridge: Natural Disaster Insurance Review.
- Letter from the Committee Chair Senator Alan Eggleston to AON Corporation Australia Limited, regarding the Committee's request for AON's documents.
- Letter from the Hon Rachel Nolan MP, Minister for Finance and the Arts, to the Committee Chair Senator Alan Eggleston, received on 18 April 2011 regarding the Natural Disaster Relief and Recovery Arrangements (NDRRA).
- Letter from the Committee Chair Senator Alan Eggleston to AON Corporation Australia Ltd requesting information relevant to the inquiry.

APPENDIX 2

Public Hearing and Witnesses

CANBERRA, 13 MAY 2011

CARTER, Miss Rachel Anne, Private Capacity

DONALDSON, Mr Paul Raymond, General Manager,
Queensland Government Insurance Fund, Queensland Treasury

KAUR, Ms Kanwaljit, Manager,
Insurance Markets Unit, Financial System Division, Treasury

MARSHALL, Mr Stephen Joseph (Steve), Chief Executive Officer,
Victorian Managed Insurance Authority

SINGLETON, Mr Neil, Insurance Commissioner, Queensland government

SPASOJEVIC, Mr John, Secretary, Commonwealth Grants Commission

WHITE, Mr Damien William, Principal Adviser, Social Policy Division, Treasury

WILLCOCK, Mr Michael, General Manager,
Personal and Retirement Income Division, Treasury