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Dear Ms Danos

ACCC NORTHERN AUSTRALIA INSURANCE INQUIRY – SUBMISSION TO SECOND UPDATE REPORT

Suncorp Group Limited (Suncorp) welcomes the opportunity to provide a submission to the second update report (the Report) of the Australian Competition and Consumer Commission's (ACCC) Northern Australia Insurance Inquiry.

Suncorp has previously provided extensive feedback on the 28 now finalised recommendations contained in the Report in our submission dated 12 April 2019. This response addresses the ACCC's current investigations in to *Focus Area 1: Measures to improve affordability and availability*.

As the largest supplier of home and contents insurance in northern Australia, Suncorp has seen first-hand the devastating impacts of cyclones and floods on our customers and their communities on countless occasions. It also means we have extensive insights into the issues impacting the supply of insurance in the region, as well as how government and insurers can work together to sustainably improve the affordability of insurance across northern Australia.

Executive summary

We maintain that government becoming an underwriter for home and contents insurance in the region is poor policy and unfairly burdens taxpayers who ultimately pay for risk that can be properly covered by the private sector.

Suncorp does not believe government intervention in the home and contents insurance market in northern Australia via a reinsurance pool, insurance mutual, or direct subsidy will deliver a sustainable reduction in premiums. Intervention has already been examined on numerous occasions over the past 40 years, and we believe these existing studies and their findings are still valid and important reference points for the ACCC's current inquiry. These investigations include the Northern Australia Insurance Premiums (NAIP) Taskforce, as well as the Productivity Commission's examination of natural disaster funding arrangements.

As the ACCC flagged in the Report, there are significant risks associated with market intervention against which any benefit, specifically premium reductions, must be evaluated. These issues arise when the insurance price signal is diluted, inefficiencies in the market are created, and poor outcomes are delivered to consumers. Examples of the negative effects of these risks can be seen in overseas markets, including the United States

(US) and United Kingdom (UK). The mistakes in the design and operation of these schemes must not be repeated in northern Australia.

The primary objective of government action should be to achieve long-term, positive impacts on insurance premiums. As a result, any action must address the main driver of high home and contents insurance premiums in the region – the physical impact on homes due to the increasing severity of natural disasters both now and in a changing climate.

Building greater resilience through improved building standards, limiting the construction of new homes in floodplains and building flood levees where necessary, as well as cyclone resilience measures like window shutters, reinforcing garage doors, and re-roofing non-cyclone rated homes, will go a long way to reduce the physical impacts of increasing natural hazard risk. This will ultimately result in more affordable insurance.

Key findings from previous inquiries and investigations

Whenever the insurance market in northern Australia has been examined, governments have always determined that market intervention is the wrong way to reduce premiums.

This can be noted as far back as 1979, when then Treasurer the Hon. John Howard issued a policy paper rejecting a proposal to introduce a reinsurance pool for north Queensland, stating:

The Government is satisfied that a scheme of the kind that had been under discussion – that is, one involving the provision of Government financial backing to a ‘pool’ of insurance companies – would be inappropriate on budgetary, technical and insurance policy grounds. Beyond that, however, the Government also believes that such a scheme would be inconsistent with a basic tenet in its political philosophy – namely, that governments and government authorities should, to the maximum extent possible, seek to avoid intervention in matters that can be left to the private sector.¹

Since 2012 there have been more than 10 inquiries and investigations which have made recommendations relating to the availability, accessibility, and cost of insurance in northern Australia. Some of the key findings from these inquiries relating to market intervention include:

- In 2014, the Productivity Commission noted ‘international experience has shown that government intervention in property insurance markets through subsidies is overwhelmingly ineffective. It creates moral hazard as well as fiscal risks’.²
- The Financial System Inquiry found the issue of high insurance premiums in disaster-prone areas ‘should be primarily handled by risk mitigation efforts rather than direct government intervention, which risks distorting price signals’.³
- Treasury’s Northern Australia Insurance Premiums (NAIP) Taskforce examined in detail the feasibility of options to address insurance affordability arising from cyclone risk (including a government funded reinsurance pool and mutual) and found that ‘mitigation to reduce the risk of damage from cyclones is the only way to reduce premiums on a sustainable basis’.⁴

As the ACCC notes in the Report – government backed reinsurance pools and mutuals have previously been considered for northern Australia but not acted upon.⁵ This is because these options were found to be unviable and too costly for government. The reasons why are articulated in the final report of the NAIP Taskforce, as outlined in Example 1.

¹ The Hon John Howard, MP (1979), *Natural Disaster Insurance Policy Information Paper*, page iii

² Productivity Commission (2014), *Natural Disaster Funding Arrangements: Inquiry Report, Volume 1*, page 32

³ Treasury (2014), *Financial System Inquiry: Final Report*, page 227

⁴ Treasury (2015), *Northern Australia Insurance Premiums Taskforce: Final Report*, page xiii

⁵ ACCC (2019), *Northern Australia Insurance Inquiry: Second Update Report*, page 31

Example 1: Northern Australia Insurance Premiums Taskforce Final Report

The NAIP Taskforce Final Report considers many of the design aspects the ACCC has requested feedback on in relation to a cyclone reinsurance pool and mutual. Some of the key findings include:

- If a reinsurance pool or mutual were run along commercial lines neither option would reduce premiums.
- To achieve a 10 – 15 per cent reduction in premiums, the Government would need to provide a subsidy via the use of its balance sheet.
- If a partially government-funded scheme were to operate for 10 years, there would be up to a 20 per cent chance that it would cost the Government more than \$2 billion.
- Restricting risk to the Government balance sheet via capping claims payments would ‘limit the reduction in premiums without significantly lowering the risk faced by the Government’.
- A subsidised insurance mutual is likely to crowd out private sector cyclone cover and be difficult for the Government to exit.

Source: Treasury (2015), *Northern Australia Insurance Premiums Taskforce: Final Report*, pages x – xi

Market conditions which have led to intervention in other home insurance markets

In instances of private insurance market failure seen overseas, governments have stepped in as a matter of last recourse to ensure consumers have access to insurance coverage for their homes and possessions. Examples include the provision of flood insurance across the United States (US) and earthquake coverage in California, as well as flood insurance in the United Kingdom (UK).

A common precursor to establishing these schemes has been the availability and affordability of insurance. The California Earthquake Authority (CEA) was established following the decision by many insurers to either restrict or stop selling home and contents insurance policies in the state.⁶ In the UK, Flood Re was created in response to a market where only nine per cent of homeowners who had made previous flood claims could get a quote from two or more insurers, and premium increases of several hundred per cent were possible after a flood event.⁷

Suncorp does not believe the same acute availability issues currently exist for home and contents insurance in northern Australia. This has been confirmed by the ACCC’s investigations, which found eight insurers supply most of the home and contents insurance policies in the region.⁸ In short, there is no market failure.

Furthermore, while premiums for home and contents insurance in northern Australia are on average approximately twice the cost compared to the rest of Australia, the underlying risk of natural disasters has been found to be a key reason for this disparity.⁹ Diluting the price signal through a reinsurance pool, mutual or direct subsidy will do nothing to reduce this risk.

The risks of market intervention

Intervention poses substantial risks which any benefit, in terms of the potential for premium reductions, must be evaluated against.

Moral hazard

Instances of market intervention internationally demonstrate that, without a price signal, moral hazard¹⁰ allows risk to continue to grow. Diluting the insurance price signal and politicising insurance premiums inevitably fails, with governments effectively locked in to providing low cost insurance as risk exposure increases.

⁶ California Earthquake Authority website. Available at: <https://www.earthquakeauthority.com/About-CEA/CEA-History>

⁷ Flood Re (2018), *Transition Plan*, page 7.

Available at: https://www.floodre.co.uk/wp-content/uploads/2018/07/Flood_Transition2018_AW.pdf

⁸ ACCC (2018), *Northern Australia Insurance Inquiry: First Interim Report*, page 8

⁹ ACCC (2018), *Northern Australia Insurance Inquiry: First Interim Report*, page v

¹⁰ Moral hazard definition: Moral hazard occurs when someone increases their exposure to risk when insured, especially when a person takes more risks because someone else bears the cost of those risks (Wikipedia).

This is illustrated by the US National Flood Insurance Program (NFIP) – where coverage has increased from 1.4 million homes in 1978 to more than five million homes in 2018.¹¹ The program is currently over USD\$20 billion in debt despite the US Government forgiving debt of USD\$16 billion in 2017.¹²

Rather than encouraging better land use planning and managed retreat from high flood risk areas, the NFIP's focus on rebuilding following a flood can trap homeowners in a cycle of 'flood, rebuild, repeat'.¹³ Suncorp is aware of a property near Baton Rouge, Louisiana which has been flooded (and rebuilt) 40 times, as well as a Houston, Texas home worth USD\$72,400 which has received more than USD\$1 million in payouts from the NFIP.¹⁴

The long-term implications of policy failure surrounding flood insurance in the US is also highlighted in a recently published study of housing growth rates since 2010, which found that in one third of coastal states, homes are being built in ten-year flood zones at a faster rate than in safer locations.¹⁵ See Example 2 for the latest attempt to reinstate the price signal for flood insurance through the NFIP.

Example 2: US National Flood Insurance Program attempts to move to risk-based pricing (again)

In May 2019, the Federal Emergency Management Agency (FEMA) announced that it will redesign the risk rating for the NFIP. This change will see a move away from broad flood rate map zones to the use of current actuarial practices to set risk-based rates that better reflect a property's unique flood risk. The stated aim of this move towards risk-based pricing is to 'help customers better understand their flood risk and the importance of flood cover'. Importantly, this initiative will need to comply with existing statutory caps on premium increases to transition policyholders who will face substantial rate increases.

An earlier attempt in 2012 to increase premiums in line with flood risk to help address the long-term insolvency of the program was met with a voter backlash and the repeal of many rate increases – demonstrating the difficulty governments face in removing long-term subsidies when underlying risk remains.

Source: FEMA (2019), *Risk Rating 2.0 Overview*.

Available at: <https://www.fema.gov/media-library/resources-documents/collections/719>

The UK's Flood Re program also demonstrates the risk of creating a mechanism to address high insurance premiums in the short term, without having a comprehensive plan to address underlying risk (see Example 3).

Example 3: UK Flood Re delivers immediate premium reductions with limited control over addressing risk

Flood Re was established in 2016 to deliver affordable insurance for high flood-risk homes built before 2009. Reductions of 50 per cent or more have been achieved for most high flood-risk households covered by the scheme. Flood Re is funded in part by a levy on insurers, which allows them to cede high flood risk policies to the scheme. This levy is passed on to all home insurance policyholders in the UK.

Flood Re is not a permanent solution and will cease to operate in 2039. By this time, it is expected that home insurance will be affordable for all properties at market rates. Flood Re's transition plan highlights, that for this to occur, it will require significant investment and action from government and other industries to improve flood management and defences, as well as the resilience of the UK's housing stock. However, Flood Re has no direct levers to influence these activities and it is unclear what will happen should these improvements not be made and a move back to risk-based pricing in 2039 is not possible.

Source: *Flood Re (2018), Transition Plan*.

Available at: https://www.floodre.co.uk/wp-content/uploads/2018/07/Flood_Transition2018_AW.pdf

¹¹ FEMA, *NFIP Total policies in force by calendar year*. Available at: <https://www.fema.gov/total-policies-force-calendar-year>

¹² Federation of American Scientists (2019), *National Flood Insurance Program Borrowing Authority*.

Available at: <https://fas.org/sqp/crs/homesec/IN10784.pdf>

¹³ Natural Resources Defence Council (2017), *Seeking Higher Ground Issue Brief*, page 4.

Available at: <https://www.nrdc.org/resources/seeking-higher-ground-how-break-cycle-repeated-flooding-climate-smart-flood-insurance>

¹⁴ The Washington Post (2017), *The country's flood insurance program is sinking. Rescuing it won't be easy*.

Available at: https://www.washingtonpost.com/national/health-science/the-countrys-flood-insurance-program-is-sinking-rescuing-it-wont-be-easy/2017/07/16/dd766c44-6291-11e7-84a1-a26b75ad39fe_story.html

¹⁵ Climate Central (2019), *Ocean at the door: new homes and the rising sea*, 2019 edition, page 2.

Available at: https://centralassets.s3.amazonaws.com/pdfs/2019Zillow_report.pdf

Efficiency

Depending on how a reinsurance pool or mutual is structured, it may be an inefficient method of delivering savings.

Premium reductions under a cyclone-specific mutual or reinsurance pool can only be achieved through cross subsidisation which dilutes the price signal to consumers about their risk and the need to consider mitigation measures. While this could provide short-term premium relief, it will not reduce natural peril risk which is the only long-term solution, particularly as the climate changes.

A reinsurance pool or mutual is likely to remove risk diversification and the associated reinsurance pricing benefits, a key efficiency gain of modern insurance portfolios that diversify risk across both perils and locations. Cover for a cyclone-only pool in one region would, on a like-for-like basis, be proportionally more expensive to reinsure than a national multi-peril program. For example, in 2015 we advised the NAIP Taskforce that removing cyclone risk from Suncorp's then program and purchasing an equivalent stand-alone cover was estimated to cost 213 per cent more per dollar of capital required.¹⁶ While the average annual loss and risk exposure would appear to simply transfer between entities, the volatility risk in a single-peril scheme is much higher, driving this cost disparity. In order to deliver a reduction in premiums, a government-run pool would need to absorb this additional cost.

Introducing a reinsurance pool or mutual will also create an additional layer of expense due to the duplication of handling costs and profit margins by the insurer as well as the pool or mutual. This will increase the costs to consumers or to taxpayers.

Consumer outcomes

Separating natural hazard risk (or risks) from multi-risk insurance via a reinsurance pool or a mutual can lead to poor consumer experiences. These impacts include:

- Confusion at the time of purchase around coverage, particularly if an individual is required to take out multiple policies – increasing the possibility of consumers purchasing incorrect or inadequate cover.
- Delays and confusion in the event of a claim due to the potential gaps or overlaps between different layers of cover provided by different parties. For example, confusion around indemnity experienced after the Christchurch earthquakes delayed assessment and payment of claims, increased claims handling costs, and stymied recovery and rebuilding efforts.

Tropical Cyclone Debbie also illustrates the potential for these issues to arise in northern Australia should a single peril be carved out of multi-peril home and contents insurance policies. While Tropical Cyclone Debbie crossed the coast in north Queensland as a cyclone, it quickly turned in to an ex tropical low which caused extensive flooding claims in southeast Queensland and northern New South Wales.

Further investment in mitigation will help to sustainably reduce premiums

Suncorp has long advocated for practical measures to help better protect communities which face significant natural hazard risks.

We continue to call on governments at all levels for increased investment in mitigation to make insurance more affordable in northern Australia. Premium reductions of up to 80 per cent for high risk properties have been achieved through public flood mitigation works.¹⁷

Through our Cyclone Resilience Benefit (CRB), Suncorp is already delivering premium reductions of up to 20 per cent to more than 40,000 home insurance customers who have self reported a range of improvements which are known to make their homes more resilient to cyclones.¹⁸ An analysis of claims from Tropical Cyclone Debbie found customers who reported CRB measures and features were less likely to lodge a large insurance claim.

The benefit of mitigation also goes beyond just addressing insurance affordability – which sets mitigation apart from the other affordability and availability measures being considered by the ACCC. Mitigation not only helps to

¹⁶ Suncorp and Aon Benfield modelling

¹⁷ Suncorp Insurance Media Release: *Suncorp starts writing new business as Roma levee kicks off*. Available [here](#)

¹⁸ Suncorp Media Release: *North Queenslanders save hundreds a year on home insurance*. Available [here](#)

drive down insurance costs for homeowners, it also contributes to regional development by fostering innovation and job creation. A recent analysis of economic activity after natural disasters found insurance is the key determiner of economic recovery, and that community resilience plays a role in the speed of this recovery (see Appendix A).

While Suncorp is pleased to see an increase in government support for mitigation measures more recently, current investment is still significantly below the Productivity Commission's recommendation that Federal Government mitigation funding should be increased to \$200 million per year (and be matched by the states).¹⁹

As an alternative to direct government funding, there is an opportunity to utilise the Northern Australia Infrastructure Facility to provide concessional loans for both public mitigation works as well as household-level upgrades. Such a household-focused program will help overcome the financial barriers to widespread investment in mitigation measures, such as roof upgrades, as demonstrated through the Queensland Government's Household Resilience Program which was fully subscribed in nine months. Suncorp understands in north Queensland alone there could be approximately 100,000 homes that may not meet current wind load codes for roofs and other building features.²⁰ These homes remain vulnerable to suffering major damage in the next cyclone and as an insurer we must price for this risk.

Investment in public and private mitigation measures must be targeted to the regions and suburbs in northern Australia with the highest exposure to natural perils. These properties face the highest insurance premiums and stand to receive the largest reductions should their risk be reduced. Suncorp continues to work with governments at all levels to assist with this analysis and is willing to lend our support to funding applications for mitigation initiatives that will help deliver sustainable premium reductions for communities in northern Australia.

Conclusion

Government-backed intervention in the northern Australia home and contents insurance market, through a reinsurance pool or insurance mutual has been investigated extensively and found to be unviable and too costly.

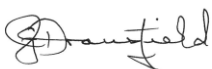
Suncorp does not believe there is currently an acute accessibility issue for home and contents insurance in the region. As a result, the only sustainable way to address affordability is to invest in building more resilient communities.

Intervention will not only expose the taxpayer to significant ongoing financial risk – it also risks diluting the insurance price signal, creating inefficiencies in the market, delivering poor outcomes for consumers, and most importantly does nothing to protect homes and possessions from natural disasters.

The key criteria by which any measure is evaluated should be the sustainable reduction of insurance premiums. We believe this can be best achieved through greater investment by governments in public and private mitigation efforts and all home and contents insurers operating in northern Australia should recognise mitigation through reduced premiums. Previous investigations have drawn the same conclusion.

Suncorp is committed to working constructively with the ACCC's ongoing examination of insurance in northern Australia. If you wish to discuss any of the points raised in this submission, please contact Joshua Cooney, Acting Executive Manager Government, Industry and Public Policy on 0477 391 260 or at joshua.cooney@suncorp.com.au.

Yours sincerely



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¹⁹ Productivity Commission (2014), *Natural Disaster Funding Arrangements: Inquiry Report, Volume 1*, page 2

²⁰ Suncorp (2015), *Build to Last Report*, page 4. Available [here](#)

Appendix A

SGS Economics and Planning (2019), Economic Recovery After Disaster Strikes: A Report for Suncorp

Available [here](#)

