SHOPPING CENTRE
COUNCIL OF AUSTRALIA

4 March 2022

Mr Mark Fitt
Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Via email: economics.sen@aph.gov.au

Dear Mr Fitt,

TREASURY LAWS AMENDMENT (CYCLONE AND FLOOD DAMAGE REINSURANCE POOL) BILL 2022

Thank you for the opportunity to make a submission to the Committee's Inquiry into Treasury Laws Amendment (Cyclone and Flood Management Reinsurance Pool) Bill 2022 (the Bill).

As the Committee may be aware, the Shopping Centre Council of Australia (SCCA) represents shopping centre owners and managers nationally. The SCCA has an inherent interest in this matter as our members are significant contributors to the terrorism reinsurance scheme, which informs our position and comments to the Committee.

The SCCA has made two submissions to the Treasury with respect to this Bill; initially in response to a Consultation Paper (24 June 2021) which is attached, followed by a confidential submission in response to the Exposure Draft Legislation (17 December 2021) that provided similar feedback to this submission.

While in principle we support the objective of a cyclone reinsurance scheme – to lower insurance premiums for households and small businesses by reducing the cost of reinsurance – we have fundamental and outstanding concerns with the Bill:

- The cyclone and flood damage reinsurance scheme should be financially independent of, and not cross-subsidised by, the terrorism reinsurance scheme. Cross-subsidisation from the ARPC's 'own resources' amounts to a transfer of our industry funds to residential home owners, which we consider inapproporiate.
- The Bill should be explicit in its intent that industry levies would be tiered based on location risk – such that commercial property owners who have no cyclone risk are not required to cross-subsidise residential houses in high-risk areas – and account for risk mitigation measures in individual assets.
- Safeguards or oversight to protect insurance policy holders from indirect increases to premiums should therefore also be a feature of the scheme.
- The absence of modelling or a cost benefit analysis affects transparency and suggests that the scheme is not financially sound or justifiable.

Ensuring financial independence from the terrorism reinsurance scheme

The SCCA supports the ARPC administrating a cyclone reinsurance scheme, however we are concerned by commentary in the Explanatory Memorandum which states that: *"The Commonwealth guarantee will be drawn from if funds from the reinsurance pool and the ARPC's own resources are insufficient to meet claim costs."*

While we appreciate that Government will provide a separate $10 billion guarantee for each pool, our view is that each pool should also be financially independent, with the exception of administrative (i.e. staffing) costs and other shared expenses.

For instance, we understand that the ARPC's 'own resources' constitutes around $595 million – built up over time by the insurance levies applied to and funded by contributors to the terrorism reinsurance scheme, such as our members – which appears to be earmarked to fund and provide the same function for the cyclone reinsurance scheme; sustaining policy holders for first losses to a ~$225 million threshold. The levy was intended to allow a pool of funds, 'industry retention funds', to accumulate which in turn would reduce the level of reinsurance that needed to be purchased, allowing the levy to be reduced overtime as the scheme became increasingly self funded.

This would give effect to our members' contributions to the terrorism reinsurance pool being used to cross-subsidise the new ARPC-administered scheme, which we consider entirely inappropriate and would derive no benefit from, in fact it would increase the terrorism reinsurance levy.

The SCCA maintains its view that the establishment and ongoing costs of a cyclone reinsurance scheme should not be funded by the assets of the existing scheme. It is not enough that the two schemes are guaranteed separately, as the ARPC's 'own assets' ultimately constitutes funds generated by contributions to a very separate scheme.

Our members contributions to the terrorism reinsurance asset base should be for the discrete purpose and conditions under which they have been made over time. It would be deeply disappointing if the scheme relied heavily on the commercial property sector by transferring our members' wealth and unfairly asking commercial landlords to subsidise a significant proportion of costs (noting that the vast majority of 'probable' losses will likely occur from residential policies) for the new scheme.

Accordingly, we recommend that the Bill be amended to ensure that the cyclone reinsurance scheme generates a separate pool of funds for this purpose, including an interim measure for its first three years of operation that is not reliant on the ARPC's existing asset base, to build an appropriately sized asset base so that the two schemes are truly independent.

Reinsurance product design

As highlighted in our submission in response to the Treasury's Consultation Paper, the SCCA supports a tiered risk rating system; one that does not disperse or equalise risk and affect what should be proportionally higher savings for buildings that have design or other mitigation measures in place or are located in less risk prone areas.

Further, qualifying small businesses in shopping centres should benefit from improved (or otherwise) risk ratings, incentivising mitigation action undertaken by or affecting policyholders. By extension, any premiums paid by policyholders should recognise mitigation measures and building design features that individual policyholders have in place.

In addition, our submission highlighted the levy should only be applicable to policies in Northern Australia, so that the costs and risks are borne by this geographic area and not shared nationally. The Bill and Explanatory Memorandum do not provide this level of detail.

The SCCA recommends that the Bill should be amended to make explicit its intent that industry levies would be applicable only to assets that would benefit from the scheme, tiered based on location risk, and account for risk mitigation in individual assets.

Safeguards to protect against indirect increases to other insurance policies

Our submission to the Treasury's Consultation Paper (May 2021) referenced a 1 June 2021 Senate Estimates hearing, in which senior Treasury staff indicated that its modelling incorporates indicative costs passed on to other policy holders. It is reasonable to assume that this modelling is underpinned by a long-term cross-subsidy, whereby the vast majority of levies will be funded from CBD properties, but the vast majority of 'probable' losses will occur from cyclone residential policies.

This is a fundamental concern of ours; that in order to fund the scheme, insurance premiums for other policy holders will be increased or used to cross subsidise residential policies.

The Explanatory Memorandum notes that the pool will be funded by the premiums that insurers would pay to participate in the scheme. While we note that the ACCC will monitor insurer premiums to ensure savings are passed to policyholders, our view is that either 1) a safeguard to prevent, or 2) a provision for the scheme auditor or ACCC to monitor for, indirect increases to other insurance policies should be introduced.

The absence of modelling to justify the scheme

Senior Treasury staff referenced modelling at the abovementioned Senate Estimates hearing, which indicated only a 10 percent reduction in premiums for those covered by the scheme. This modelling has not, and should have been, released to accompany the draft legislation. Further, the Fact Sheet indicates that a pricing formula will only be finalised prior to the commencement of the scheme on 1 July 2022.

This lack of transparency is particularly concerning given that the ACCC investigated and recommended that Government should not pursue a reinsurance pool, rather explore 1) direct subsidies based on both premium level and income eligibility requirements, and/or 2) that a portion of revenue from stamp duties on insurance products be directed towards measures to improve affordability for low-income consumers or to fund mitigation works.

Our view is that the consultation process was not transparent in this regard and did not allow stakeholders to thoroughly examine the scheme or its prospective benefits and outcomes. This approach suggests that the scheme is not financially sound or justifiable, such that stakeholders cannot be assured that the policy approach is fit for purpose.

Further, we are deeply disappointed that the scheme gives effect to commercial property owners cross-subsidising a policy aimed at residential land owners and small businesses. Our view is that the scheme is inherently unfair and fundamentally flawed in its design.

Thank you for consideration of the SCCA's feedback and commentary on the Bill. Please do not hesitate to contact me on [redacted] as required.

Yours sincerely,

James Newton

Manager – Policy and Regulatory Affairs

Att Submission – Reinsurance Pool for Cyclones and Related Flood Damage (24 June 2021)

SHOPPING CENTRE
COUNCIL OF AUSTRALIA

24 June 2021

Manager
Cyclone Reinsurance Pool Taskforce
The Treasury
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PARKES ACT 2600

Via email: reinsurancepool@treasury.gov.au

Dear Sir or Madam

REINSURANCE POOL FOR CYCLONES AND RELATED FLOOD DAMAGE

Thank you for the opportunity to comment on the proposed key design features of a Reinsurance Pool for Cyclones and Related Flood Damage, as outlined in Treasury's Consultation Paper (May 2021), and an extended timeframe for submission (granted on 18 June 2021). The Shopping Centre Council of Australia (SCCA) is the national industry group for major shopping centre owners. Some of our members own and operate more than 40 assets in Northern Australia.

SCCA members are significant contributors to the Terrorism Reinsurance Scheme, administered by the Australian Reinsurance Pool Corporation (ARPC), and therefore have relevant perspective and experience to inform the development of the Cyclone Reinsurance Scheme.

As tenants within shopping centres may be covered by the Cyclone Reinsurance Scheme, and our membership may be required to pay higher insurance premiums or a levy to subsidise the scheme, the SCCA has an inherent interest in its design.

We respectfully raise the following matters for Treasury's consideration and would welcome an early opportunity to discuss these further.

Reinsurance pool coverage

Property insurance in Northern Australia is a significant cost borne by businesses. Accordingly, the SCCA generally supports Government's objective of improving the accessibility and affordability of property insurance.

Treasury highlights the complexity of capturing small business policies, with particular reference to shopping centres.

To provide clarification, shopping centre tenants are generally required to hold (and provide evidence of) insurance as a standard feature of retail leases, which themselves are regulated by various state and territory legislation. This typically takes the form of property and business interruption insurance, in addition to other coverage. These costs are directly paid by the tenant and are not recovered as a cost through individual leases.

Shopping centres do not take out coverage to include all individual tenants, with a view to passing on the costs. Building insurance (and other related) costs are met by landlords, who are typically indemnified through leasing arrangements. Landlords are liable to pay the lessee compensation if a premises or centre is damaged or destroyed or if the lease is ended as a result of damage or destruction.

Cyclone and related flood damage insurance would need to be factored into the premiums of products that retail tenants typically take out, as required by leasing arrangements across our membership. The introduction of a Cyclone Reinsurance Scheme within this context should be mindful of existing insurance arrangements with respect to shopping centres and their tenants.

Without further detail or modelling, the SCCA notes that the scheme presents as a means to impose a levy on larger businesses and insurance policyholders outside of Northern Australia, to fund the insurance premiums of homeowners and smaller businesses. This would contribute to the already considerable insurance costs of our sector. Unlike with the Terrorism Reinsurance Scheme, our members would derive no direct benefit.

Such a scheme stands to benefit the insurance sector and a comparatively small group of policyholders, including some shopping centre tenants, whose insurance costs would, in effect, be part subsidised by their landlords, irrespective of the state-/territory-based retail leasing arrangements and the status quo.

The SCCA understands that the scheme will cover residential, strata and small business property insurance policies only and will therefore not address cost pressures faced by our members, who will not be eligible to participate or benefit. Rather, the scheme may be applicable to some of our members' tenants that qualify as a small business as defined for the purposes of accessing the scheme.

The SCCA agrees that a definition is warranted and should determine eligibility to the scheme. In terms of an applicable definition, our experience is that this varies significantly and that various definitions are broadening the scope of what really should constitute a small business, by encompassing larger and larger businesses (see table below).

Organisation/Legislation	**Definition/Test to determine a 'small business'**
Australian Bureau of Statistics (ABS)	An entity with 5-19 employees.
Corporations Act 2001 (Cth)	Satisfies at least two of the following: (a) consolidated revenue of <$50 million, (b) value of the consolidated gross assets <$25 million, and/or (c) <100 employees.
Competition and Consumer Act 2010 (Cth)	Considered on the basis of contracts issued: a) employing <20 employees <u>and</u> the upfront price payable under the contract does not exceed $300,000, <u>or</u> b) if the contract has a duration of >12 months, the upfront price payable under the contract does not exceed $1 million.
Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth)	A business: a) employing <100 employees, <u>or</u> b) <$5 million in revenue p.a.
Retail Shop Leases and Other Commercial Leases (COVID-19 Emergency Response) Regulation 2020 (Qld)	A business: (a) carried on by a sole trader; or (b) employing <20 full-time, or full-time equivalent, employees.

Definitions that a) encompass businesses that require less staff but have high turnovers, or b) allow for a structure that disregards the principal/wider business, are fundamentally deficient. For the purposes of accessing the scheme, an appropriate definition should apply only to genuinely small businesses; for instance, that of the Australian Bureau of Statistics, which defines a small business as having 5-19 employees. A two-limb test would address these issues, for example:

- that the business has a national turnover of less than $10 million, and
- that the business has between 5-19 employees.

Reinsurance product design and insurer participation

The SCCA notes that Treasury proposes that the '*pool would be intended to provide targeted reinsurance premium reductions at the individual property level based on each property's risk profile, where higher risk properties receive higher discounts*'.[1] The SCCA agrees that a tiered risk rating system should be implemented; however, this should not disperse or equalise risk and effect what should be proportionally higher savings for buildings that have design or other mitigation measures in place or are located in less risk prone areas.

The SCCA submits that qualifying small businesses in shopping centres should benefit from improved (or otherwise) risk ratings, which should be modelled on those applied by insurance companies. This would incentivise mitigation action undertaken by or affecting policyholders. By extension, any premiums paid by policyholders, such as our membership, should recognise mitigation measures and building design features that individual policyholders have in place.

The SCCA appreciates that Treasury will be aware of the findings of Australian Competition and Consumer Commission's (ACCC) Northern Australia Insurance Inquiry. In particular, the ACCC recommended direct subsidies over other measures considered (including reinsurance) as having '*the greatest potential to work in a targeted way to relieve some of the acute affordability and cost of living pressures facing consumers in higher risk areas, at a lower cost and more effectively than other measures*'.[2]

Treasury officials spoke to this at a recent Senate Estimates hearing of the Economics Legislation Committee, explaining that a preliminary analysis based on actuarial analysis of the market suggested a 10 percent reduction in premiums.[3] Further, Treasury officials explained that this modelling (which was unavailable at Senate Estimates, and has not been available since) incorporates indicative costs passed on to other policyholders.

The SCCA is concerned that this level of detail has not been provided in the consultation paper as part of Treasury's initial consultation. It is important that we are able to comment on the proportion of costs shared (residential vs. business policyholders), whether this is determined by insured amount or insurer-calculated premiums etc.

The ACCC was clear in its view that a government reinsurance pool would not be *'well-suited to address affordability concerns in a targeted way'*.[4] The Australian Prudential Regulation Authority and a majority of the insurance industry also questioned and opposed the introduction of a reinsurance pool, respectively.[5] The SCCA is mindful of these contrasting views, which call into question the viability of a Cyclone Reinsurance Scheme. In contrast, the ACCC suggested the following, amongst other measures:

- *'direct subsidies based on both premium level and income eligibility requirements'*, and
- a *'portion of revenue from stamp duties on insurance products (however they are levied) should be directed* [by state or territory governments] *towards measures to improve affordability for low income consumers or to fund mitigation works.'*[6]

It is disappointing that Government has not heeded this advice and sought to address insurance affordability with a broader approach, or one that is supported by regulators and the insurance sector itself. Arguably, issues that are unique to Queensland, the Northern Territory and Western Australia should be addressed, at least in part, by Goods and Services Tax and stamp duty levied on insurance policies in these jurisdictions.

Reinsurance pool governance and monitoring

The SCCA agrees with Treasury that an initial (12 month) review followed by triennial reviews of the Cyclone Reinsurance Scheme would be appropriate.

The SCCA also reiterates concerns that it has held over some time with the Terrorism Reinsurance Scheme, whereby contributors to the scheme are not recognised as owners of the scheme, like a mutual insurance company. Contributors should be recognised as owners of any Cyclone Reinsurance Scheme to oversee aspects of the scheme including reserve levels, fees and payments to government.

The SCCA also recommends that the scheme should have an end date and a post-funding model for when the pool reaches an agreed reserve.

Links to risk reduction

The SCCA supports the view that insurance premiums be adjusted to reflect mitigation action undertaken by or affecting policyholders to encourage cyclone risk mitigation and that new builds only be allowed to participate if built to adequate standards.

Interactions with the ARPC's existing functions

If Government proceeds with the establishment of a Cyclone Reinsurance Scheme then it will be critical that the pool is guaranteed separately to the Terrorism Reinsurance Scheme, to ensure that no risk is shared and its establishment and ongoing costs are not co-funded by the existing scheme.

The SCCA looks forward to working with Treasury as its consultation progresses. Please do not hesitate to contact me on [redacted] as required.

Yours sincerely,

James Newton
Manager – Policy and Regulatory Affairs

[1] The Treasury, *Consultation paper: Reinsurance pool for cyclones and related flood damage*, May 2021, p. 12.
[2] Australian Compet tion and Consumer Commiss on (ACCC), *Final report: Northern Australia Insurance Inquiry*, November 2020, p. 194.
[3] Commonwealth of Australia, *Senate Estimates*, Econom cs Legislation Comm ttee, 1 June 2021, pp. 72-73.
[4] Australian Prudential Regulation Authority, Submission: Northern Australia Insurance Inquiry, 6 September 2019, p. 6; ACCC, Final report: *Northern Australia Insurance Inquiry*, p. xvi.
[5] Ibid, p. 58,
[6] Ibid, pp. 194;59.