17 December 2021

The Manager
Cyclone Reinsurance Pool Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

Email: ReinsurancePool@treasury.gov.au

Dear Sir/Madam,

Response to the Exposure Draft Legislation – cyclones and related flood damage reinsurance pool

The Actuaries Institute ('the Institute') is the sole professional body for actuaries in Australia. The Institute is committed to promoting and maintaining a high standard of actuarial practice and contributing to public policy through submissions, thought leadership and expert analysis.

The Institute provides commentary on public policy issues where there is uncertainty of future financial outcomes. It strives to act in the public interest and our contributions to public policy issues are guided by the principles of transparency, a 'level playing field' and good regulation (proportional and the most appropriate regulatory tool/s).

General comments

This response to the 'Exposure draft legislation – cyclone and related flood damage reinsurance pool' draws on the context provided in the Institute's 18 June 2021 submission on the initial consultation. Many of the points raised in that submission remain valid.

For this response, the Institute's comments are confined to the following areas:

- Technical clarification of the Event Definition;
- Transparency and disclosure of data and the pricing framework; and
- Other risk control measures.

Technical Clarification of the Event Definition

The draft legislation sets out clearly the definition of an event, based on Bureau of Meteorology (BoM) measures, including when an event is classed as a Cyclone, and when the event finishes. It also defines the claim period, based on date and time, to identify claims which will be covered under the pool. However, we highlight some differences to current market practice.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street, Sydney NSW 2000, Australia
t +61 (0) 2 9239 6100 **f** +61 (0) 2 9239 6170
actuaries@actuaries.asn.au | www.actuaries.asn.au

- The time a claim occurs is not generally collected. It can be difficult to determine the actual time, for example if the home occupier is not on the premises at the time of the loss.
- Claims may occur outside of the strict claim period, for example in the lead up the cyclone forming, and from the after-effects of the cyclone, such as flooding.
- Events can also be defined by location, typically an event is defined by the industry as originating from a weather system, and so may capture a broader range of claims by time and location than the BoM definition. This narrower definition for coverage may lead to overall premium savings being lower than sought by the Government as significant weather-related losses from downgraded cyclonic weather systems can still be material.
  - A good example is during Cyclone Yasi the commercial reinsurance market responded to some of the storm/flood losses as geographically remote as locations in Melbourne and Sydney as part of the cyclone event, on the basis that the storms were caused by the same meteorological event of the cyclone. This might bring ambiguity over each cyclone event, whether some of the physically distant rain/storm losses are part of the cyclone loss or not.
- The industry and reinsurance contracts typically use an 'hours clause' to address these types of issues, where an event is defined to extend for example 72 hours after the first loss defined under the event.

These issues may impact the cost of administering the pool, require additional data collection, as well as additional complexity in assessing the claim and potential delays to claim settlement. The Institute suggests it might be helpful to draw on past events to understand how the pool definitions will apply in practice and resolve issues related to claims which may fall outside the draft pool definitions.

Transparency and disclosure of data and the pricing framework

The Institute understands that the ARPC will be implementing a more granular pricing schedule than the current terrorism (three) tiers. We offer our support as Treasury continues to define a pricing basis, and make the following general points for consideration.

- We commend the intended aim to reduce cyclone and related flood costs for those communities experiencing high affordability pressure. The extension of the government guarantee provides additional protection.
- Equity across both insurers and insureds is considered. There is a delicate balance to be struck between providing support (in the form of cross subsidies from the pool) to the people most affected by cyclone and related flood risk while still providing economic incentives for good risk taking behaviour across the whole population. Finding this balance also includes consideration of impacts to high risk insureds, and increases to premium rates, when current capping and cross subsidies are reduced or removed, and potential relative impacts on insurers arising from the implementation dates.

- Clarity as raised earlier in the actual coverage of the pool, with insurers needing to consider treatment for those claims which may fall outside of the definition, and any considerations for capital or reinsurance requirements. This lack of clarity may lead to increased reinsurance costs for insurers as reinsurers increase loadings to reflect greater uncertainty reducing the potential savings for insureds.
- Transparency of the pricing basis and data being used, which will assist in confidence of the basis, and understanding of the risks.

Importance of Other Risk Control Measures

As the Institute's Research Paper *Property Insurance Affordability: Challenges and Potential Solutions* of November 2020 outlined, there is no single solution to addressing the insurance affordability issue and it is important that other public policy measures continue to address the overall risk reduction through improved building codes, land use planning and investment in physical risk mitigation for communities. Meaningful risk reduction will take sustained effort and considerable funding over many years. The opportunity to grow risk intelligence on a range of cyclone, flood and actions of the sea is an important part of addressing the drivers of high risk premiums. The Institute encourages inclusion of specific objectives for the Corporation to facilitate and measure risk reduction in its risk pool.

The Institute supports the ARPC being able to consider for its management of cyclone and related flood damage risk, retrocession, issue of insurance linked securities and/or utilisation of other post-loss funding mechanisms such as bonds to help the pool achieve its goals.

If you would like to further discuss this submission, please contact Vanessa Beenders, Executive General Manager Public Policy and Professionalism of the Actuaries Institute, at vanessa.beenders@actuaries.asn.au or phone (02) 9239 6107.

Yours sincerely,

Jefferson Gibbs
President