NIBA
National Insurance Brokers Association.

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Select Committee on the Impact of Climate Risk
on Insurance Premiums and Availability
Parliament House
Canberra ACT 2600

Via Upload

NIBA Submission: Impact of Climate Risk on Insurance Premiums and Availability

1. Introduction

The National Insurance Brokers Association (NIBA) welcomes the opportunity to provide feedback to the Senate Select Committee's inquiry into the Impact of Climate Risk on Insurance Premiums and Availability.

Australia has long been familiar with natural perils, having experienced numerous floods, hailstorms, bushfires, cyclones, and severe storms over the past five years. In addition to increasing the frequency and severity of these risks, Climate change has also introduced new risks, such as coastal inundation and soil subsidence.

In 2021, 432 catastrophic events were recorded globally, significantly higher than the annual average of 357 events recorded between 2001 and 2020. Floods were the most prevalent of these events, with 223 recorded instances compared to an average of 163.[1]

The Intergovernmental Panel on Climate Change predicts that an increase in the average global temperature of just 1.5 degrees Celsius above pre-industrial levels will lead to a fourfold increase in natural disasters.[2] For Australia, which typically experiences an average of twelve severe weather events annually, this projection could mean that communities will face up to fifty severe storms, floods, bushfires, cyclones, hailstorms, and earthquakes each year.[3]

Insurance against climate risk is essential for mitigating the adverse effects of climate-related disasters. The Intergovernmental Panel on Climate Change (IPCC) emphasises the importance of risk-sharing and risk-transfer mechanisms for addressing the adverse effects of climate change.[4] Reports by the United Nations Framework Convention on Climate Change further highlight the importance of insurance in addressing losses and damages

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1 Reinhard, J., & Lefebvre, M. (2022). *The Cost of Extreme Weather.* Sydney: The McKell Institute.
2 Intergovernmental Panel on Climate Change. (2022). *Climate Change 2022: Impacts, Adaptation and Vulnerability. Contribution of Working Group II Intergovernmental Panel on Climate Change.* Cambridge, UK and New York, NY, USA, : Cambridge University Press.
3 Insurance Council of Australia. (2023, January). *Historical Catastrophe Data.* Retrieved from: https://insurancecouncil.com.au/wpcontent/uploads/2023/01/JANUARY-2023-HISTORICAL.xlsx
4 Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaptation: Special Report of the Intergovernmental Panel on Climate Change

associated with climate risks. [5] However, data published by the Climate Council shows that one in 25 homes in Australia will be "effectively uninsurable" by 2030 due to the increased risk of extreme weather events and climate change.[6]

2. The role of insurance in supporting resilience and recovery

Insurance supports communities in recovering from natural disasters more efficiently, thereby enhancing economic recovery and reducing reliance on ex gratia government support.[7] Various studies into the role of insurance in disaster recovery have demonstrated that homeowners who lack adequate insurance coverage were less likely to rebuild following a natural disaster and, in some cases, were more likely to abandon their properties.

A study examining the experiences of homeowners following the 2005 Hurricane Season in America found that the most common reason homeowners chose not to rebuild was due to a lack of funding and that properties with insurance were 37% more likely to be rebuilt than those without.[8] (Kousky, 2019). Of those who decided not to rebuild, more than 36% of respondents indicated that their decision was based on their inability to obtain flood insurance for their properties.[9]

These findings underscore the critical role of insurance in disaster recovery. By providing financial resources and risk transfer mechanisms, insurance enables affected individuals and communities to rebuild and recover more effectively. This, in turn, contributes to overall economic stability and reduces the burden on government resources for disaster relief and recovery efforts.

3. The unaffordability and availability of insurance due to climate-driven disasters

It is widely assumed by homeowners and businesses that insurance will always be available for their properties and other risks. However, increasing insurance losses due to more frequent natural disasters, as well as changes to actuarial and underwriting models and underlying risk profiles, have resulted in significant increases in insurance premiums in many parts of the country.[10]

Insurance affordability and availability are intrinsically linked. Insurance products may be unavailable due to a lack of available cover within a region or class, or the insurance

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[5] UNFCCC (United Nations Framework Convention on Climate Change) Approaches to Address Loss and Damage Associated with Climate Change Impacts in Developing Countries that Are Particularly Vulnerable to the Adverse Effects of Climate Change

[6] Hutley, N., Dean, D., Hart, N., & Daley, J. (2022). *Uninsurable Nation: Australia's most climate-vulnerable places.* the Climate Council of Australia Ltd.

[7] McKinnon, D., Eriksen, D., & de Vet, D. (2020). *Why insurance matters: insights from research post-disaster.* East Melbourne: Australian Institute for Disaster Resilience.

[8] Kousky, C. (2019, November). The Role of Natural Disaster Insurance in Recovery and Risk Reduction. *Annual Review of Resource Economics*, pp. 399-418.

[9] Ibid

[10] Hextell, A. (2023). Beyond 2030: Examining the impacts of an uninsurable regional Australia. *Farm Policy Journal, 20*(1).

premiums are so high as to be unaffordable to the average policyholder, making insurance effectively unavailable.

This phenomenon is already occurring in parts of Northern Australia where on average, home insurance premiums are almost double that of the rest of Australia. Higher-risk areas are more likely to have a larger portion of consumers who pay significantly more, for example, in the town of Port Hedland on the West Australian coast 25% of households were paying premiums more than four times higher than the average for the rest of Australia.[11] Of this premium, cyclone risk accounts for approximately 54% of gross premiums.[12] This has led to higher-than-average rates of non-insurance, exacerbating the economic impact of cyclones on these communities.

This is compounded by the "unusual competitive dynamics" observed in the region. The Australian Competition and Consumer Commission's Northern Australia Insurance Inquiry noted that rather than compete to win new business, insurers in Northern Australia were taking steps to minimise their exposure in regions they considered volatile or high-risk. Such measures include increasing premiums to force clients to move to another insurer or declining to write or renew policies once a certain level of exposure has been reached.[13]

Property owners in flood-prone areas of New South Wales also experience insurance unaffordability concerns when attempting to protect their property against flood and rainwater run-off. A recent determination by the Australian Financial Complaints Authority (AFCA) highlights just how unaffordable flood premiums are for property owners in high-risk areas, with one insurer quoting $27,000 to provide flood coverage on a sum insured of approximately $500,000. Removing flood, rainwater and storm surge cover decreased the premium to $2,225.[14]

4. The Underlying Causes and Impacts of Increases in Insurance Premiums

Several factors contribute to the rising cost of insurance premiums in Australia, particularly in regions affected by climate-driven disasters. These factors include:

1. **Higher claims costs due to increased frequency and severity of natural disasters**: Over the past 5 years, insurers have incurred $20.9 Billion in claims due to natural disasters. In comparison, insurers incurred $9.9 Billion in the five-year period prior. These increased claims costs are passed on to policyholders in the form of higher premiums.[15]

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[11] Australian Competition and Consumer Commission. (2020). *Northern Australia Insurance Inquiry Final Report.* Canberra, ACT: Commonwealth of Australia.

[12] Paddam, S., Liu, C., Philip, S. (2023). *Home Insurance Affordability Update*. Actuaries Institute. Sydney.

[13] Australian Competition and Consumer Commission. (2020). *Northern Australia Insurance Inquiry Final Report.* Canberra, ACT: Commonwealth of Australia.

[14] Australian Financial Complaint Authority. (2022, September 28). Determination 879287. Australian Financial Complaint Authority.

[15] Insurance Council of Australia. (2023, January). *Historical Catastrophe Data.* Retrieved from https://insurancecouncil.com.au/wp-content/uploads/2023/01/ JANUARY-2023-HISTORICAL.xlsx

2. **Higher Reinsurance Costs**: Insurers rely on reinsurance to manage their risk exposure. In 2023, reinsurance costs rose to a 20-year high, with Australian insurers facing cost increases of up to 30 percent.[16]
3. **Increased labour and supply chain costs**: The increase in natural disasters has placed significant pressure on both supply chains and building trades, increasing both claims costs and premiums.

Economic Impact on Policyholders

Higher insurance costs strain household budgets, particularly for low- and middle-income families who are unlikely to afford to self-insure. This financial burden can lead to reduced disposable income, decreased savings, and increased financial insecurity. Consequently, families may be forced to forgo essential coverage, leaving them vulnerable to substantial financial losses in the event of a disaster.

Decreased economic resilience

Without adequate insurance, households and businesses will become more vulnerable to natural disasters. Businesses and households will be less equipped to recover from natural disasters, increasing the economic impact of these events as economies struggle to return to pre-disaster levels of activity and supply chains take longer to resume. Businesses without sufficient capital will be less likely to recover and may be forced to close, resulting in job losses and further decreases in economic activity.

Greater reliance on government support

A lack of available insurance would increase reliance on governments and, by extension, taxpayers to fund recovery efforts. Following natural disasters, those without adequate insurance coverage are forced to rely on government or non-government organisations to support their recovery. This can lead to broader economic impacts, such as higher national debt levels and reduced economic productivity.[17] For non-government organisations, these costs can be significant and redistribute funds away from other priorities and programs.

Disruption to local economies

The economic impact of natural disasters extends far beyond the initial event. Natural disasters are usually followed by a period of recovery and rehabilitation, during which time disruption decreases. For large-scale disasters such as floods, cyclones, and bushfires, this period can last several years. The timely payment of insurance claims during this period reduces the recovery and reconstruction phase, minimising lost economic output, which can often exceed the value of the initial damage.[18]

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[16] Insurance Council of Australia. (2023). *Insurance Catastrophe Resilience Report 2022-23,*

[17] Hutley, N., Dean, D., Hart, N., & Daley, J. (2022). *Uninsurable Nation: Australia's most climate-vulnerable places.* the Climate Council of Australia Ltd.

[18] Rousová, L. F., Giuzio, M., Kapadia, S., Kumar, H., Mazzotta, L., Parker, M., & Zafeiris, D. (2021). *Clmate Change, Catastrophes and the Macroeconomic Benefits of Insurance.* Luxembourg: European Insurance and Occupational Pensions Authority. doi:10.2854/407671

Socioeconomic Impact on Policyholders

The burden of rising insurance premiums is not evenly distributed across communities. The paradox of insurance is that those who are most impacted by natural perils are least likely to be able to afford to protect themselves from the effects of such events. Rising unaffordability and unavailability of insurance have the potential to further exacerbate existing inequalities by trapping vulnerable populations in high-risk areas and exposing them to greater social harm.

Vulnerable populations, such as those from low socioeconomic backgrounds, are both less likely to be able to absorb premium increases and less likely to recover from natural disasters when they occur.

A lack of adequate insurance is also linked to an increased risk of experiencing homelessness and poor mental health outcomes following a natural disaster. A study of cross-sectional survey data from individuals impacted by flooding events in the United Kingdom found that uninsurance was closely associated with mental health morbidity, with uninsured respondents more likely to experience anxiety, depression or post-traumatic stress disorder (PTSD) than those who held insurance.[19]

5. Pricing of Increased Climate Risk into Insurance Products Not Exposed to Climate-Driven Risks

There is growing concern that increased climate risk is being priced into insurance products that are not directly exposed to climate-driven risks. This section examines the evidence of cross-subsidisation within insurance products, the fairness and transparency of insurance pricing, and the impact on policyholders.

Insurance pricing models are designed to spread risk across a broad base of policyholders. Traditionally, this has meant that the premiums collected from low-risk policyholders help cover the losses of high-risk policyholders. However, as climate risks increase, there is evidence that insurers are adjusting their pricing models to incorporate the heightened risk of natural disasters into all products, regardless of direct exposure. This approach can lead to significant premium increases for policyholders who do not directly face climate-driven risks.

The practice of cross-subsidisation raises important questions about the fairness and transparency of insurance pricing. Policyholders who do not face direct climate risks may feel unfairly burdened by higher premiums. To address these concerns, it is crucial insurers provide clear and detailed explanations of their pricing structures. Enhanced transparency

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[19] Mulchandani, R., Smith, M., Armstrong, B., Beck, C. R., Oliver, I., & English National Study of Flooding and Health Study Group, 5. (2019). Effect of Insurance-Related Factors on the Association between Flooding and Mental Health Outcomes. *International Journal of Environmental Research and Public Health, 16*(7).

can help policyholders understand the rationale behind premium increases and foster greater trust in the industry.

7. The role of governments to implement climate adaptation and resilience measures to reduce risks and the cost of insurance

The role of government in implementing climate adaptation and resilience measures is paramount to reducing risks and the cost of insurance. Through strategic investments in infrastructure, sustainable practices, risk-sharing mechanisms, and research, governments can enhance community resilience and ensure the long-term viability of insurance markets.

Natural disaster mitigation has many benefits; improved community safety and resilience, reduction in property damage, faster recovery, and a reduction in the economic impact of natural disasters.

NIBA welcomes recent commitments by both state and federal governments to implement resilience measures, including the establishment of the Disaster Ready Fund and improved building resilience under the National Construction Code. To build on these initiatives, NIBA encourages the government to adopt a long-term approach to climate resilience, including extending the Disaster Resilience Fund to a ten-year rolling program to facilitate long-term planning and investment and ensure sustained support for mitigation projects.

Thank you for the opportunity to provide feedback. Should you have any queries in relation to our submission, please do not hesitate to contact Allyssa Hextell, Head of Policy and Advocacy, at ahextell@niba.com.au.

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About NIBA

NIBA is the peak representative body for the general intermediated insurance industry. NIBA serves as the collective voice of approximately 450 member firms and 15,000 individual brokers. Our membership encompasses a diverse range of entities, including large multinational insurance brokers, Australian broker networks, as well as small and medium-sized businesses located in cities and regional areas around Australia.

NIBA advocates for the interests of general insurance brokers, ensuring that the general industry operates with integrity and professionalism. Guided by our core pillars: community, representation, and professionalism, NIBA's mission is to enhance the professional standing of insurance brokers through robust advocacy, education, and ethical standards. By fostering a collaborative and innovative environment, NIBA aims to elevate the quality of service provided to consumers, strengthening trust and confidence in the insurance broking profession.