

Budget Policy Division
Department of the Treasury
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6 February 2015

Dear Sir/Madam

PRE-BUDGET SUBMISSION 2015-16

The Insurance Council of Australia¹ (Insurance Council) welcomes the opportunity to provide views on the priorities for the Commonwealth Government's 2015-16 Budget. The Insurance Council considers that Commonwealth Budget planning will be enhanced if greater consideration is given to the funding of disaster mitigation and if industry is given opportunity to meaningfully input into the Australian Prudential Regulatory Authority's (APRA) funding process, which ultimately derives funding from an industry levy. These initiatives are discussed in greater detail below.

Funding of Disaster Relief

The Insurance Council notes a concerning imbalance in total government spending on major national natural disaster funding, which is heavily biased toward recovery when contrasted with mitigation. Natural disaster funding expenditure for the three years between 2009/10 to 2012/14 comprised of approximately \$11.2 billion (98%) for recovery efforts versus approximately \$0.23 billion (2%) for mitigation measures.² In hindsight, a systemic approach to reducing existing community exposures and prevention of planning mistakes through mitigation could have significantly reduced the total natural disaster expenditure over this period.

The Insurance Council believes the 2014/15 Budget should prioritise disaster mitigation funding to reduce community exposures from natural disasters, which is likely to lessen the need for disaster response activities. Specifically, in formulating the Budget the

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. March 2014 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$41.4 billion per annum and has total assets of \$111.5 billion. The industry employs approximately 60,000 people and on average pays out about \$111 million in claims each working day.

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

² Figure 2.2 Natural Disaster Funding Arrangements Productivity Commission Draft Report, p67

Government should carefully consider Recommendation 3.2 in the Productivity Commission's Draft Report³ on Natural Disaster Funding Arrangements⁴:

Draft Recommendation 3.2

If the Australian Government reduces the relief and recovery funding it provides to state and territory governments, it should increase annual mitigation expenditure gradually to \$200 million, distributed to the states and territories on a per capita basis. The amount of mitigation spending could be adjusted over time to reflect the imputed 'savings' from reduced relief and recovery funding.

Increased mitigation funding should be conditional on matched funding contributions from the states and territories and best practice institutional and governance arrangements for identifying and selecting mitigation projects. These would include:

- project proposals that are supported by robust and transparent evaluations (including cost-benefit analysis and assessment of non-quantifiable impacts), consistent with National Emergency Risk Assessment Guidelines risk assessments and long-term asset management plans, and subject to public consultation and public disclosure of analysis and decisions;
- considering all alternative or complementary mitigation options (including both structural and non-structural measures);
- using private funding sources where it is feasible and efficient to do so (including charging beneficiaries);
- partnering with insurers to encourage take-up of adequate private insurance and private mitigation through measures such as improved information sharing and reduced premiums."

The Insurance Council considers that the allocation of mitigation funding should be undertaken on a project-by-project basis, with funding priorities largely determined by the benefits that will be accrued by the local population through reduced exposure to hazards.

In terms of the macro level of funding distribution, it may be appropriate for certain states to receive a higher share than less-exposed states and territories. We note that disaster losses over the past 40 years consistently demonstrate that Queensland incurs greater natural disaster losses than other jurisdictions. This imbalance is reflected in insurance price signals. A variety of factors exacerbate disaster losses in Queensland beyond hazard frequency and intensity. The most important one is a consistent absence of permanent physical mitigation and, in many areas, building codes that fall short of providing property protection.

The Insurance Council submits that once the macro level of mitigation funding allocation between states and territories is determined, a key consideration in the prioritisation of specific mitigation projects within a jurisdiction should be the potential reduction of insurance

³ The final inquiry report has not yet been released publicly, however was submitted to Government on 17 December 2014.

⁴ <http://www.pc.gov.au/inquiries/completed/disaster-funding/draft-report>

premiums for exposed individuals. The possibility of reductions in premiums resonates with the public, ensuring that communities who ultimately fund mitigation through their taxes, rates and levies can see the impact it has on their insurance bills.⁵

The Government should also closely consider Recommendation 3.3 in the Productivity Commission's Draft Report on Natural Disaster Funding Arrangements:

“Draft Recommendation 3.3

The Australian Government should publish estimates of the future costs of natural disasters to its budget in the Statement of Risks. It should also provision through annual appropriation for some base level of natural disaster risks that can be reasonably foreseen. For more catastrophic, less quantifiable risks, it is likely to be more efficient to finance the related costs if and when the risks are realised.”

The Insurance Council strongly supports the Australian Government publishing estimates for the future costs of natural disasters in the Budget's Statement of Risks. We also submit that the natural disaster recovery budget should be informed by catastrophe modelling, rather than the simple historical average of costs currently used in NSW and proposed to be used in the above recommendation.

APRA Funding

The Australian Government has had a formal cost recovery policy since December 2002.⁶ Despite this policy, there has historically been little meaningful consultation on the level of industry funding to be provided to APRA and a lack of accountability for its efficient and effective use.

The Insurance Council has requested in previous submissions on the Financial Industry Levies that APRA should consult early with industry on the proposed activities for the year ahead which have led it to recommend to the Government a particular level of funding. The opportunity for debate on priorities would result in higher industry understanding and commitment to APRA's work programs.

As a result of the Insurance Council raising this issue again in the context of the Auditor-General's 2013 review of the determination and collection of Financial Industry Levies, Treasury invited the Insurance Council to put its views on the level of APRA funding in a pre-budget submission. While the interest in consultation is appreciated, there are practical obstacles to this being an effective option.

⁵ For example, many consumers in Queensland have experienced a sharp reduction in premiums in flood-prone areas following the construction of permanent mitigation or improvements to flood mapping availability and accuracy. Premiums for new policies and renewals have been slashed by many insurers in Charleville and St George following the completion of flood mitigation works. In Roma, an average 45 per cent reduction in insurance premiums is expected following the completion of a flood levee, and in some cases up to 90 per cent for flood risk properties.

⁶ This requires: (1) a high degree of transparency about what costs are recovered and to demonstrate that charges reflect the cost of government goods and services, including regulation, provided to specific individuals, organisations or groups; (2) that there needs to be a close relationship between the amount raised and the amount spent on cost recovered activities; and (3) that cost recovery charges should have a high degree of consultation to ensure only efficient costs are being recovered. (Treasury Levy Methodology Response, p3)

The Insurance Council and its members cannot comment meaningfully on the appropriate level of funding for APRA without dialogue with APRA on how it sees the regulatory landscape and what its priorities are for the coming year. The Insurance Council therefore is very supportive of the process endorsed by APRA in its submission responding to the FSI's Interim Report (page 67):

- Industry and other stakeholders would receive an opportunity to provide feedback on the budget proposals and the level of APRA resourcing proposed (with a range of mechanisms that could be instituted to give effect to this).
- A final budget and levies proposal would then be submitted to Government, including a summary of the feedback received from industry and other stakeholders and APRA's response to these.
- The Government would adopt the proposed budget, and efficiency dividends would not be applied to APRA.
- APRA would also publish more detailed, and multiyear, budget projections as a basis for the consultation process.

The Insurance Council agrees that a process along the lines set out above would provide greater certainty and stability of APRA's funding from year to year. The enhanced external consultation process would also drive greater internal and external scrutiny of the allocation of APRA's resources across functions, and assist APRA in identifying opportunities for efficiencies.

In moving to a more autonomous funding model for APRA, to ensure maximum effectiveness, it must also be accompanied by greater accountability and transparency. The Insurance Council submits that the recommendation in the FSI Report for a Financial Regulator Assessment Board would be a way of achieving this. This becomes even more important if, in line with the FSI recommendation, APRA, along with other regulators, places more emphasis on encouraging competition.

The reforms discussed above for industry funding of APRA would also be relevant if the Government is considering the adoption of the FSI recommendation that ASIC also be funded by industry levies.

If you have any questions or comments, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on tel: 02 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely



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