NIBA
National Insurance Brokers Association.

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Treasury

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NIBA Submission: Exposure draft legislation: cyclone and related flood damage reinsurance pool

The National Insurance Brokers Association **(NIBA)** welcomes the opportunity to provide feedback on the draft legislation for the cyclone and related flood damage reinsurance pool (the reinsurance pool).

As the peak representative body for the intermediated insurance industry, NIBA represents more than 15,000 brokers all around Australia. Our members include major international broking firms, large Australian-owned firms and over 400 medium and small insurance broking firms operating in the cities, towns and regions across the length and breadth of Australia.

Insurance brokers perform a number of valuable services for their clients including;

• Helping clients to understand, manage and minimise their risk exposure.

• Identifying and arranging appropriate insurance or other risk financing mechanisms.

• Acting as the client's advocate when an insured event occurs.

In performing these duties, insurance brokers act as agents of their client and have statutory, common law and professional obligations to act in the best interests of their client at all times.

Insurance brokers represent the interests of the purchasers of insurance, the policy- holders, and not those of insurance companies. Consequently, comments made by NIBA and its members are made on behalf of its members and the public that purchases insurance not on behalf of insurance companies.

While we commend the Federal government for their efforts to address the availability and affordability of insurance in Northern Australia NIBA has identified a number of areas where changes are required in order for the reinsurance pool to deliver the promised benefits to consumers and businesses. NIBA's concerns and recommendations are set out below.

Insurer requirements

The draft legislation requires general insurers who undertake liability, under pool insurance contracts, **in respect of eligible cyclone losses** to maintain contracts of reinsurance with the Australian Reinsurance Pool Corporation (the Corporation).

Based on the current wording, insurers who write other risks in Northern Australia but do no write cyclone risks, or who have ceased writing such risks by the date they are required to join the pool are not required to participate.

Despite the Northern Australia Insurance Inquiry finding that there were not significant insurance availability issues in northern Australia[1], feedback from our members, who engage with this market on a daily basis, have indicated that there are very few insurers willing to write cover for cyclone exposed risks. Of those that still write cyclone risks, a number have placed embargoes on new risks.

NIBA notes that there is nothing preventing these insurers from gradually declining to renew existing cyclone exposed risks until eventually they are no longer required to participate. In NIBA's view this directly contradicts the pools' aim to increase insurer participation and competition in the Northern Australian market. NIBA recommends that Treasury consider a notification obligation on insurers regarding the risk as was done in relation to flood damage.

NIBA also notes, that the legislation does not contain provisions to allow insurers to not participate in the reinsurance pool if they can source reinsurance at a lower price from within the market. While NIBA understands that the pricing model for the reinsurance pool is yet to be released, care needs to be taken to ensure that consumers are not negatively impacted by their insurer being forced to purchase reinsurance at a higher rate than is currently available within the market.

Lloyd's

Under the current legislation only general insurers, as defined by the *Insurance Act 1973* are required to participate in the reinsurance pool. Unauthorised foreign insurers exempt under the Insurance Act and Lloyd's syndicates which do not satisfy the definition of a "general insurer" are not caught.

Subsequent sections of the legislation[2] appear to indicate the intention that excluded insurers can voluntarily participate in the Pool, provided they purchase contracts of reinsurance for all eligible cyclone-exposed risk.

However, this intention is not supported by the legislation, as the legislation continues to refer to "general insurers". There appears to be no provision to allow Lloyd's underwriters to voluntarily purchase reinsurance from the Corporation. As a specialised market with

[1] Northern Australia Insurance Inquiry: Final Report (2020), Australian Competition and Consumer Commission, p.146.
[2] s8A(5), 8A(6), 8A(7) and 8A(8).

centuries of underwriting experience Lloyd's syndicates provide valuable security for small businesses in Northern Australia.

NIBA recommends that the draft legislation be amended to explicitly provide for Lloyd's syndicates to participate in the reinsurance pool. This will also increase the number of participants, further spreading the burden of risk.

NIBA recommends that changes be made to the to the draft legislation writeback provisions in s8A(8) which refers to "general insurer" to make sure the law reflects policy.

Who's left behind?

While the reinsurance pool has the potential to provide relief to some policyholders, a number of properties are excluded in the regulations. These properties include Mixed-use Strata and Aged and Residential Care homes.

Mixed-use Strata

Currently, mixed-use strata and community title properties are excluded from the reinsurance pool if more than 20% of the total floor space is used for commercial purposes. For the purposes of the legislation, short-term accommodation is considered a commercial use. Under the definition of the legislation, those who live in a building where 21% of the floor space is used for short-term holiday rentals would be ineligible for the pool. This unfairly penalises those for whom a mixed-use Strata building is their principal place of residence.

Under Queensland Strata regulations, body corporates may adjust the contributions payable by lot owners in a way that in a way that reflects the proportion of the total risks covered by the policy attributable to activities carried on the owner's lot.[3] This means that lot owners who use their premises for commercial uses (including holiday lettings) could be required to contribute the difference between the existing premium and the premium if the building were eligible for the reinsurance pool.

NIBA also notes there are provisions within the draft legislation for commercial buildings with a sum insured of more than $5 million, however similar provisions do not exist for commercial strata buildings.

NIBA supports data being collected on an ongoing basis to test whether the eligibility criteria can be broadened over time depending on the performance of the scheme.

Aged and Residential Care

Under the current legislation Aged Care and Residential Care homes are considered commercial properties, despite them being the primary place of residence for those who require care. This means that properties will only be eligible if they have a sum-insured less than $5 million.

[3] s201 *Body Corporate and Community Management (Accommodation Module) Regulation 2020.*

Many of these facilities are run by not-for-profit and community-based organisations, where increases in operating costs have a significant impact on the number and/or quality of services they provide. Excluding these properties would likely increase the cost of care for residents.

To address this issue, NIBA recommends that aged care and residential care properties be classified as residential properties for the purposes of the reinsurance pool, removing the sum-insured value test.

Mitigation

NIBA notes that the reinsurance pool is only part of the solution. Risk mitigation by customers and Government public infrastructure reforms are likely to be the most effective way to reduce premiums rather than direct government intervention in the market for reinsurance, where reinsurance does not make up a significant portion of premiums.

Natural disaster mitigation has many benefits; improved community safety and resilience, a reduction in property damage, faster recovery, and reduction in the economic impact of natural disasters.

There are a diverse array of mitigation measures. These may be carried out by the state and its agencies (public mitigation works), or the property owner (private mitigation works).

Public mitigation

Public mitigation options may include both structural and non-structural measures, for example; increasing building standards, land-use planning, hazard reduction and flood levees.

Following consecutive large flooding events in the Queensland town of Roma in 2010, 2011, 2012 local, State and Federal governments jointly funded a series of flood mitigation works including the construction of a diversion drain and a town levee. Following the completion of these works property insurance premiums were reduced by an average of 45%[4].

Private mitigation

Building science research consistently shows that losses caused by severe wind events can be minimised if appropriate mitigation activities are employed[5], however, such works are not widely implemented. Cyclone mitigation works vary significantly by the age, location and structure of the property but may include;

- increasing the wind uplift resistance of the premises
- sealing the building envelope from water ingress
- securing items outside the house that are susceptible to wind uplift (e.g., outdoor furniture).

[4] https://insurancenews.com.au/daily/roma-gets-a-flood-risk-tick-after-mitigation-works

[5] Improving the resilience of existing housing to severe wind events: Annual project report 2014-2015 Smith, Henderson & Ginger et al.

From 2007-2009 the Florida Department of Financial Services administered the 'My Safe Florida Home' program. The program offered homeowners free assessments of their home for structural vulnerabilities and allowed them to apply for a $5000 grant to retrofit their homes.

Participating homeowners were provided with a report that outlined the findings of the assessment, including necessary structural improvements, the costs of such works and the associated reduction in insurance premiums if the improvements were completed.

Over a three-year period 401,372 home inspections were carried out and more than $80 million in mitigation grants was distributed. An evaluation of the program estimated that the 100-year probable maximum loss (PML) had reduced by at least $1.50 per dollar invested.[6]

Delivering Benefits

NIBA has previously raised concerns about the actual savings that will be delivered by the reinsurance pool. Reinsurance makes up a very small portion of total premiums, with the largest portion being the underlying risk due to more frequent and severe natural disasters.

Whilst savings as high as 50% have been touted by government, NIBA estimates that the real saving that will be delivered to policyholders is more in the range of 10-15%. While this saving may provide reprieve to some consumers for many, the saving delivered will not be sufficient to keep businesses open and family homes insured. NIBA looks forward to reviewing the proposed pricing and reinsurance premium models when they are released, to ensure they deliver material savings to policyholders in Northern Australia.

Flooding Subsequent to Cyclone

In many coastal areas Cyclones are followed by an extensive rain depression, eventually leading to flooding. This is especially true for coastal towns that are also situated along a river, for example Townsville.

Under the proposed legislation, the ARPC will be responsible for declaring when a Cyclone has begun and finished (based on Bureau of Meteorology advice). Once the ARPC has declared that the Cyclone has ended, a 'damage period' will then apply to account for flooding and other damage caused by the rain depression. The draft regulations, currently provide for a 48hour damage period, after such time any damage to properties will not be covered by the reinsurance pool.

However, this period fails to take into consideration the extensive damage caused to other parts of Northern Australia by ex-Cyclones as they move across the country. A large number of towns and regional centres are not affected by cyclones but are impacted by flooding once the cyclone turns into a tropical low.

Many properties in these areas face increasingly high premiums as a result of flood risk, however the reinsurance pool is unlikely to provide any relief for those who reside in these

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6 https://knowledge.aidr.org.au/resources/ajem-jul-2016-towards-effective-mitigation-strategies-for-severe-wind-events/

areas, as the flooding does not usually occur until after the proposed 'damage period' has finished.

NIBA recommends that the proposed damage period be extended to account for cyclone-related flooding. Alternatively, as the ex-cyclone/tropical low moves inland, a new damage period should commence for each affected area.

While NIBA supports the Federal government in their attempts to address the availability and affordability issues currently affecting Northern Australia, NIBA does not believe that the draft legislation in its current form will achieve a suitable outcome for consumers. It is critical that issues around requirements for insurer participation, mixed-use Strata and Aged care properties and cyclone-related flooding are addressed prior to the Bill being introduced.

NIBA welcomes further consultation with Treasury should you require clarification any issues raised in this submission.

Yours faithfully,

Philp Kewin

Chief Executive Officer

National Insurance Brokers Association