9 September 2019

Deputy Chair Delia Rickard
ACCC Northern Australia Insurance Inquiry
GPO Box 520
MELBOURNE VIC 3001

Dear Ms Rickard

NORTHERN AUSTRALIA INSURANCE INQUIRY: SECOND UPDATE REPORT

The Insurance Council of Australia[1] (**ICA**) appreciates the opportunity to provide comments on the ACCC's Northern Australia Inquiry: Second Update Report.

Measures to improve affordability and availability

What measure(s) do you think have the greatest potential to improve insurance affordability and accessibility in Northern Australia?

Introduction

The ICA supports the ACCC's investigation into measures with the potential to improve insurance affordability and accessibility. That said, we consider focus should be given to measures that will effect long-lasting change by addressing the underlying cause of insurance affordability issues, namely the high level of risk within the built environment in Northern Australia.

Similarly, with the exception of removing stamp duty on insurance, we urge caution in considering measures which propose to offer a quick solution to premium prices, without forming part of an overall scheme to improve resilience or reduce hazard exposure in Northern Australia. Quick solutions to pricing without addressing the underlying cause, risks disincentivising community engagement in critically-needed disaster mitigation and therefore only delays the issue of insurance affordability to the near future.

[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2019 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of $48.4 billion per annum and has total assets of $128.4 billion. The industry employs approximately 60,000 people and on average pays out about $151.4 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

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Instead, the ICA proposes a systematic approach to improving insurance affordability by improving the overall resilience of the built environment in Northern Australia. Key to this proposed measure is improving land use planning, reforming building quality and standards and effective investment in mitigation. Each of these aspects is detailed below.

This submission will firstly respond to specific measures raised by the ACCC in its Second Update Report dated July 2019, before outlining the ICA's proposed solution to achieving lasting insurance affordability in Northern Australia.

A reinsurance pool

The ICA does not support the establishment of a reinsurance pool in Northern Australia. Such a measure would create a significant financial liability for Government, provide only marginal – if any – benefit to consumers, and potentially disincentivise investment in critically-needed disaster mitigation.

Reinsurance pools are generally established following an insurance market failure characterised by the unavailability of cover. For example, the Australian Reinsurance Pool Corporation (APRC) was created in response to market failure following the World Trade attack in September 2001, when private insurers globally withdrew from offering terrorism cover in any form for property risks. Insurers were of the view that, given the dramatic escalation in capability of terrorists and the resultant losses, they could no longer accurately calculate or capitalise the risk of a major terror incident causing catastrophic loss.

There is a stark contrast between the circumstances that gave rise to the ARPC and the current insurance market in Northern Australia. Firstly, there is no market failure in home and strata insurance in Northern Australia. While fewer insurers are operating in the region compared with in the rest of Australia, insurance product remains available from multiple providers. Secondly, unlike terrorism risk, insurers can accurately calculate the risk of disaster. Insurance premiums in Northern Australia are high for some policyholders simply because the risk is known to be high and remains unmitigated.

Elsewhere in the world, reinsurance pools that cover disaster risk arose either because no private insurance market existed, the private market threatened to withdraw without government assistance, or the private market failed. None of these triggers have occurred in Northern Australia nor are they likely to occur. The insurance market in Northern Australia remains competitive and continues to provide effective signalling of high risk through high premiums.

Reinsurance pools are bad public policy, and once implemented they become extremely difficult for Government to withdraw from. As soon as premiums are subsidised by a pool, homeowners are no longer motivated to invest in mitigation because the financial incentive of doing so has been removed. The demand on Government from constituents to reduce the disaster risk through mitigation also abates. Despite this, the underlying risk of disaster impacting the built environment only continues to grow. Once price signals regarding exposure are removed, accelerated development of high risk areas occurs, usually without effective planning and countermeasures to reduce the risk. By the time Government wishes to withdraw from the scheme, no private insurance market is willing to take on the risk.

The difficulty for governments to withdraw from a reinsurance pool has been demonstrated by numerous international examples. Despite foreign reinsurance pools being established as temporary measures, once these schemes have been implemented, governments have been unable to withdraw and have instead incurred significant costs. As an example, the US

National Flood Insurance Program is currently USD24 billion in debt after having an additional USD16 billion of debt cancelled. Over the last 40 years, the scheme has paid USD66.5 billion in claims, which is particularly significant considering only about 1/3rd of homes with a flood risk in the US are covered for flood. Despite artificially low premiums provided by the program, fewer homeowners are covered for flood than a decade ago. This indicates that artificially lowering premiums simply makes homeowners more complacent of hazard exposure rather than more informed of their risk.

The ACCC notes that reinsurance pools have been considered in previous inquiries but have not been implemented. This is simply because previous inquiries have found pools to be unviable. In 2015, Treasury's Northern Australia Insurance Premiums Taskforce thoroughly investigated the feasibility of a reinsurance pool to improve insurance affordability in the North. The Taskforce found that, if a reinsurance pool were to operate commercially, it would be unable to offer any reduction in insurance premiums for consumers. Modelling commissioned by the Taskforce indicated the only way for a pool to reduce premiums was through subsidies backed by a Government guarantee. If implemented, a pool could potentially offer a 10-15% reduction in premiums for consumers. Critically though, Government would be required to assume a significant financial risk.

The Taskforce found that, for a 10-15% reduction in premiums, there would be a 50-60% chance of the Government having to make a payment under the guarantee during a 10-year period. In addition, there would be a 10-20% probability the payment(s) would exceed $2 billion and a 5-10% chance the scheme would cost the Government over $5 billion in the 10-year period. As a reference, cyclones alone have caused approximately $4.87 billion dollars in insured losses in Northern Australia over the previous 10 years, including Severe Tropical Cyclone Debbie in 2017 ($1.78 billion) and Severe Tropical Cyclone Marcia in 2011 ($1.48 billion).

If a reinsurance pool were created, the financial risk assumed by Government would simply subsidise homeowners for their existing risk. The Government guarantee does not lower hazard exposure nor does it improve the resilience of the built environment. Further, subsidies encourage homeowners to assume more risk, which exacerbates the underlying cause of high insurance premiums. Therefore, a pool not only creates a significant liability for Government with no reduction in disaster risk, but would likely increase community exposure to hazards. Any investment in disaster mitigation must occur separate to Government's financial obligations to a pool. However, Government funding for mitigation may be consumed by Government in meeting the costs of operating a pool, should a disaster occur.

Rather than risk incurring significant costs via a reinsurance pool which does nothing to reduce disaster risk, Government should instead make a comparable investment in mitigation. With effective mitigation investment, insurance premiums will naturally decrease and resolve insurance affordability concerns. Further, mitigation investment will also substantially reduce Government disaster response and recovery costs as well as reducing the long-term implications of a changing climate and the associated increase in hazard exposure.

An insurance mutual

The ICA also does not support the development of an insurance mutual as a means of improving insurance affordability. Similar to a reinsurance pool, we consider a mutual would only provide marginal – if any – premium reductions to consumers yet create a significant financial exposure to Government. Further, a mutual provides no sustainable solution to insurance affordability because it does not address the underlying risk of disaster in Northern Australia.

Treasury's Northern Australia Insurance Premiums Taskforce also considered the feasibility of an insurance mutual, however ultimately determined such a scheme was an impracticable solution to insurance affordability. Taskforce modelling found that without Government support, a mutual could not offer premiums below the current level offered by the private market, and mutual premiums may in fact be higher. Additionally, implementing a mutual for cyclone risks within the broader cover (for other hazards) provided by private insurance companies would be costly and the claims experience for consumers would likely be complicated and frustrating.

With Government support via a guarantee, a mutual could potentially offer premium reductions similar to a reinsurance pool, however only with the same significant financial exposure to Government. As with a reinsurance pool, these artificial premium reductions via subsidisation only serve to dilute risk-based pricing, obscure hazard exposure, encourage homeowners to assume greater risk and disincentivise mitigation.

Despite having similar consequences to a pool, a mutual would be even more difficult for Government to withdraw. While a pool would generally not have any impact on insurance markets, a mutual would force insurers out of the market. If Government sought to withdraw support from a mutual, private insurers would be reluctant to re-enter the market and may have lost capability to effectively price hazard risk in the region. Additionally, a mutual would be unable to sustain itself without continued Government support. Therefore, it is likely Government would be unable to exit a mutual without causing significant financial harm to consumers and economic damage to the region.

Rather than risk incurring significant costs via a mutual from which it would have difficulty withdrawing, Government should instead make a comparable investment in mitigation. Doing so will reduce disaster risk and improve insurance affordability.

Direct subsidy

The ICA supports subsidies if implemented by directly subsidising private mitigation efforts. Measures through which this can most effectively reduce insurance premiums are discussed below under the ICA's proposed solution to insurance affordability.

However, the ICA cautions against adopting direct subsidisation of insurance premiums as a measure to improve insurance affordability. This approach only offers to temporarily alleviate the symptoms of high hazard exposure, without making any lasting improvements affordability because the underlying risk remains unchanged. Further, direct subsidy also creates a moral hazard by disincentivising mitigation and therefore exacerbating the ongoing risk of disaster in Northern Australia.

The ICA considers the only means of effecting lasting improvements to insurance affordability in Northern Australia is through adopting measures that reduce disaster risk and improve community resilience. Direct subsidisation of insurance does neither and offers only

a spurious solution. The underlying hazard exposure remains unchanged and the built environment remains just as vulnerable.

Further, direct subsidies create a moral hazard by diluting risk-based pricing. Price-signalling via insurance premiums allows hazard exposure and risk to be measured and understood. Currently, a highly exposed home with low resilience will attract a high insurance premium commensurate with the risk. As a result, the homeowner is motivated to lower this cost by undertake mitigation. A direct subsidy dilutes this price signalling, and therefore reduces a homeowner's financial motivation to improve their homes resilience.

Further, if the price signalling between a vulnerable home and a resilient home is obscured, residents will have less appreciation of hazards exposure and vulnerability. The rationale that people will avoid high-risk areas from fear of being impacted by a disaster is logical but does not reflect reality. Human nature dictates each of us has an overly optimistic view of risk and homeowners almost universally underestimate their risk exposure. However, financial indications of risk (i.e. insurance) are tangible. An optimistic homeowner is unlikely to think they will be impacted by a disaster, but they will certainly reduce their risk if there is a financial incentive to do so. If price-signalling of risk via insurance is diluted through subsidisation, a homeowner will likely lose their appreciation of their risk exposure, vulnerability and resilience. This may result in homeowners placing themselves and their assets in locations that are highly-exposed to hazards because the financial disincentive of doing so (ie high insurance) has been obscured.

A further consequence of diluting risk-based pricing through direct subsidy, is it disincentivises mitigation. For this reason, direct subsidy should not be considered as a viable measure for improving insurance affordability, even if implemented in conjunction with proposed mitigation solutions. Mitigation is critical to long term affordability and economic viability of Northern Australia. Yet, even with existing insurance affordability concerns, neither Federal or State Governments have committed meaningful investment in mitigation. Government funding for disaster risk reduction remains a fraction of the $400 million per year recommended by the Productivity Commission in 2015. Therefore, any solution which artificially reduces insurance premiums will only serve to temporarily remove insurance affordability as a major concern for constituents. Without pressure from constituents to reduce insurance costs, Governments will lose the impetus to invest in large-scale mitigation. Therefore, direct subsidy will simply create a far greater risk in the future by disinventivising critically-need mitigation investment.

Finally, a direct subsidy will be extremely difficult for a government to withdraw from in the future. Our changing climate is likely to increase hazard exposure, which will necessarily drive an increase in insurance premiums. As a result, without adequate mitigation taking place, insurance affordability will return as a leading concern for residents. At this point, it will become near-impossible to remove the subsidy without causing significant financial harm to the subsidy recipients. In offering a direct subsidy, constituents will have viewed Government as assuming responsibility for maintaining insurance affordability. As a result, constituents will expect government to increase direct subsidies as insurance premiums rise.

It follows that offering direct subsidies to improve insurance affordability is bad policy and will adversely affect the long-term disaster resilience in Northern Australia.

INSURANCE COUNCIL OF AUSTRALIA

Insurance in Northern Australia

Insurance premiums for homes and strata buildings in Northern Australia are, on average, more than double the premiums charged in the rest of the country. Despite this, providing insurance in Northern Australia remains unprofitable for insurers in the aggregate[2]. This lack of profitability despite the higher premiums demonstrates the significant risk posed by natural hazards to communities in the North.

That said, high hazard exposure does not in-itself cause high insurance premiums. There are many examples in Australia and around the world where high hazard exposure has been effectively mitigated through designing a built environment resilient to the natural elements. In such cases, insurance premiums are lower, reflecting the reduced risk of loss. After all, insurance is merely a financial instrument that places a dollar value on residual risk. If the residual risk of damage to a property is lowered by effectively mitigating high hazard exposure, insurance premiums will reflect this. Therefore, high insurance premiums are not simply a result of high hazard exposure, but occur only when the built environment has not been designed and constructed to withstand the natural elements it is exposed to.

This vulnerability of the built environment is the driving force behind rising insurance premiums in Northern Australia. Communities have not been designed or constructed to withstand the high hazard exposure to which they are exposed. Thousands of homes and strata buildings have been built on flood prone land that previously served as a natural mitigation to flood. Homes and suburbs have been constructed with only the Q100 flood level in mind as determined from the most recent flood study. Land development and large infrastructure projects have dramatically altered natural watercourses and flood plains, placing homes and buildings downstream at greater risk. In many cases, climate change was not and still has not been effectively accounted for in local land use planning.

Further, our changing climate indicates that Northern Australia's exposure to natural hazards will only increase. Rising sea levels are likely to bring increased coastal erosion and cause more frequent flooding to communities with close proximity to the ocean. Warmer sea levels are likely to cause more intense tropical storms and cyclones impacting communities further South than in the past. Warmer air temperatures are likely to cause more intense wildfires occurring outside of the traditional fire season.

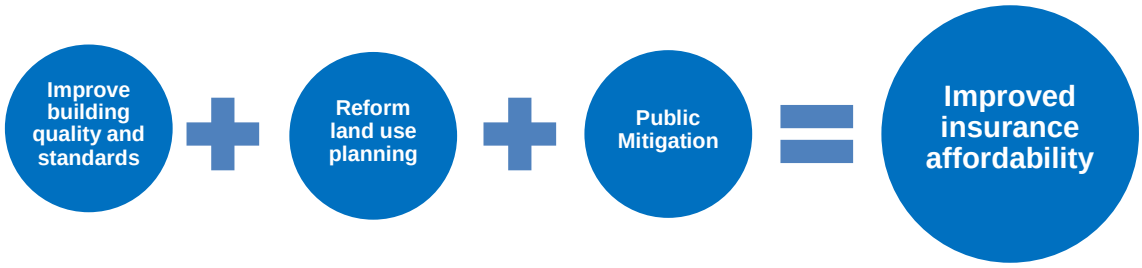
Unfortunately, without effective measures to mitigate the increasing hazard exposure in Northern Australia, insurance premiums will continue to rise. Therefore, intervention now to improve the resilience of Northern Australia's built environment is the most effective means of ensuring lasting insurance affordability.

[2] ACCC Northern Australia Insurance Inquiry: Second Update Report, July 2019

ICA's Proposed solution to insurance affordability

The ICA maintains the only means to effect lasting change to insurance affordability and accessibility in Northern Australia is by adopting a systematic approach to disaster risk reduction in which the measures interact to improve the resilience of communities, reduce the residual risk of disaster and ultimately improve insurance affordability. This position focuses on three key measures:

1. Improving building quality and standards so both new and old homes and strata buildings are stronger, more resilient and better maintained
2. Reforming land use planning to more effectively mitigate against increasing hazard exposure
3. Investment in mitigation to better defend North Queensland communities from natural hazards.



Crucially, solutions need to be framed as the responsibility of not just governments or industry, but all stakeholders including residents. Each stakeholder must understand its responsibility for improving the vulnerability of Northern Australia.

- Residents: Maintaining their property in good condition, repairing wear and tear, understanding their own vulnerability and investing in private mitigation
- Governments: large scale mitigation investment, land use planning, educating residents on hazard exposure and mitigation
- Insurance Industry: reducing premiums where risk is quantifiably reduced, advising government on quantifiable mitigation, educating residents on risk-based pricing
- Building industry: supporting improved building resilience, building to or above code, educating consumers, promoting building maintenance

1. Improving building quality and standards

Improving the quality of both new and existing buildings in Northern Australia is a critical component to improving resilience and effecting lasting change to insurance affordability and accessibility.

While newer buildings remain vulnerable to extreme weather, older buildings are more susceptible to damage due to being constructed to a lower standard than the present day code or becoming vulnerable as a result of wear and tear, pre-existing damage or general degradation. Therefore, measures targeting the quality of older buildings should focus on

addressing these vulnerabilities. In respect to new buildings, building codes need reform to reduce existing vulnerabilities in design and compliance needs to be more effectively enforced.

Older buildings – household resilience programs

The ICA considers one of the most effective measures to improve resilience to older homes is through programs which retrofit critical components of an older property to present-day standards. Importantly, measures that quantifiably improve the resilience of existing buildings have demonstrated success in lowering insurance premiums.

Older homes are disproportionately represented in disaster damage assessments due to their lower resilience. This higher risk is reflected in insurance premiums, with 66 per cent of premiums above the median in Northern Australia relating to homes built before the introduction of wind speed designs in the construction code. Further, 89 per cent of premiums above $5,000 relate to pre-1980 homes with both a cyclone and flood exposure.

The recently completed Household Resilience Program, operated by the Queensland Department of Housing and Public Works (HPW) provided eligible households with up to $11,250 to fund risk mitigation measures such as roof replacement and strengthening of windows and doors. The insurance industry supported the program and the benefits for participants was immediate improvement to insurance affordability. According to HPW, the average insurance premium reduction once program participants had completed the works, was 7.8%. The highest premium reduction captured by the program was 25%. Unfortunately, despite the clear success of the program, no further funding has been allocated for its continuation.

The success of these types of programs at reducing insurance premiums is two-fold. First, the retrofitting of older, more vulnerable homes reduces the residual risk of damage being passed onto the insurer. Secondly, when retrofitting occurs as part of a program, insurers have greater confidence in the nature and quality of the work undertaken without the need to independently verify each property.

The insurance industry would support further programs aimed at retrofitting older homes to meet today's more disaster-resilient building codes. That said, the ICA considers these programs should not be means-tested or at least have a broader eligibility than the Household Resilience Program. The means-testing of the Household Resilience Program resulted in many residents excluded from participating. The difficulty with this approach is that residents excluded are very unlikely to then retrofit their home on their own accord. The reality is, most residents do not appreciate their homes vulnerability to hazards and require incentivisation to improve undertake improvements to their home.

It follows that the ICA supports initiatives which aim to retrofit older, more vulnerable homes to current standards but consider a broad eligibility would have greater success at improving insurance affordability. Although a scheme would require investment from Government, the cost would be significantly less than the likely costs of a reinsurance pool or a mutual. Further, investment in a resilience scheme would actually improve community resilience rather than artificially lowering insurance premiums. As a result, a resilience scheme would result in lasting improvements to insurance affordability in Northern Australia.

Older buildings - periodic building inspections in high risk areas

As well as having a lower standard of construction, older buildings often have a greater vulnerability to extreme weather due to pre-existing damage or building degradation through wear and tear. Too often these vulnerabilities are not addressed leaving these building highly susceptible to damage.

Pre-existing damage or significant wear and tear is often easily detected by obtaining an inspection by a qualified builder. However, despite a home often being its owner's greatest asset, few homeowners arrange for their home inspected for wear and tear unless the consequences of damage are obvious, such as a leaking roof. Even still, many homeowners will simply use a bucket to mitigate damage from a leak without investigating the cause of the leak or whether their roof has been compromised. This approach to maintenance of a home is in clear contrast to the maintenance we carry out on our vehicles. Residents are likely to service their car at least once a year, despite its value being significantly less than their home. In addition, cars older than a few years are required to have an annual safety inspection before registration can be renewed.

It follows that a community's resilience could be substantially improved if buildings in high-risk regions were periodically inspected for vulnerabilities such as pre-existing damage or general degradation affecting the building's resilience. Such a measure would be most effectively delivered through a Government program so as to effect behavioural change in homeowners and provide a level of fidelity for insurers.

The cost of an individual building inspection can range from $200 to $500 per building depending on the size of the house and the extent of the inspection. However, a regional program would likely see reduced per-building inspection costs due to economies of scale. Costs could also be reduced by limiting the scope of the inspection to the highest vulnerabilities, such as the roof, doors and windows. Inspections could focus on quality of the roof, ensuring screws and tie-downs are secure, battens have not rotted or corroded, doors have been installed to code and window flashings and seals have not deteriorated.

The cost of the building inspection could be borne by individual homeowners. That said, the program may suffer from low engagement without cost subsidisation or a quantifiable benefit for the homeowner to justify the cost. Therefore, a form of subsidisation by Government would most likely deliver a successful outcome.

Any inspection program could be voluntary or mandatory depending on the risk profile of an area or variable depending on the age of a home. For example, inspections could be mandated for homes over a particular age. Likewise, inspections could be mandated following an extreme weather event in which a building may have sustained damage which is not easily visible.

New buildings – improved construction code

Improving the building standards of new homes and strata buildings is also critical to long-term insurance affordability in Northern Australia. As evidenced by high insurance premiums, even new buildings remain too vulnerable to damage from extreme weather and this risk is being passed onto homeowners. That said, reforms to building standards are not only needed to ensure homes can withstand the hazards present today, but it also must account for future hazard as a result of the changing climate.

There are two main aspects to improving building standards for new constructions. First, the National Construction Code (**NCC**) needs to be amended with a greater focus on protecting the building assets from extreme weather. Secondly, greater monitoring and enforcement is required to ensure compliance. If effective improvements can be made to new building standards and compliance in Northern Australia, the long-term resilience of the built environment will be improved which will have a positive influence on insurance affordability. The reduced risk would also likely attract new entrants to the market and increase market competition.

Specific changes to the NCC require a more technical assessment than provided for in this response. That said, key vulnerabilities within the built environment in Northern Australia are detailed in the technical reports published by James Cook University's Cyclone Testing Station (**CTS**).

The ICA considers the governance of the NCC must be reformed to place a greater focus on protecting buildings from damage during extreme weather. As it stands, the ABCB's predominate focus is on the preservation of life through ensuring buildings provide a safe refuge to occupants. However, though the NCC ensures buildings will not collapse under high wind loads, these buildings have not been designed to prevent damage to the building itself during extreme weather. For example, strata buildings have been designed to withstand high wind speeds to ensure they don't collapse. However, window and door flashings have not been designed to withstand water ingress under high wind speed. As a result, strata buildings in Northern Australia are highly vulnerable to extensive water damage during storms which contributes to high strata insurance premiums. It follows, the ABCB's focus on preserving life rather than protecting the building itself has contributed to the growing cost of insurance in Northern Australia.

Without detracting from the need to protect life, the ICA considers a focus on protecting both buildings and life in equal measure would result in a more positive outcome for the residents of Northern Australia. After all, a building that is more resilient to extreme weather will naturally provide greater protection to its occupants.

The cost of improving building standards will vary depending upon the measures adopted. That said, improving building standards within the NCC will ultimately be incorporated into construction costs. Although these costs are likely to flow through to home and unit owners, the benefit to the homeowner of living in a more resilient home cannot be overstated. Despite marginally higher construction costs, the homeowner will likely benefit from lower insurance premiums reflecting the improved resilience. Additionally, a property's value would likely reflect its higher quality and improved resilience.

In addition, improvements to the NCC can only be effective with increased compliance monitoring and enforceability to prevent new constructions being built below NCC requirements. Unfortunately, the CTS's technical reports following recent cyclone events highlighted numerous instances of new buildings suffering damage as a result of being constructed below the standards required in the NCC.

Therefore, for a building code to effectively mitigate hazard exposure, it must be complied with and breaches must be adequately rectified through monitoring and enforcement.

2. Reforming land use planning

In many parts of Northern Australia, the built environment has developed in locations highly exposed to natural hazards. Notably, homes and strata buildings have been constructed in

close proximity to the ocean with very little accommodation for rising sea levels or storm surge. Further, entire suburbs have been developed on flood prone land so long as floor heights have been constructed above the Q100 flood level. In essence, poor land use planning has resulted in entire suburbs being inevitably exposed to damage from natural hazards.

Understandably, Local Governments have, at times, been under pressure to utilise land that is highly exposed. Further, hazard data in the past may not have been as accurate or as understood as it is now. Similarly, the effects of climate change were not previously understood and is only now being effectively modelled by more progressive Local Governments. Notwithstanding, poor land use and urban planning has significantly contributed to high insurance premiums in Northern Australia by allowing development in areas that are highly exposed to hazards.

Although land use planning has improved in respect to reducing disaster risk reduction, there is still clear evidence of recent planning decisions placing communities at a known and obvious risk of disaster. For example, development in the suburb of Idalia in Townsville is only partially completed, yet it was significantly inundated by flood in February 2019. Many of these new homes have been constructed on stumps or concrete slabs despite the known flood risk in the suburb. Although these homes meet the minimum design standard above the predicted Q100 flood level, this still remains a significant and predictable risk of flood damage during the expected lifetime of a building. As a result, despite these newly constructed homes being built to the latest standards, they will attract a high insurance premium due to land use planning that allowed these homes to be constructed with an unnecessary level of residual risk of damage from flooding.

Conversely, many older 'Queenslander' style homes were constructed to be elevated well above any known flood risk despite no requirements from Local Government to do so. However, with today's more stringent building codes and land use planning requirement, developers are more inclined to construct only to the minimum standard stipulated.

It follows that, to improve insurance affordability in the North, land use and urban planning needs to be reformed to ensure new developments are not constructed in locations that pose a significant risk or are likely to in the future. Where land has a high exposure to hazard, building development simply should not occur and the land should be purposed for its natural hazard mitigation qualities. If development must occur, significant action should be taken to ensure the hazard exposure is effectively mitigated, not simply building to the minimum standard.

Developing more effectively land use planning requires action from both local and State Governments. While Local Governments dictates the planning of their community, support is required from State Governments to ensure consistency and enforceability of the planning system. Additionally, State Governments must ensure State legislation does not allow the judiciary to overturn planning determinations which would adversely affect the resilience of the existing community or unnecessarily expose a proposed development to risk. In Queensland, there have been numerous instances in which the Planning and Environment Court allowed the development of strata buildings on highly exposed flood-prone land despite Local Government objections.

Finally, where developed land is - or is likely to be - highly exposed to natural hazards as a result of poor land use planning, Governments should consider creative solutions to capturing and repurposing the land for hazard mitigation. For example, if a home built on

highly-exposed flood prone land is destroyed in a flood, Governments could consider a land swap for that resident to a nearby location outside of the flood risk. The flooded land parcel could then be returned to its natural state and potentially reduce the flood risk for other properties. Similarly, highly exposed coastal properties which are at risk of rising sea levels or storm surge could be repurposed as natural sea barriers. The ICA considers such measures warrant further investigation and investment by Federal and State Governments.

3. Public Mitigation

Even with improved building quality and land use planning, in many instances the only effective means at reducing a community's risk is by mitigating the natural hazard through infrastructure – such as a dam, levee or sea wall. However, despite having the ability to make broad-scale improvements to resilience; investment in large mitigation projects is infrequent in Australia due to the lack of investment, the cost of the proposed mitigation or difficulty valuing the proposal.

Despite the high cost, mitigation projects should be treated as nation-building infrastructure initiatives, on par with highways, rail and the national broadband network. Once completed, mitigation protects communities, has a substantial impact on the economy and productivity, and helps prevent loss of life.

Funding for public mitigation

The ICA has long advocated for a substantial increase in Federal Government investment in mitigation to reduce disaster risk in Northern Australia. Yet Government focus remains on disaster response rather than prevention. Between 2009-10 and 2012-13, over $8.3 billion was spent on disaster response and recovery in Australia. Yet, our investment in preventing these disasters from occurring in the first place remains low and inefficiently managed. Over the same 2009-10 to 2012-13 period, only $170 million was spent on disaster mitigation.

This disparity in spending continues today, despite many inquiries and organisations calling for increased mitigation funding. Notably, the Productivity Commission recommended in its 2014 Natural Disaster Funding Arrangements Inquiry that the Federal Government allocate $200 million annually to disaster mitigation, with a further $200 million provided by the States and Territories. This investment outlay would be offset by the reduced cost of disaster response and recovery.

In 2013, the Australian Business Roundtable for Disaster Resilience and Safer Communities White Paper demonstrated that carefully targeted resilience investments of $250 million per annum have the potential to generate budget savings of $12.2 billion for all levels of government and would reduce natural disaster costs by more than 50% by 2050. In a more recent report, the Australian Business Roundtable estimated the total economic cost of disasters in 2015 exceeded $9 billion, would double by 2030 and would average $39 billion a year by 2050 without substantial investment in mitigation.

Additionally, the 2016 Northern Australia Insurance Premiums Taskforce found the only means to reduce high insurance premiums in Northern Australia was to invest in mitigation to reduce the region's high exposure to natural hazards. Similarly, the Australian Institute of Actuaries estimates the annual cost of disasters as between $11-12 billion, only 40% of which is insured. In its pre-budget submission in February 2019, the institute repeated its calls for government to adopt the productivity commission's recommendations to increase investment in mitigation.

Without a commitment from Federal and State Governments to adequately invest in mitigation, many communities in Northern Australia will remain highly exposed to disaster and insurance premiums will remain commensurate to the high risk.

Valuing public mitigation

Aside from funding, another reason for lack of investment in disaster mitigation infrastructure is difficulty in accurately valuing proposals. Without doubt, valuing mitigation is complex and not always tangible. In essence, it requires placing a price on the prevention of an occurrence that may not happen at all. Further, many consequences of disasters are so intangible they can be difficult to accurately value.

Commonly, the value of a mitigation proposal is assessed through formal economic modelling of cost-benefit analysis. This known and accepted method for investment consideration and, in respect to disaster mitigation, analysis consists of a risk assessment before mitigation, assessment of mitigation options and the costs, and a risk assessment after mitigation. The economic effectiveness of the mitigation is evaluated by comparing the benefits of the projects against its costs (Benefit-Cost Ratio).

That said, applying traditional cost benefit analysis to disaster mitigation has significant limitations. For example, traditional means of measuring investment have an inability to assess qualitative benefits and estimate climate change impacts. Additionally, traditional economic analysis has difficulty quantifying systemic mitigation. For example, it may be effective in assessing the effectiveness of a flood levee, but the model less effective in assessing a system of mitigation initiatives such as a flood levee combined with a household resilience program and the restoration of a mangrove forest. The result of these limitations in using cost-benefit analysis means this approach frequently underestimates the cost-effectiveness of mitigation investment or supports a mitigation option which is more cost-effective in the short-term but is less effective at improving long-term resilience.

That said, more recent mitigation valuation models which do incorporate more qualitative aspects risk being too complex and subjective.

Difficulty also arises in valuing mitigation when a discount rate is applied. A discount rate is a means of accounting for the higher value money has today than money realised in the future. This operates so that the longer it takes to realise a return on investment, the lesser the value of that return. This has a useful application when the goal of investment is financial return, however it is less relevant where the goal is community resilience to disasters.

In Australia, the Federal Government typically applies a discount rate of 5%-7% to investment considerations. However, elsewhere in the world, a discount rate of 3% is considered more appropriate for mitigation investment to account for intangible benefits and the impact of climate change.

Example: Launceston Flood Mitigation

The Launceston flood levee is an example of both the benefits of mitigation and the limitations of utilising cost-benefit analysis and discounts rates when applied to mitigation. In 2014, the old Launceston flood was upgraded and raised. The initial cost estimate for the upgrade was $27.9 million however the final cost increased to $58 million. Maintenance costs for the new levee were estimated to be $181,000 per annum, with an additional $250,000 every five years.

In 2018, the Bushfire and Natural Hazards CRC conducted a study to evaluate the cost effectiveness of the Launceston levee. Based on the initial estimated cost of the levee of $27.9 million, the study found the benefit-cost ratio (when applying a discount rate of 7%) was 1.48. However, when using the actual cost of $58.4 million, the benefit-to-cost ratio fell to 0.71, indicating an unsound investment. If a lower discount rate of 4% were to be applied, the study found the benefit-cost ratio for the initial estimated cost rose to 2.49, and actual benefit-cost ration rose to 1.19, indicating a cost effective investment.

In June 2016, the city experienced a 1/50-year flood. In its report into the flood, the BNHCRC found that the reconstruction of the Launceston flood levee resulted in avoiding losses of approximately $216 million had the pre-existing levee failed. In other words, the losses (from this single event) would have been four times greater than the investment in the new flood levee, had the old levee failed.

It follows that mitigation investment should be viewed as nation-building infrastructure projects and projects selected based on their quantitative and qualitative benefits to the community rather than projected investment return. Further, Governments must adopt a different mindset and approach to mitigation investment compared to other forms of infrastructure where a financial return is expected. Finally, if discount rates are applied to mitigation investment decisions, a lower rate of 3-4% should be adopted to account for climate change and qualitative benefits.

The ICA has publicly produced a list of the most highly exposed electorates in Australia that would benefit most from public mitigation. We remain committed to assisting Governments in implementing mitigation via lower insurance premiums commensurate to reduced hazard exposure.

Final recommendations on consumer information and choices

The Insurance Council also notes that the ACCC has finalised its draft recommendations regarding consumer information and choices, claims handling and mitigation.

Recommendations regarding consumer information and choices

The Insurance Council notes the ACCC's position that informed and engaged consumers drive competition and share its concern that consumers currently face difficulties in comparing insurance covers and making informed decisions.

However, for reasons outlined in our submission of 23 April 2019, our view continues to be that the ACCC's final recommendations regarding consumer information and choices will not be effective in improving consumer outcomes. We note in particular the concerns raised in our submission in relation to: the disclosure of the premium impacts of optional inclusions or exclusions (Rec 3); the establishment of a national home insurance website (Rec 4); and the disclosure of where premium increases are capped (Rec 6).

Also relevant are the consumer focused initiatives that the industry has been developing to improve disclosure in general insurance, as outlined in submission of 1 March 2019 to the Treasury Discussion Paper 'Disclosure in General Insurance: Improving Consumer

Understanding'.[3] The Government's announced review of the Standard Cover Regime in the Insurance Contracts Act will provide a valuable opportunity to discuss how the industry and the Government can work together to improve consumer information and choices.

Concluding remarks

If you have any questions or comments in relation to our submission please contact Karl Sullivan, Head of Risk and Operations, on 02 9253 5155, or ksullivan@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director & CEO

[3] The submission is publicly available on our website: http://www.insurancecouncil.com.au/assets/submission/2019/030119_ICA_SUB_Disclosure.pdf