



NATURAL DISASTER FUNDING ARRANGEMENTS

SUBMISSION FROM THE
NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA

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INTRODUCTION

NIBA welcomes the opportunity to provide brief comments in response to the Productivity Commission Issues Paper on Natural Disaster Funding Arrangements.

Overall, NIBA believes it is very timely to critically review the assessment, management and funding of risk to Australian communities as a result of natural disasters. Natural disasters are having a significant impact on the Australian insurance market at the present time, and in particular property insurance in North Queensland is an extremely difficult market, with limited supply and high pricing.

Substantial losses have occurred in recent times in many Australian communities. The insured losses are occurring in the built environment. The location, nature and extent of building is controlled by governments and government agencies. Government therefore has a role in the future management of risks likely to arise from natural disasters, the potential cost of those risks, and the mitigation of those risks.

Individuals and businesses are increasingly accepting the need to manage risks, in order to prevent losses from occurring, or to limit the need for risk transfer (insurance) or other risk financing mechanisms. NIBA believes it is now appropriate for broader community risks to be assessed and managed on a similar basis.

Insurance brokers have extensive experience in helping clients identify, assess, manage and finance their risks. They are able to provide expert guidance and support on a wide range of risk financing strategies, using products and financing packages from Australia and the world wide financial markets.

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 400 member firms and over 3000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia.

Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling an estimated \$18 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 400 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on risk insurance products.

ABOUT INSURANCE BROKERS

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent and representative. Insurance brokers offer many benefits to customers and consumers:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages
- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;
- assistance in interpreting, arranging and completing insurance documentation;
- experience in predicting, managing and reducing risks; and
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).

In limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

INSURED LOSSES OCCUR IN THE BUILT ENVIRONMENT

Insured losses occur in the built environment, where governments and government agencies have an influential – and often controlling – interest in the nature, extent and level of development.

Most government activity relating to land use, planning controls and building standards occurs at the State and local government levels. However, the principal source of funding for natural disasters comes from the Federal Government to date.

In these circumstances, NIBA respectfully submits that responsibility for the identification, assessment, management and funding of risks arising from natural disasters should be accepted as the joint responsibility of all levels of government. This would suggest an important, ongoing role for the Council of Australian Governments.

RISK ASSESSMENT, MANAGEMENT, MITIGATION AND FUNDING

The risk of loss arising from natural disasters and major weather events is ever present in Australia, particularly in the summer months. Australia has long history of fires, floods, cyclones and other major natural disasters.

Recent experience has shown that the cost of natural disasters now reach many billions of dollars. This includes insured losses, losses to private and corporate property that were not insured, and losses to public and community assets.

Clearly, there is a need for a carefully designed risk management approach, whereby the risk of loss from natural disasters is identified and assessed, risk management and mitigation strategies are designed, funded and implemented, and residual risks are funded by the most appropriate means available. For individuals and businesses, the usual funding mechanism is via insurance (risk transfer), but for larger corporations and governments, a wider range of risk funding mechanisms can be considered.

Insurance brokers in Australia have extensive experience in assisting clients (individuals, businesses, corporations and governments) manage and finance risks. The insurance broking industry has access to the world wide financial markets to provide simple to extremely sophisticated risk funding solutions.

INSURANCE IS IMPORTANT, BUT MUST REMAIN AFFORDABLE

For individuals and most businesses, the risk of loss as a result of natural disasters is financed via the property insurance markets.

Insurance is the pooling of risk. The premiums of the many fund the losses of the few. The size of the pool is determined by the level of loss the pool is likely to incur. The projected (expected) level of loss therefore has a direct impact on the level of premiums needed to fund the pool.

In recent years, two major developments have occurred in relation to property insurance in Australia.

Firstly, it is clear that natural disasters and major weather events have the capacity to cause damage valued at billions of dollars. The majority of Australians live near the coast, where most of the severe weather events occur. Many other Australians live in areas susceptible to fire and flood. Substantial losses are now a regular event.

Secondly, the insurance industry is now using increasingly sophisticated data to determine the actual level of risk faced by individual properties. This means that insurers will be able to determine the relative risk of two properties adjacent to each other, based on their specific characteristics. Rating will no longer be done based on the postcode of the properties.

The net result of these developments is that a combination of recent experience of loss in an area, together with high risk exposure (floor level close to ground, inadequate building standards, etc) can and will result in significantly higher insurance premiums than has historically been the case.

In some parts of Australia, especially North Queensland, there is major community concern about the cost of property insurance. The Australian Government Actuary has now published two reports on the matter.

These concerns indicate that the cost of insurance (ie the cost of funding the pool) has reached levels that are unacceptable to the community, and may well be unaffordable to many property owners. If they chose to not continue with their insurance, they expose themselves to significant personal loss, including the potential loss of their family home.

In order to keep premiums affordable, the potential value of losses that need to be funded by the insurance pool needs to be kept within reasonable levels. This can only occur if the risk of loss as a result of natural disasters is properly identified, assessed, managed and mitigated.

It is crucial, therefore, that governments at all levels play a more active role in the assessment, management and mitigation of the risk of loss arising from natural disasters. It is only by doing this that the level of insurable losses will be kept within reasonable limits, and the premiums needed to fund those losses will remain affordable.

CONCLUSION

As noted in the Issues Paper, most government efforts to date for natural disasters have been in relation to funding and managing disaster response and recovery. Much good work has been undertaken in relation to risk mitigation, but the funding of mitigation is limited in comparison the funding that has been needed for disaster response and recovery.

This has meant that government finances – and budgets - have been and remain exposed to the potential cost of further natural disasters.

At the same time, the level of insured losses has been increasing – particularly in areas exposed to natural catastrophe and extreme weather. As a result, insurance premiums have been increasing to levels many now regard as unacceptable and/or unaffordable.

NIBA respectfully submits that Australia must take a comprehensive risk management approach to the threat of loss from natural disasters. As all levels of governments and all jurisdictions are involved, leadership should and must occur at the Council of Australian Governments.

Once risks are identified, managed and mitigated, any residual risk of loss needs to be funded in the most effective means. Insurance brokers in Australia have the knowledge, experience and access to Australian and international financial markets to assist this process.

FURTHER CONTACT RE THIS SUBMISSION

For details about any comments in this paper please contact:

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