One Company Many Brands

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12 June 2014

Jonathan Coppel and Karen Chester
Commissioners
Natural Disaster Funding Arrangements
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

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Dear Commissioners

Natural Disaster Funding Arrangements – Issues Paper

Suncorp welcomes the opportunity to respond to the Productivity Commission's Issues Paper on Natural Disaster Funding Arrangements. As one of Australia's largest general insurance groups, Suncorp is acutely aware of the impacts of natural disasters.

Australia's risk profile is changing and it is crucial that our investment in disaster mitigation increases to better manage natural hazard risk. Additionally, our post-disaster recovery investment should ensure resilience against recurrent damage. This focus on resilience should be supported by improved planning and building regulations.

Natural disaster risk management has been a growing area of concern for many years and Suncorp believes now is the time for action. Improving the funding mechanisms and regulations that support natural disaster risk management will place the community, and the economy, in better stead to withstand future disasters.

Our submission is enclosed and Suncorp would be happy to provide further information to the Commission to assist with your deliberations.

Should you have any further questions regarding our submission, please contact me

Yours sincerely

Duncan Bone
Executive Manager, Public Policy

Productivity Commission Natural Disaster Funding Inquiry 2014

Suncorp General Insurance Submission

June 2014

One Company Many Brands

SUNCORP GROUP

Executive Summary

As one of Australia's largest insurers, Suncorp is all too familiar with the social and economic effects of natural disasters like storm, cyclone, flood and bushfire.

Recently, trends including urbanisation, economic growth and population shifts towards the coast have all contributed to an increased level of natural disaster risk in Australia. This heightened level of risk has broad impacts across the economy, including increasing the cost of insurance. One of the most startling economic impacts however is the scale of government expenditure on relief and recovery. There continues to be a heavy focus on post-disaster recovery funding which is becoming increasingly inefficient and costly.

To counter increasing levels of risk, Suncorp believes it is necessary to place a stronger focus on disaster mitigation and risk management. Greater pre-disaster investment could also deliver significant benefits in post-disaster financial outcomes. Disaster mitigation is a highly effective form of government investment preventing productivity losses, reducing recovery expenditure, allowing the economy to stay open for business throughout natural hazard events and reducing insurance premiums.

Disaster mitigation, rather than post-disaster recovery assistance, also makes economic sense in the long term. Suncorp recently commissioned KPMG to model the impact of a structured disaster mitigation program. The study found a structured mitigation program provides a GDP boost felt across household consumption, exports and imports, with a lower need for investment capital and returns due to a reduction in rebuilding activity. Over a 10 year period, the proposed $250 million annual disaster mitigation program is modelled to produce a $6.2 billion increase in GDP.

A successful disaster mitigation program must be coordinated, national and multi-faceted. Mitigation can be achieved through investment in dedicated infrastructure, such as a flood levee, or through regulations such as construction codes and state-based planning regulations. Disaster mitigation spans all levels of government with a wide-variety of possible actions to address each identified hazard.

In the past, this has resulted in mitigation across the country being haphazard, incoherent and patchwork in nature. Effective disaster mitigation is reliant on commitment, coordination and investment by each level of government. The key to improved outcomes will be a national focus provided by the establishment of a taskforce to guide investment in infrastructure, ensure resilience and to promote

sharing of information and resources nationally. This will ensure the full range of disaster mitigation actions are identified, prioritised and implemented.

In addition to a stronger focus on disaster mitigation, the level of government intervention in insurance markets should be reduced. A clearer and more efficient insurance market can be supported by revisiting post-disaster grant structures, insurance taxation, capital requirements and the sharing of hazard risk information. Improving these regulations will allow a greater proportion of risk to be transferred through the insurance market, provide a clearer market signal of risk and reduce the need for Government to provide post-disaster financial assistance.

Key Recommendations

- Natural disaster funding arrangements should be reformed to shift the focus of funding from post-disaster relief and recovery towards pre-disaster mitigation. Increased investment in disaster mitigation offers economic benefits to the community and is a practical way to reduce future Federal Government expenditure on disaster relief and recovery.

- Building code and urban planning frameworks should be reviewed by the Council of Australian Governments to ensure best-practice disaster risk management is incorporated into regulations nationally. Lessons from previous disasters should be adopted nationally to ensure new homes, businesses and infrastructure are resilient to known natural hazard risks.

- Post-disaster recovery funding provided by the governments should be managed to ensure damaged infrastructure is rebuilt to a more resilient standard, preventing recurrent damage in the future.

- Federal, State and territory governments should support an affordable and efficient insurance market by removing state-based insurance taxes, reforming inflexible capital requirements and improving the sharing of hazard risk information.

- State and territory governments should establish centralised advice and support services to provide expert natural hazard risk management assistance to local government. This centralised service should focus on assisting local government to overcome their current funding and expertise challenges.

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About the Suncorp Group

Suncorp is the largest general insurance group in Australia offering a range of personal and commercial insurance products, protecting the financial wellbeing of millions of Australians. As a Group, Suncorp has nearly 15,000 employees and more than nine million customers across the country. Its General Insurance business alone, Suncorp paid out $5.8 billion in insurance claims in 2012-13, averaging more than $15 million each day.

Suncorp offers a range of personal insurance products including car, home and contents, travel, boat, motorcycle and caravan insurance. The key to Suncorp's success in personal insurance is its portfolio of well-known brands. These include Suncorp Insurance, Apia, AAMI, GIO, Vero, Shannons, Just Car Insurance, Insure My Ride, Bingle, Terri Scheer, CIL Insurance and Resilium. These brands have built reputations for insurance innovation, outstanding customer service and trustworthy products.

The Need for Investment

Australia has a long history of floods, bushfires, storms and cyclones. Recently, urbanisation, population shifts towards the coast, intense weather and sustained economic growth have combined to change our risk profile and increase the chance that a natural hazard, becomes a natural disaster. The average annual cost of natural disasters is $1.7 billion across the insurance and government sector and this cost is likely to increase into the future.

Our changing risk profile is translating into higher natural disaster costs with more than $14.5 billion of disaster claims over the past decade. Suncorp alone received 40,000 disaster claims during the 2010-11 Queensland summer of disasters totalling $767.7 million for residential customers and $267.2 million for commercial customers. The broader impact of these disasters is estimated to have reduced Queensland's gross state product by around $6 billion in 2010-11.[1]

The current approach to natural disaster funding is weighted toward disaster recovery funding, with limited levels of investment in preventative disaster mitigation. This results in the inefficient practice of minimising costs upfront only to be faced with significant recovery bills following each disaster. This was recognised recently by the National Commission of Audit which categorised recovery funding as a "large and volatile expenditure [which] poses significant and ongoing risks to the Budget."[2] Current arrangements also lead to the highly inefficient practice of rebuilding assets and infrastructure to the original standard, maintaining high levels of risk and allowing the benefit of recovery investment to be wiped out by subsequent disasters.

In contrast to relief and recovery funding, investment in preventative disaster mitigation remains low. The Productivity Commission has previously found that the Australian government's investment in disaster mitigation between 2005 and 2011 ranged between $24m and $37m.[3] In another example, the Queensland Government recently received 174 disaster mitigation grant applications totalling $547m in value.[4] The program has combined funding of just $46.8 million, including $12 million of Commonwealth funding which is yet to be released.[5] Clearly the level of investment in disaster mitigation could be increased to better manage natural hazard risk and reduce the need for post-disaster recovery.

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[1] Deloitte Access Economics, *Road to Recovery*, October 2011, pg. 7. available: http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTEyOTcyfENoaWxkSUQ9LTF8VHlwZT0z&t=1 (Accessed: 30/05/2014)
[2] National Commission of Audit, *Towards Responsible Government,* Phase One Report, February 2014, pg. 187.
[3] Productivity Commission*, Barriers to Effective Climate Change Adaptation – Final Report*, 19 September 2012, pg. 255.
[4] The Hon. David Crissafulli MP*, Record applications for flood defence projects,* media statement, 15 May 2014.
[5] Department of Local Government, Community Recovery and Resilience, *Queensland disaster mitigation and resilience funding,* 10 April 2014 available: http://www.dsdip.qld.gov.au/grants-and-subsidies-programs/queensland-disaster-mitigation-and-resilience-funding.html (Accessed: 30/05/2014)

It is essential that funding efforts are shifted towards the prevention of natural disasters. Increased funding for disaster mitigation will make better use of limited resources and more effectively safeguard individuals, communities and the economy from natural hazards. A stronger focus on disaster mitigation will also offset growing risk trends and reduce the level of disaster risk being built into the economy. A small investment in a smarter decision today will deliver benefits to the community and governments for decades to come. It will also reduce the need for post-disaster government recovery assistance.

Disaster Mitigation

The way Australians approach disaster mitigation needs significant reform. Each year that disaster mitigation fails to keep pace with Australia's growing risk profile is another year where up to $1.7 billion of largely preventable losses occur.

Economic Imperative

In the context of this review, increased disaster mitigation offers a practical way to reduce the amount of recovery funding required after a disaster. Each dollar invested in disaster mitigation reduces the resources required across disaster response and recovery. Over time this will lead to a reduction in the level of resources used in managing natural hazard risks.

The 2002 COAG review, *Natural Disasters in Australia*, highlighted additional investment in disaster mitigation offers all three levels of government a conservative rate of return of 15 per cent. Flood mitigation is particularly effective, with each dollar of investment saving Government $2.10 in future recovery expenditure.[6] For communities, the investment return can be even greater with lower insurance premiums, increased economic activity and improved peace of mind.

Suncorp recently commissioned KPMG to model the material impacts on the economy from switching from the current natural disaster structure to either a pooled insurance system or a publically mitigated system from our current baseline. The KPMG Report found:

- that over the long-term government investment in natural disaster management is more economical when applied to structured mitigation than post disaster assistance;
- the current framework of pre-disaster management is still inherently incoherent and segmented;
- a sufficiently incentivised community with access to funding can lead the coordination of mitigation programs at a regional level and effectively drive down the cost of insurance premiums; and
- accurate risk pricing by insurers is critical in communicating actual risks to customers and incentivising risk reducing decision making.

[6] Australian Government Department of Transport and Regional Services, *Natural Disasters in Australia*, 2004, pg. 24.

Overall, the study found a structured mitigation program provides a GDP boost felt across household consumption, exports and imports, with a lower need for investment capital and returns due to a reduction in rebuilding activity. Over a 10 year period, the proposed $250 million annual disaster mitigation program is modelled to produce a $6.5 billion increase to GDP.

Insurance Premiums

The insurance industry plays an important role in supporting natural disaster mitigation. Risk-based insurance premiums act as a messenger of risk. High insurance premiums indicate high levels of risk and provide the community an incentive to reduce risk. More importantly however, lower insurance premiums act as a financial reward when risks are reduced.

A demonstration of the immense value disaster mitigation can be observed in Charleville, Queensland where a flood mitigation program was recently completed. This project has significantly reduced disaster risks with an average home and contents premium for a new policy now around $990 - without flood mitigation this average home insurance premium would be over $3000.

The table below shows a number of towns that have either completed flood mitigation works, or have provided enough information for Suncorp to predict premium impacts. This is only possible as a result of close collaboration with relevant local councils and demonstrates the value of transparent risk information, discussed in further detail later.

TABLE 1 - DISASTER MITIGATION AND INSURANCE PREMIUMS

TOWN	CLAIMS HISTORY	MITIGATION DETAILS	PREMIUM IMPACT
Charleville, Queensland	Since 2008, Suncorp alone has paid 296 natural disaster home claims at a total cost of $18.8 million.	$20 million flood levee combined with Bradley's Gully diversion and house raising program. Risk analysis suggests a 158% increase in the number of properties assigned a nil flood risk rating.	Average home and contents premium for a new policy is now around $990, without flood mitigation the average home insurance premium would have been over $3,000.
St George, Queensland	Since 2008, Suncorp alone has paid 169 natural disaster home claims at a total cost of $5 million.	$6 million flood levee combined with house raising grants and land swaps.	The average premium of an existing policy has dropped by around 15% and the cost of a new home policy has reduced by $270.

Rockhampton, Queensland	Rockhampton has experienced 17 moderate and major flood events in the past century or about one every six years.	Proposed flood levee protecting around 1,000 homes estimated to cost $48 million. Suncorp risk analysis suggests a potential 14% increase in the number of properties assigned a nil flood risk rating.	Average premiums for homes exposed to flood risk will likely reduce 32% or around $400. The average cost of a home policy will be around $1,000.
Roma, Queensland	Since 2008, Suncorp alone has paid out more than 1,000 home claims at a cost of $100 million +	$16 million flood levee, currently under construction, protecting around 500 homes combined with house raising and diversion channel.	Average premium reductions of around 30% for a $300,000 home. Reductions of up to 80% for highest flood risk properties.

This table demonstrates the relationship between large scale flood mitigation projects and local insurance premiums. These projects over time will also reduce the cost of reinsurance for Suncorp and help support and overall lower cost of insurance for the broader insurance market. They will also reduce the amount of capital required to underwrite risks, leading to lower costs for insurers and greater competition in the insurance market.

Although these examples relate to specific large scale projects, smaller scale disaster mitigation steps can also lead to lower premiums over time. For example, stronger building codes and smarter urban planning will reduce the risks faced by future developments. This reduced level of risk will flow through the insurance market and result in lower premiums. It is therefore important that a national and multi-faceted approach to disaster mitigation is taken.

Disaster Risk Management

As new homes and communities are established, it is important that disaster risk is managed throughout building and planning regulation. This is particularly important in coastal and waterfront locations that are desirable areas to live, but also come with high levels of natural hazard risk. Ensuring that both building and planning regulations adequately manage risks will protect future communities from the high costs associated with future natural disasters.

Building Stronger Homes

The national construction code is a key piece of regulation that affects the level of risk throughout Australia. The value of requiring homes to be constructed to a stronger building code is particularly clear in cyclone prone areas. Following Cyclone Tracy in 1974, wind resistance standards were significantly increased through building codes. This has significantly reduced the risk to life from cyclones, but also reduced the risk of damage to homes and generated more affordable cyclone insurance premiums.

An example of the effect of building codes can be seen in the cost of Cyclone claims in the towns of Innisfail, Tully and Cardwell in North Queensland. In 2006, Cyclone Larry damaged a number of homes in Innisfail, which were repaired or rebuilt subject to the new stronger building code. In 2011, when Cyclone Yasi again impacted Innisfail the rebuilt areas saw average repair costs of $56,000. This was almost half of the $110,000 repair costs in nearby Tully and Cardwell that were largely built prior to the new cyclone building standards.

While clearly building codes have already played an important role in lessening the impact of natural disasters, more can be done to improve their effectiveness. For instance, the current objective of the Australian Building Codes Board (ABCB) includes to:

> …establish codes and standards that are the minimum necessary to efficiently achieve the relevant mission of ensuring safety and health, and amenity and sustainability objectives.[7]

The mission of the ABCB should be expanded to include an explicit resilience objective. This would ensure the full range of economic benefits associated with code improvements are considered throughout regulatory impact analysis. Currently,

[7] Australian Building Codes Board, *Australian Building Codes Board Intergovernmental Agreement,* 2012, pg. 8.

the ABCB mission only supports analysis based on safety, health and sustainability objectives.

Changes that would improve resilience, but don't improve safety and health, are likely to fail regulatory impact analysis and are therefore not included in building codes. For example, protection against wind driven rain ingress around windows and doors has no effect on safety and health, but would significantly improve outcomes following a tropical cyclone by avoiding consequential damage to furnishings and plasterboard.[8]

This gap in objectives was recognised by the ABCB Chairman in his submission to the Productivity Commission's Inquiry *Barriers to effective climate change adaptation*:

> The ABCB's commitment through the IGA [Intergovernmental Agreement] to BCA [Building Code of Australia] provisions being cost effective may restrict efforts to make buildings more resilient. The costs change to building design is a real cost that can be easily estimated, while the benefits provided would be in terms of probable reductions in damage, injury or loss of life and are often intangible, difficult to estimate and have a long timeframe.[9]

We advocate for amendment of the mission and objectives of the Australian Building Codes Board (ABCB) to include an explicit focus on building community resilience to natural hazards. Importantly, this would recognise the economic and productive value of assets in addition to the protection of life goals currently within the regulation.

A resilient building code will require investing a small amount upfront to manage the long-run risks associated with natural hazards. For example, the Keelty Review into the Perth Hills Bushfires found that for between $200 and $500, ember screens could easily be fitted to evaporative air conditioners resulting in a dramatic decrease in risk from ember attack.[10] This is clearly a smart investment when benchmarked against the risk of total loss following a bushfire.

A more resilient building code will also reduce the need for post-disaster financial assistance from Government. A 2012 Milliman study found a stronger building code

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[8] Boughton et. al, "Tech Report No 57", *Tropical Cyclone Yasi Structural Damage to Buildings*, James Cook University, 19 April 2011, pg. 81, available: https://www.jcu.edu.au/cts/publications/content/technical-reports/jcu-078421.pdf/view, (Accessed: 11/12/2013)

[9] Australian Building Codes Board, *Submission to the Productivity Commission Inquiry into Regulatory and Policy Barriers to Effective Climate Change Adaption – Draft Report*, June 2012, pg.10.

[10] Perth Hills Bushfire Review, *A Shared Responsibility: The Report of the Perth Hills Bushfire February 2011 Review,* 16 June 2011, pg. 143.

act could have saved the US Federal Government an average of nearly $500 million a year in hurricane relief payments if it had been enacted in 1988.[11]

A stronger building code should also be supported by enforcement. The Queensland Building and Construction Commission recently conducted a random audit of 112 buildings in Mackay and found 11 did not meet cyclone standards.[12] It is crucial that the building code is robustly enforced to ensure new homes stand the best possible chance of withstanding future cyclones and natural hazards.

Beyond the mandatory requirements of the building code, it is also often wise for homeowners to voluntarily invest in more resilient homes. To support this voluntary investment, the insurance industry has established the Australian Resilience Taskforce to develop a Building Resilience Rating Tool (BRRT).[13] This tool combines natural hazard risk information from the insurance industry with information about building materials to develop a simple 1 to 5 resilience rating for homes.

The BRRT provides the community an opportunity to educate themselves about the risks they face and make smarter decisions about building or renovating their homes. We believe the BRRT will help to enhance resilience but is limited by awareness of the tool and competing cost interests during home construction and renovation.

To help overcome these competing interests, an insurance premium incentive program could be linked to the BRRT, similar to the Resilience STAR™ program in the United States. Resilience STAR™ is a partnership between the Institute for Business and Home Safety (operated by US Insurers) and the US Department of Homeland Security to promote and incentivise resilience.

The program incentives include insurance premium reductions, building permit rebates, state-level tax incentives, as well as state and federal grant funds that can be used to offset retrofitting or building costs.[14] Such a program with similar incentives in Australia would increase the motivation for individuals to go beyond the minimum requirements of the building code to achieve greater resilience.

Suncorp believes the combined influence of a stronger building code and increased incentives for resilient construction will significantly improve the durability of homes and businesses. This will have a wide range of positive impacts for communities

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[11] Environmental and Energy Study Institute*, Support for climate adaptation and resiliency*, 2013, available: http://www.eesi.org/policy/resiliency#.U409Jt3ibfU (Accessed: 03/06/2014)
[12] Melissa Maddison, *Mackay building audit reveals cyclone standards shortfall*, ABC News, 21 March 2013, available: http://www.abc.net.au/news/2014-03-21/mackay-building-audit-reveals-cyclone-standards-shortfall/5336012 (Accessed: 03/06/2014)
[13] Insurance Council of Australia*, Building Resilience Rating Tool,* 2013, available: http://www.buildingresilience.org.au/brrt (Accessed: 05/12/2013)
[14] See: Institute for Business & Home Safety, *Resilience STAR™*, available: http://www.disastersafety.org/resilience-star/ (Accessed: 14/01/2014)

including continuity of business during disasters, reduced social stresses associated with asset loss and more affordable insurance premiums.

Smarter Urban Planning

Disaster risk management can also be achieved through risk-informed urban planning. As more homes and businesses are built, the impact of natural hazards increases due to the higher number of structures exposed to natural hazards. Placing homes and businesses in smarter locations will help reduce the likelihood and cost of natural disasters.

Our expanding built environment creates a clear need for risk-informed urban planning that helps to manage exposure to natural hazard risks. Risk-informed planning is not a new concept, indeed a 1909 Royal Commission into the town planning of Sydney states:

> Provision should also be made in such an Act to minimise fire risks arising from the overcrowding of building areas, the absence of fire breaks and proper means of access.[15]

More than a century later, the National Strategy for Disaster Resilience expresses a similar concept:

> The strategic planning system is particularly important in contributing to the creation of safer and sustainable communities. Locating new or expanding existing settlements and infrastructure in areas exposed to unreasonable risk is irresponsible.[16]

Urban planning has a critical relationship with the level of risk in a community and its economic resilience to disasters. Take an example town of 100 homes that is impacted by a bushfire on average once every 40 years. Each time a bushfire affects the town, 10 houses are burnt at a replacement cost $300,000 per house. This results in a $3 million expense per bushfire or an annualised insurance premium of $750 for each homeowner ($3,000,000 event cost ÷ 40 years ÷ 100 households - if we assume nil operating costs or profit for the insurer).

Over time, population growth creates demand for 20 new homes that could either be constructed on the urban fringe, or within the town as infill development. Constructing these homes on the urban fringe increases the number of homes in close proximity to bushland and may result in additional five homes being destroyed

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[15] Royal Commission for the Improvement of the City of Sydney and its Suburbs, *Final Report*, 1909, pg. xxiv, available: http://www.photosau.com.au/CoSMaps/maps/pdf/RC_R/6%20-%20FINAL%20REPORT.pdf (Accessed: 15/11/2013)
[16] Council of Australian Governments, *National Strategy for Disaster Resilience*, February 2011, pg. 11.

during each bushfire event. This would increase the event cost to $4.5 million and result in annualised premiums of $937.50, an increase of 25% ($4,500,000 event cost ÷ 40 years ÷ 120 households).

Alternatively, the 20 new homes could be planned as in-fill development and located further away from bushland. This would still increase exposure, but to a lesser extent and perhaps only one additional home is destroyed during each event. This would increase the event cost to $3.3 million but the greater number of homeowners allows for the risk to be shared by a larger number of policyholders. In this scenario, the annualised premium would actually reduce to $687.50 ($3,300,000 event cost ÷ 40 years ÷ 120 households).

While the interrelationships between planning, risk and insurance premiums are far more complex in an actual town, the fundamentals of this example demonstrate how risk-informed planning can be used as a policy tool to manage community risk and influence insurance premiums. In the example where development has been guided by risk, the community collectively saves $30,000 in insurance premium expenses each year.

It is clear that urban planning is a challenging policy area with a huge range of competing priorities making regulation difficult for governments. The long lifespan of buildings and infrastructure however, mean that a shortfall in the planning scheme can leave the community at an unacceptable level of risk environment for 100 years or more.

Recent natural disasters, including the 2009 Victorian Bushfires, the 2010-11 Queensland floods and Cyclone Yasi, have highlighted some weaknesses in planning regulations throughout Australia. Suncorp believes it is crucial for State and territory governments to quickly respond to the changing risk environment throughout Australia and improve planning regulations.

A good example of the need to strengthen planning regulations is the recent approval of a 970-dwelling complex in a flood plain by the Gold Coast City Council. Although the development is sufficiently high risk to warrant an evacuation helipad, a three-day emergency food supply and two lifeboats, the Council felt they did not have the legal standing to decline the development application.[17]

[17] Kim Stephens, *Development on Gold Coast flood plain to have lifeboats, emergency food*, Brisbane Times, 19 July 2013, available: http://www.brisbanetimes.com.au/queensland/development-on-gold-coast-flood-plain-to-have-lifeboats-emergency-food-20130719-2q9km.html (Accessed: 10/12/2013)

Similarly, development continues in the Hawkesbury-Nepean flood plain, despite multiple government reviews finding it an extreme flood risk. A 2012 report for Infrastructure NSW states:

> A repeat of the 1867 flood in the Valley is expected to flood around 7,000 homes of which 1,000 would be likely to fail. The SES has plans to evacuate more than 60,000 people in an extreme flood.[18]

Suncorp risk estimates place the Gold Coast and Hawkesbury-Nepean among the highest risk areas in the country. These are clear examples of where planning frameworks could be improved to better manage natural hazard risk. It is crucial that smarter urban planning takes place today to ensure that new developments can proceed in a resilient manner, protecting future communities from the harsh impacts of natural disasters.

[18] Molino Stewart Pty Ltd, *Hawkesbury-Nepean Flood Damages Assessment – Final Report,* , September 2012, pg. 1, available: http://www.infrastructure.nsw.gov.au/media/16727/molino_stewart_hn_flood_damages_report_final.pdf

Post-disaster Investment

The long life of infrastructure, homes and businesses means it is vital we use the opportunity presented by disasters to rebuild in a resilient way. It only makes sense that assets damaged once by disasters will be damaged again unless something is changed. Post-disaster investment should be managed to ensure damaged infrastructure is rebuilt to a more resilient standard, preventing recurrent damage in the future.

In a recent article, Dr Sarah Boulter, Research Fellow at the National Climate Change Adaptation Research Facility is quoted:

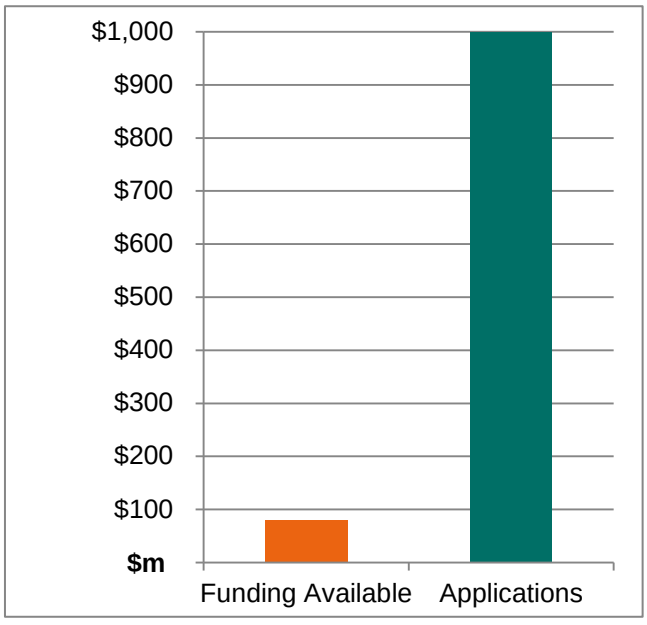
> Often, following a disaster, there is an option to 'build back better' but this requires considerable political will and financing. It's more common to simply rebuild in a desire to return to normality as soon as possible.[19]

A prime example of the need for smarter post-disaster investment is the Gayndah water pump in Queensland. The water pump was damaged by the 2011 floods and was rebuilt in the same location using disaster recovery funding. Two weeks after it was recommissioned it was damaged again by flood waters due to its poor positioning. Moving the pump to a higher level was the first project to be funded under the Queensland Government's betterment program.[20]

This program, jointly funded by State and Federal Governments, received nearly $1 billion worth of applications with only $80m of funds available.[21]

This almost $1 billion funding shortfall, in one year, just in Queensland, demonstrates how common it is for damaged infrastructure to be rebuilt or repaired to the original standard and therefore remain exposed to natural hazard risk.

Figure 1 - POST-DISASTER INVESTMENT SHORTFALL



[19] Sunanda Creagh, *Experts urge caution when rebuilding after disaster,* The Conversation, 4 December 2014, available: http://theconversation.com/experts-urge-caution-when-rebuilding-after-disaster-11133 (Accessed: 31/05/2014)
[20] The Hon. David Crisafulli MP, *Betterment funds flow for North Burnett,* media statement, 4 May 2013.
[21] The Hon. David Crisafulli MP, *Councils seek nearly $1 billion for better building*, media statement, 28 April 2013.

While it is costly to build infrastructure to a more resilient standard, it is even more costly to continually rebuild after natural disasters. Suncorp strongly believes post-disaster investment in resilience should be built into recovery funding arrangements. It is inefficient to fund recovery to an existing standard when that standard has been proven vulnerable to natural hazards.

Insurance Markets

Insurance plays a vital role in the financing recovery from natural disasters. Individuals, businesses and governments can transfer the financial risk of disaster through insurance markets to help fund unexpected and severe costs associated with natural disasters. The risk-based price of insurance also ensures individuals receive a market indication of risk, which influences decision making.

Government policy should support the provision of attractive and affordable insurance products by minimising interference with insurance markets. This will improve the uptake of insurance and reduce the need for government to act as the "insurer of last resort" by providing inefficient and costly post-disaster financial assistance. The below policies can be changed to improve the functioning of the insurance market, increasing economic resilience to disasters and reducing the need for government assistance.

Disaster Recovery Grants

Suncorp has observed that the Australian Government Disaster Recovery Payment (AGDRP) and the Disaster Recovery Allowance (DRA) may give rise to 'charity hazard'. The receipt of AGDRP or DRA payments, or the knowledge of payments to others, has occasionally influenced sum insured and insurance excess decisions of our customers and reduced the overall level of insurance coverage.

KPMG found that:

> There are significant challenges associated with supplementing the cost of disaster recovery. For households, the provision of post disaster government assistance has been inconsistent across historic natural disaster events generating uncertainty and, if you are assuming some degree of government support, that in turn makes pre disaster decision making difficult.[22]

For example, a Suncorp customer in New South Wales received a $1,000 grant following the 2010-11 floods. Upon renewal the customer contacted us to increase their insurance excess to $1,000, citing the availability of assistance as a reason for increasing their excess above a level they could ordinarily afford to pay. This has not only increased the individual's reliance on future government assistance, it has also exposed them to substantial additional risk from non-disaster events such as a small kitchen fire for which no government assistance is available.

[22] KPMG, *Risk Apportionment in the Insurance Sector,* March 2014, pg.15

Research into the effects of the United States federal disaster assistance grants has found that for each $1,000 of government assistance provided, average insurance coverage decreases by between $5,322 and $6,350.[23] The research also found in contrast that federal disaster loans had no systematic effect on insurance coverage for consumers.

Capital Requirements

APRA's Life and General Insurance Capital (LAGIC) reforms have recently amended capital requirements for the insurance industry. While Suncorp supports strong prudential regulation, these reforms have introduced some inflexible capital frameworks, which have unnecessarily increased the cost of insurance.

One example of this is the Insurance Concentration Risk Charge (ICRC) which prescribes the minimum amount of capital required to be held against insurance risks and has implications for reinsurance.

As a result of an APRA decision which conservatively estimates the potential cost of reinsurance reinstatements, Suncorp has been forced to change our reinsurance structure and buy two additional reinstatements upfront. These reinstatements are highly unlikely to ever be used but are necessary in order to avoid well over $100 million of capital charges under the ICRC. This excessive regulation has resulted in an additional $20 million in reinsurance costs which has increased the cost of insurance.

Insurance Taxation

Insurance taxes, duties and levies currently form a significant barrier against Australians purchasing affordable insurance cover. Insurance premiums are currently subject to the imposition of multiple taxes, with the Australian Bureau of Statistics reporting that insurance taxes contributed $5.53 billion in taxation revenue across all levels of government in 2012-13.[24] This is more than the amount collected through gambling taxes.

The need for insurance tax reform is particularly clear when taxation revenue growth is considered. Insurance taxes are applied as a percentage of premiums, meaning that as premiums increase due to extreme weather costs, additional taxes are collected from the community and the government receives unexpected tax revenue. This also results in a higher tax burden for those at highest risk, resulting in a

[23] Kousky, C., Michel-Kerjan, E., Raschky, P., *Does Federal Disaster Assistance Crowd Out Private Demand for Insurance,* Risk Management and Decision Processes Center, October 2013, Available: http://www.aeaweb.org/aea/2014conference/program/retrieve.php?pdfid=102 (Accessed: 01/06/2014)
[24] Australian Bureau of Statistics, *5506.0 - Taxation Revenue, Australia, 2012-13*, 28 May 2014.

reduced likelihood to take out insurance coverage and an increased need for post-disaster Government assistance.

Suncorp strongly supports recommendation 79 of Australia's Future Tax System which recommends that "[a]ll specific taxes on insurance products, including the fire services levy, should be abolished."[25] Insurance tax reform has also been recommended by the 2009 Victorian Bushfires Royal Commission,[26] the Productivity Commission *Barriers to Effective Climate Change Adaptation* Inquiry,[27] and the Senate *Recent trends in and preparedness for extreme weather events* Inquiry.[28]

In 2013, Suncorp welcomed the decision by the Victorian Government to abolish the Fire Services Levy. Since transition to a property based levy Victoria has introduced concessions for pensioners and veterans while also lowering Fire Services Levy rate.[29] Abolishing insurance taxes clearly improves the fairness and efficiency of tax collection and Suncorp advocates for further insurance tax reform.

Transparent Risk Information

Typically, government agencies at the State and local level hold significant amounts of hazard information developed for planning and emergency management purposes. The sharing of this information is highly valuable for the community, both better informing individuals to prepare for disasters and supporting a more efficient insurance market.

Access to government risk information can improve the accuracy of insurance pricing leading to corrections of under pricing and to the removal of uncertainty pricing. Uncertainty pricing occurs where there is an unclear picture risk for an insurer and an additional safety margin must be charged to maintain prudential standards, ensuring that the possible range of risks is fully accounted for. When data becomes available that better defines risk, premiums can be adjusted to better reflect risk.

Table 2 shows some example reductions of insurance premiums where Suncorp customers have provided a copy of their council-developed, updated flood risk map. This has allowed Suncorp to improve our assessment of risk and offer a lower overall insurance premium.

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[25] The Treasury, *Australia's future tax system—Report to the Treasurer*, December 2009, p. 94.
[26] 2009 Victorian Bushfires Royal Commission, *Final Report- Summary,* July 2010 pg. 36
[27] Productivity Commission*, Barriers to Effective Climate Change Adaptation – Final Report*, 19 September 2012, pg. 30
[28] The Senate Environment and Communications References Committee, *Recent trends in and preparedness for extreme weather events,* August 2013, pg.78.
[29] The Hon. Michael O'Brien MP and the Hon. Peter Ryan MP, *Coalition Government reduces fire levy rates*, media release, 21 May 2014.

TABLE 2 - EXAMPLE UNCERTAINTY PREMIUM REDUCTIONS

PREMIUM WITHOUT FLOOD MAP	PREMIUM WITH COUNCIL FLOOD MAP	DIFFERENCE IN PREMIUM
$1,474.99	$1,260.74	-$214.25
$2,075.42	$1,664.86	-$410.56
$1,775	$1,264.50	-$510.50

A more efficient way of reducing uncertainty pricing is for governments to provide bulk access to risk information. This has occurred in some areas through a recent update to the National Flood Insurance Database. Suncorp has used this additional flood risk information to improve our pricing models and has been able to substantially reduce premiums in some towns as a result.

For example, updated information for Port Douglas in North Queensland has allowed Suncorp to assign a nil flood risk rating to a large a section of properties previously assigned a low to medium risk rating. This has led to premium reductions of up to $1,000 and overall could save the Port Douglas community up to $2.5m in premiums each year.

Similarly, for Wyong in NSW, access to flood risk information saw the number of properties rated as no flood risk increase by 19 per cent. This has generated an average 35 per cent premium reduction that could potentially equate to an annual premium saving of $2.8m across the community.

Geoscience Australia is currently developing a National Flood Risk Information Program to provide improved access to flood studies developed by all levels of government.[30] This project follows recommendations of both the Natural Disaster Insurance Review (NDIR) and the Queensland Floods Commission of Inquiry to enhance the transparency of flood risk.

Suncorp supports increased sharing of risk information. A centralised way to access historical loss information and government risk data will help to develop a consistent picture of natural hazard risk providing significant benefits for the community, government and the insurance market.

The community will benefit from increased risk awareness, leading to better management of risk. There have been a number of examples of individuals and home owners moving into a hazard-prone area with little or no risk information being

[30] Geoscience Australia *National Flood Risk Information Program*, 18 June 2013, available: http://www.ga.gov.au/hazards/flood/national-flood-risk-information-project/national-flood-risk-information-program.html (Accessed: 29/10/2013)

provided to them. The Sydney Morning Herald has even highlighted a number of residents in the Hawkesbury-Nepean region, one of Australia's highest flood risk areas, were unaware a flood may affect their home and require evacuation.[31]

The insurance market will also benefit with risk information leading to increased competition. Risk information improves the ability for insurers to model risk, which in turn increases the likelihood of new entrants into the insurance market. A better understanding of risk is particularly important for attracting new insurers to high risk markets such as North Queensland. Accurate risk modelling allows new entrants to expand with confidence and avoid holding excessive capital in reserve.

Finally, governments will benefit from the improved management of risk at the individual and insurer level, reducing the need for post-disaster financial assistance. A better understanding of risk at a national level will also improve provide a basis on which to prioritise disaster mitigation funding.

[31] Han, E, "I didn't know an 1867-type flood could happen here", Sydney Morning Herald, 26 March 2013, available: http://www.smh.com.au/environment/water-issues/i-didnt-know-an-1867type-flood-could-happen-here-20120326-1vtvr.html

Supporting Local Government

Local government is an important stakeholder in natural disaster risk management. As the interface between regulation and community, local government provides the local knowledge required to effectively implement disaster mitigation.

Suncorp's conversations with local councils highlight that many are struggling to find the support they need to build disaster mitigation infrastructure. One local mayor even contacted Suncorp seeking advice as to which government department could assist their town progress a flood study.

Disaster risk management responsibilities are often devolved to local governments due to their expert local knowledge. Local governments however, struggle to fulfil those responsibilities with key pressures of funding and expertise, making it challenging to progress disaster mitigation initiatives.

The funding challenge is not a new issue for local government. Council rates account for just three per cent of the overall revenue raised by overall taxes, but are used to cover a wide variety of local services including roads, parks, planning and disaster management. The limited capacity of regional councils to raise rates means they have an even tougher funding task. Most regional councils rely heavily on financial assistance from States and the Federal Government, with grant revenue sometimes accounting for more than half of council revenue.[32]

The limited capacity for many councils to raise their own revenue, combined with the lack of disaster mitigation funding being passed down from State or Federal Governments, means in many cases there is simply no money available to invest in disaster mitigation. This can be observed, for example, in Rockhampton where a flood mitigation program was first recommended following severe flooding in 1991 but has yet to be implemented.[33]

Adding to the funding challenge is the difficulty in developing the expert knowledge required to build a sound disaster mitigation plan. Disaster mitigation requires a mix of local knowledge, history and professional skills like hydrology, forestry and geology. Finding this expert knowledge is difficult for most local councils with many engaging consultancy firms to provide risk reports. As noted by the Queensland Floods Commission of Inquiry:

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[32] *Facts and Figures,* Australian Local Government Association, 2014, available: http://alga.asn.au/?ID=59&Menu=41,83 (Accessed: 07/02/2014)
[33] See: *Flood Studies*, Rockhampton Regional Council, available: http://www.rockhamptonregion.qld.gov.au/Our_Region/Disaster_Management/Disasters/Flood_Season/Flood_Studies (Accessed: 02/06/2014)

> In almost every case, creating a comprehensive flood map involves undertaking a detailed flood study: an expensive, time consuming and technically complex process, beyond the reach of many councils.[34]

The rapid flood mapping support provided by the Queensland Reconstruction Authority is an example of how it is more efficient to have State-level coordination of risk mapping. This offers a cost effective way to fast-track flood mapping with experts engaged by a State body and allocated to projects in a coordinated way.

Enhanced support for local government may also help overcome disparity in the allocation of grant funding. For example, in the Productivity Commission's *Barriers to Effective Climate Change Adaptation* Inquiry, Mr Eddie Love, Deputy Director Environment Planning, Gosford City Council stated:

> I guess our ability to be successful in getting grant funding has been very good and because traditionally or historically there has been a fairly consistent pot of money and there's been few councils looking to try and grab that pot of money, we've been one of those councils that has been successful in getting some of that.[35]

This example highlights how a grant approach to disaster mitigation funding can result in a distorted allocation of funding towards councils most willing to invest time and resources into grant applications. Greater support for local government through the provision of access to expertise from higher levels of government will help resolve this distortion.

A good example of the need to better support local government can be observed in the town of Roma, Queensland. A flood levee has been discussed for the town since 2007 but was not constructed due to funding issues. After being flooded three times in as many years, Roma had faced several multi-million dollar recovery bills, but still did not have a flood levee. In 2012, Suncorp made the difficult decision to refuse cover to new customers and increase premiums for our continuing customers in the town.

This temporary embargo was both a business and community driven decision, with our ultimate intention being to highlight the need for more investment in disaster mitigation for the community of Roma. A flood levee is now under construction in Roma and new policies are being accepted. Suncorp expects the levee will result in average premium reductions of around 30 per cent, and for high risk customers, a reduction of up to 80 per cent. Again this demonstrates the challenges local

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[34] Queensland Floods Commission of Inquiry, *Final Report*, 2012, pg.62.
[35] Productivity Commission, Transcript of Proceedings, *Inquiry into barriers to effective climate change adaptation*, 10 July 2012, pg. 62.

government face with regard to disaster mitigation, but also how these can be overcome with external support.

The experiences observed in Rockhampton, Gosford and Roma demonstrate the need to rethink our approach to disaster mitigation across levels of government. A more effective approach will be to ensure local government have access to support from higher levels of government. State and territory governments should establish a centralised advice and support service to assist local governments overcome the funding and expertise challenges associated with natural disaster risk management.

Role of State and Territory Governments

State and Territory governments have responsibility for a number of policies that influence natural hazard risk, insurance coverage and the capacity to recover post-disaster. This submission has already addressed a number of State-level policies including:

- land-use planning;
- the National Construction Code;
- insurance taxation;
- disaster mitigation funding programs;
- sharing of natural hazard risk information; and
- improved support for local government.

Considerable improvement could be obtained through enhanced coordination of these policies, both within and across jurisdictions. A good example of the need for greater coordination is pre-sale natural hazard risk disclosures.

The Productivity Commission has previously identified that each State currently has different requirements related to which natural hazards must be disclosed by the vendor when selling a property.[36] Harmonising this regulation would come at minimal cost but would significantly improve risk awareness and prompt Australians to consider natural hazard risk when purchasing their homes.

In February 2013, Queensland established a ministerial portfolio for community resilience to improve natural disaster risk management. Since this time Suncorp has observed considerable progress in disaster mitigation with improved focus and coordination across policy areas. This has resulted in improved mitigation planning, enhanced transparency around funding arrangements and planning reforms targeted at natural hazard risk management.

Improving knowledge sharing and coordination of policies across jurisdictions is a low cost way of improving natural disaster risk management. This allows lessons

[36] Productivity Commission, *Barriers to Effective Climate Change Adaptation – Inquiry Report*, 19 September 2012, pg.141.

identified in post-disaster inquiries to be developed into best-practice regulation in one State or territory and then adopted nationally where appropriate.

Role of the Federal Government

Natural disasters can have significant regional economic implications. Reducing recovery funding without first reducing risk is likely to expose regional economies to significant levels of risk. Ultimately, regardless of policy decisions made today, the Federal Government is likely to provide financial assistance when faced with the risk of significant economic collapse post disaster.

The most effective way of achieving reduced Federal expenditure on post-disaster assistance is to invest in preventative disaster mitigation. It is for this reason that Suncorp suggests the Federal Government adopt a leadership role by increasing investment in resilient infrastructure. Funding arrangements should support resilient infrastructure investment both through post-disaster investment, as discussed earlier, and in pre-disaster infrastructure investment.

A record $50 billion dollars of infrastructure investment is budgeted through to 2019/20.[37] The significant scale of this investment presents the opportunity to ensure new infrastructure is developed in a resilient way, better preventing the need for future repair and reconstruction following disasters. This will not only protect the Federal Government budget from significant post-disaster expenditures, it will also ensure infrastructure continues to contribute to productivity during natural hazard events.

Alongside ensuring smart, targeted investment in disaster resilient infrastructure, vital national tools including a national picture of hazard risk and a national understanding of disaster impacts should be developed to support national decision-making.

A national understanding of risk will inform prioritisation of infrastructure investment and ensure new investments are resilient to known risks. Additionally, this picture of risk will better inform individuals, businesses and government of the natural hazard risks they face. This will ultimately reduce the call for post-disaster financial assistance in the future.

Similarly, a national understanding of disaster impacts would support better national decision making. Current disaster decision making predominantly relies on data related to insured losses held by the Insurance Council of Australia. The impacts of disasters extend far beyond insurable losses however, with significant economic, social and environmental impacts. Suncorp believes a more robust understanding of

[37] *Catalysing infrastructure investment*, Budget 2014-45, Australian Government, available: http://www.budget.gov.au/2014-15/content/glossy/infrastructure/html/infrastructure_02.htm (Accessed: 02/06/2014)

the impacts of disasters across sectors is crucial to ensure risk management is truly commensurate with risks.

We believe a better understanding of disaster risks and impacts will improve decision making and ensure national funding is directed towards resilience.

Conclusion

As the trends of urbanisation, economic growth and population shifts towards the coast continue, the level of risk throughout Australia will continue to rise. The current natural disaster funding arrangements place the Federal Government as insurer of last resort, exposing the Budget to significant risk.

It is important that reforms are made now to improve resilience to natural hazards going forward. These reforms will ultimately reduce the need for post-disaster relief and recovery and safeguard the economy. Most importantly, governments at all levels need to increase investment in pre-disaster mitigation in order to reduce the impact of hazards on communities, along with their own liability for post-disaster recovery funding.

Suncorp believes improvements in the building code, urban planning practices, sharing of risk information, investment in disaster mitigation, insurance taxation and improved support for local government are achievable in the short term. These changes will ensure a whole of community approach to disaster mitigation and ultimately place Australia on a better footing to withstand future natural hazards.

These issues are well-known and longstanding. Suncorp believes it is time for concerted action to progress coordinated structural changes today that will deliver ongoing benefits to the economy and the community for years to come.

Appendix A – Additional Documents

The below additional documents may also be of interest to the Productivity Commission:

Risk Apportionment in the Insurance Sector

This KPMG prepared report provides an empirical analysis using a comparative static, computable general equilibrium (CGE) model to test the material impacts on the economy from switching from the current natural disaster structure to either a pooled insurance system or a publically mitigated system.

Overall, the study found a structured mitigation program provides a GDP boost felt across house hold consumption, exports and imports, with a lower need for investment capital and returns due a reduction in rebuilding activity. This document is available at:

http://www.suncorpgroup.com.au/media/public-submissions

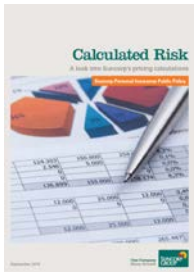
The Road to Recovery

This report prepared by Deloitte Access Economics examines the role played by Suncorp in the wake of the unprecedented Queensland natural disasters over the summer of 2010-11. The economic analysis highlights the extent and scale in which claims payouts and broader risk mitigation services to Suncorp policyholders were pivotal in delivering urgent financial stimulus and restoring economic flows across Queensland. This document is available at:

https://www.deloitteaccesseconomics.com.au/uploads/File/Suncorp%20-%20Role%20of%20insurers%20in%20natural%20disasters%20-%20Final%20-%2017%20October%202011.pdf

Risky Business

The relationship between risk, risk management and insurance premiums is a concept that Suncorp has previously explored in *Risky Business* following the challenging series of natural disasters between 2009 and 2012. This document is available at: http://www.suncorpgroup.com.au/media/public-submissions?year=2013



Calculated Risk

Suncorp's approach to risk based insurance premium calculation is explained in *Calculated Risk.* Modern insurance pricing practices have changed significantly over the past few years and this document provides a comprehensive overview of Suncorp's current pricing approach. This document is available at:

http://www.suncorpgroup.com.au/media/public-submissions?year=2014

Reinsurance – Hero or villain?

The relationship between insurance and reinsurance has been explored by Suncorp's Commercial Insurance team. This document provides insight into the importance of reinsurance to a well functioning insurance company. This document is available at:

http://www.suncorpgroup.com.au/media/public-submissions?year=2012