Law Council
OF AUSTRALIA

Office of the President

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Senator Mehreen Faruqi
Chair
Select Committee on the Impact of Climate Risk on Insurance Premiums and Availability
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: climaterisk.insurance.sen@aph.gov.au

Dear Senator

Impact of Climate Risk on Insurance Premiums and Availability

Introduction

1. The Law Council of Australia appreciates the opportunity to respond to the Select Committee's inquiry into the impact of climate risk on the availability and affordability of insurance premiums. We are grateful for the contributions received for this submission from the Law Council's Climate Change Working Group, the Australian Environment and Planning Law Group[1] and National Insurance Lawyers of the Law Council of Australia's Legal Practice Section, and the Law Society of New South Wales (**LSNSW**).

2. Consistent with its Climate Change Policy, adopted in 2021,[2] the Law Council encourages the proper management of climate risks, including physical impacts, transitional risks and litigation risks, through appropriate climate action. The Law Council supports appropriate legislative and policy responses relating to mitigation and adaptation.

3. Our response to this inquiry addresses points (a) to (f) of the terms of reference. It builds on our earlier submissions to various inquiries and consultations on the management of climate-related risks and should be read in connection with those submissions. They include:

    a. Our previous submissions to the Senate Economics Legislation Committee and the Treasury on the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill, where we expressed our support for the development in Australia of a legislative regime that mandates Climate-related Financial Disclosures (**CRFD**) consistently with internationally prescribed requirements for climate-related disclosures by the Taskforce on Climate-related Financial Disclosures (**TCFD**) and the International Sustainability Standards Board (**ISSB**). When established, the CRFD regime

[1] We also acknowledge the contribution of Cameron Algie at Kellehers Australia Pty Ltd in the preparation of this submission.
[2] Law Council of Australia, Climate Change Policy Statement, 21 November 2021, 3-4.

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will impose legal obligations on insurance companies to manage and disclose climate-related financial risks.[3]

b. Our Business Law Section's previous submission to the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) Inquiry into the impact of the practices of the insurance industry on small businesses.[4]

Response

(a) The unaffordability of insurance in some regions due to climate-driven disasters

4. The Law Council recognises that the physical impacts of climate change, including climate-related natural disasters and extreme weather events, are unevenly distributed and disproportionately affect individuals and small businesses in certain parts of Australia such as regional and remote areas.[5] The Insurance Council of Australia stated, in 2022, that 'there is no area of Australia that is uninsurable, although there are some locations and industries where there are clearly affordability and availability constraints'.[6] However, half a million properties (or approximately one in 25 homes) in Australia are predicted to be uninsurable by 2030, with 80% of the risk presented by riverine flooding.[7] Other major risks include bushfires and flash flooding.[8]

5. Households and small businesses in affected regional and rural areas are plagued by chronic underinsurance and significant insurance affordability stress. Many of these areas are highly vulnerable to climate-related natural disasters.[9] Legal practitioners are observing that small businesses are experiencing difficulty in obtaining affordable insurance due to significant increases in premiums, particularly in high flood-risk areas such as the Mid-North Coast region of NSW.

6. We understand that there are also significant data gaps relating to "the nature and scale of non-insurance and underinsurance due to unaffordable premiums".[10] This creates significant risks in predicting the potential economic impact of climate-related natural disasters, and likely reliance on post-disaster government assistance by the uninsured.

(b) The unavailability of insurance for some people due to climate-driven disasters

7. The Law Council understands that rising insurance premiums have detrimentally impacted the availability and coverage of insurance in high exposure locations across Australia. Gaps and restrictions in coverage are particularly evident in parts of regional Australia that are highly vulnerable to climate change impacts.[11]

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[3] Law Council of Australia, Submission to Senate Economics Legislation Committee, *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill* (online, 22 April 2024);
Law Council of Australia, Submission to the Treasury, *Climate-related Financial Disclosure: Exposure Draft Legislation* (online, 9 February 2024);
Law Council of Australia, Submission to the Treasury, *Climate-related Financial Disclosure: Second Consultation – Consultation Paper* (online, 2 August 2023);
Law Council of Australia, Submission to the Treasury, *Climate-related Financial Disclosure: Consultation Paper* (online, 2 March 2023).
[4] Law Council of Australia, Submission to ASBFEO, *Input to ASBFEO Insurance Inquiry launched in July 2020* (online, 3 September 2020).
[5] Law Council of Australia, Climate Change Policy Statement, 21 November 2021, 3.
[6] Insurance Council of Australia 2022, *Affordability,* (online, July 2024).
[7] Climate Council, *Uninsurable Nation: Australia's most climate-vulnerable places* (online, 2022) III.
[8] Ibid.
[9] Actuaries Institute, *Home Insurance Affordability Update Report* (online, August 2023) 13.
[10] CHOICE, *Weathering the Storm: Insurance in a changing climate* (online, August 2023) 16.
[11] n 6, 3.

8. Recent large-scale climate-related bushfire (e.g. the Black Summer bushfires) and flooding events (e.g. in northern NSW and southeast Queensland) have revealed that many individuals and small businesses remain underinsured or uninsured.[12] Underinsurance and non-insurance result in escalating costs for all governments in the aftermath of a natural disaster and create an onerous financial burden for post-disaster recovery.

9. We are aware that coverage for certain lines of insurance is being withdrawn entirely. This is due to the fact that insurers seek to manage their exposure to particular perils, or geographic areas, through the use of risk management mechanisms such as exposure limits (designed to cap the volume of customers or proportion of sums insured in a particular area) or embargoes (applied to deny underwriting policies entirely) implemented by insurers to avoid potentially significant claim costs.[13] These restrictions on the supply of insurance limit the choice, or availability, of insurance for consumers.[14] These restrictive underwriting practices may present significant issues for some strata-titled properties in Western Australia, Queensland and Northern Territory, where legislation requires owners to insure common property building and assets for their full replacement or reinstatement value.[15]

10. Comprehensive insurance coverage for climate-related natural disasters can play a critical role in absorbing the costs of future climate damages and losses and in supporting economic recovery in the aftermath of these events:

> There is some evidence that higher levels of insurance coverage for damages and losses from disasters is linked to quicker recovery and more limited economic disruption.[16]

11. Given the importance of having comprehensive insurance coverage for climate-related natural disasters, to assist in community recovery after a natural disaster, a review of the Standard Cover regime[17] may assist in delivering comprehensive cover to policy holders. We note that the Standard Cover regime has not kept pace with changes in the insurance industry and has not been materially amended given the changing nature of climate-related disasters.

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[12] ACCC, *Insurance monitoring - Second report following the introduction of a cyclone and cyclone-related flood damage reinsurance pool* (online, December 2023) 23.
[13] Ibid, 73 -74.
[14] Ibid, 73 -74.
[15] Ibid, 75 – 76.
[16] Organisation for Economic Cooperation and Development, *Enhancing the insurance sector's contribution to climate adaptation* (online, March 2023) 4-5. A number of examinations of the impact of broad insurance coverage on post-event economic recovery have shown that countries with high levels of insurance (and reinsurance) coverage usually recover more quickly (See: Martin Melecky and Claudio Raddatz, *How Do Governments Respond after Catastrophes? Natural-Disaster Shocks and the Fiscal Stance,* Policy Research Working Paper, No. 5564, World Bank (online, 2011); Goetz Von Peter, Sebastian von Dahlen and Sweta Saxena, *Unmitigated disasters? New evidence on the macroeconomic cost of natural catastrophes*, BIS Working Papers, No. 394, Bank for International Settlements (online, 2012); OECD, *The Contribution of Reinsurance Markets to Managing Catastrophe Risk* (online, 2018); Cambridge Centre for Risk Studies and AXA XL, *Optimising Disaster Recovery: The Role of Insurance Capital in Improving Economic Resilience*, Cambridge Centre for Risk Studies at the University of Cambridge Judge Business School (online, 2020); Linda Fache Rousová, et al., *Climate Change, Catastrophe and the Macroeconomic Benefits of Insurance,* European Insurance and Occupational Pensions Authority (online, 2021)).
[17] The Treasury's March 2024 consultation paper at 14 provides the following background on the Standard Cover regime: "The standard cover regime was established to standardise terms and conditions between prescribed types of insurance contracts. By restricting the scope for variation between comparable insurance contracts and ensuring a minimum level of consistency, the standard cover regime sought to guard against a lack of coverage for events that are commonly expected to be covered by that type of insurance contract. By reducing the degree to which insurance policies could depart from a 'common' understanding of what any given insurance contract should cover, this aimed to reduce the likelihood of inadvertent underinsurance by consumers."

(c) The underlying causes and impacts of increases in insurance premiums

12. The Law Council understands that the increased frequency and intensity of natural disasters such as bushfires, floods and storms, the growing volume of compensation claims and class action litigation relating to such events, as well as the COVID-19 pandemic, are major causes of rising insurance premiums in recent years.[18] A key contributing factor is the higher costs associated with reconstruction and rebuilding after a climate-related natural disaster, due to a shortage in construction materials and labour as a result of global supply chain disruptions.

13. Another contributing factor is the growing complexity of risk modelling methodology, particularly in relation to natural peril claims. The unpredictability of climate-related natural disaster events has traditionally made it difficult for insurers to accurately price risk.[19] However, in recent years, natural peril modelling has become more sophisticated and granular due to technological advancements, which has enabled case-by-case and localised assessments of a particular site or property to be undertaken. This has helped to generate more accurate risk data and has a redistributive effect in relation to climate risk, with insurers acknowledging that:

> more granular risk modelling has resulted in changes to premiums at a policy level, with some consumers in higher-risk areas seeing premiums increase and others in lower-risk areas paying less for their premiums.[20]

14. We note that risk analytics and modelling expertise developed by insurers to manage their own exposure could be utilised to reduce costs for policy holders in high-risk areas, by encouraging mitigation to lower their risk.

(d) The extent to which increased climate risk is being priced into insurance products not exposed to climate driven risks

15. As noted in section (c) above, the insurance industry is increasingly using advanced modelling to distribute the costs associated with increased climate risk across its base of policy holders, resulting in policy holders in both low- and high-risk areas experiencing a significant increase in their premiums from previous years. The National Insurance Brokers Association has noted anecdotal evidence that insurers are adjusting their pricing models to incorporate the heightened risk of natural disasters into all products, regardless of direct exposure.[21] The distribution of climate risk across policy holders located in low-risk areas (i.e. cross-subsidisation) has led to growing calls from consumers and policy holders for greater transparency about how premiums are being set by insurance companies.[22]

16. Some parts of the legal profession have expressed the view that government and property owners (households or businesses) should bear the primary obligation for natural disaster risk management—and that this risk should be managed through a combination of appropriate planning / land use, resilient construction practices, and disaster mitigation. They contend that cross-subsidisation of insurance premiums should be minimised as it removes the incentives for policyholders in high-risk areas to manage their risk through mitigation steps to reduce their exposure, including though more resilient building

[18] Law Council of Australia, Submission to ASBFEO, *Input to ASBFEO Insurance Inquiry launched in July 2020* (online, 3 September 2020).
[19] n 12, 47.
[20] Ibid.
[21] National Insurance Brokers Association, *NIBA Submission: The Impact of Climate Risk on Insurance Premiums and Availability* (online, 2 July 2024) 5
[22] Ibid, 23.

practices or relocation to lower risk areas—and that the role of insurance is to assist parties to manage their residual risk.

17. The Law Council notes that the Australian Financial Complaint Authority (AFCA) treats the underwriting rationale for premium increases and an insurer's underwriting considerations as commercial-in-confidence. In addition, the AFCA must exclude, and therefore cannot consider, any complaint about rating factors and weightings that an insurer applies to determine the insured's base premium, or a complaint about a decision to refuse to provide cover.[23]

18. We consider that there is a need for greater information transparency about how climate risk is being priced into insurance products, and how insurance companies are engaging with climate risk more broadly. Confidence in the equitable setting of premiums would be improved with information transparency, education and oversight of new and emerging approaches to use of data and pricing. As noted in point 3a above, we also strongly support the introduction of the CRFD regime (as reflected in our previous submissions on this topic), which would impose a suite of legal obligations on insurance companies to properly manage and disclose climate risks.

19. Greater information transparency and risk disclosure are also consistent with international best practice in the management of climate-related financial risks by corporations, including insurance companies. In this regard, we note that the TCFD has issued sector-specific guidance for the insurance industry about the management of climate-related litigation risks. Notably, in relation to pricing, the TCFD recommends:

> Insurance companies should describe key tools or instruments, such as risk models, used to manage climate-related risks in relation to product development and pricing.[24]

(e) The distributional impact of increases in insurance premiums across communities, demographics and regions

20. As noted in sections (b) and (d) above, climate change disproportionately affects individuals and small businesses located in regional and remote areas, which are highly vulnerable to climate impacts such as riverine flooding and bushfires. The lower uptake of insurance has been associated with a lower socio-economic profile and/or higher exposure to extreme weather.[25] Policy holders located in high-risk areas are often the least able to bear the economic burden of managing climate risks and are therefore often underinsured or uninsured.

21. Low insurance literacy is another contributing factor to non-insurance and under-insurance and varies geographically, with lowest literacy in more remote areas. There is a compounding effect with many who do not have coverage viewing insurers as untrustworthy based on dissatisfaction with previous claims experience.[26]

22. The distributional impact of premium increases has been recognised as a significant challenge for a long time. In 2011, the then Australian Government commissioned the National Disaster Insurance Review. That review recommended that insurers have access to a government-sponsored reinsurance facility to enable discounts to be

[23] Australian Financial Complaints Authority, *Complaint Resolution Scheme Rules* (online, 1 July 2024) rule C.1.4.c).
[24] TCFD, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* (online, October 2021) 34.
[25] Actuaries Institute, Home insurance affordability and socioeconomic equity in a changing climate (Green Paper, August 2022) 17-18.
[26] Ibid.

delivered to consumers without compromising the commercial interests of the insurers.[27] That approach was, to an extent, adopted with the implementation of the North Queensland cyclone reinsurance pool, and the establishment of the Australian Reinsurance Pool Corporation. Broadening of the reinsurance pool to include certain cohorts/regions may assist the delivery of insurance savings to policy holders, although it is recognised that a broadening of the scheme would mean that some of the risk for natural disasters would be borne by the Government, and therefore the taxpayer.

(f) The role of governments to implement climate adaptation and resilience measures to reduce risks and the cost of insurance

23. The Law Council considers that the socio-economic burden of managing climate risks, including post-disaster recovery, cannot be exclusively borne by the insurance industry or consumers (whether individuals or small businesses). Governments have a critical role to play in relation to climate change mitigation and adaptation.

24. As a party to the Paris Agreement, Australia has a legal obligation to pursue ambitious climate action through mitigation and adaptation that increases Australia's climate resilience and rapidly lowers greenhouse gas emissions through the pursuit of Nationally Determined Contributions (NDCs).[28] The *Climate Change Act 2022* (Cth) prescribes Australia's greenhouse gas emissions targets[29] at a level that is consistent with the current NDC that Australia has communicated under the Paris Agreement.[30] The Act also requires the Minister for Climate Change to prepare an annual climate change statement, detailing the progress Australia has made towards achieving its greenhouse gas emissions reduction targets as well as the effectiveness of Commonwealth policies in contributing to these efforts.[31]

25. In its submission to this inquiry, the Productivity Commission suggests that there is currently no market failure in the insurance sector in relation to the management of climate risk and that government regulation of insurance markets should be avoided.[32] However, the feedback we have received from the legal profession is that there are clear signs of market dysfunction in the insurance sector, with skyrocketing costs of premiums in recent years indicating a trend towards potential market failure if the impact of climate risk on the availability and cost of insurance is not properly managed.

26. In its 2024 annual climate report, the Commonwealth Bank has expressed concern that the frequency and impact of extreme weather events is adversely affecting the insurability of homes and property values and identified insurance affordability as an emerging risk to its customers and operations.[33] KPMG has also expressed this view and warned of a looming market failure in relation to disaster insurance and affordability.[34] We believe that deregulation would only exacerbate this trend. Australia's legal obligations, as outlined

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[27] The Treasury, *Natural Disaster Insurance Review: Inquiry into flood insurance and related matters* (online, September 2011) 55,
[28] Paris Agreement, opened for signature 22 April 2016 [2016] ATS 24 (entered into force 4 November 2016) arts 2, 4. Australia ratified the Paris Agreement on 10 November 2016: Statement by the Hon Greg Hunt MP, 'National Statement, Signing of the Paris Climate Change Agreement' (New York, 22 April 2016) <4523504.pdf;fileType=application/pdf (aph.gov.au)>.
[29] *Climate Change Act 2022* (Cth), s 10.
[30] Australian Government, 'Australia's Nationally Determined Contribution Communication 2022' 3 <AUSTRALIA'S NATIONALLY DETERMINED CONTRIBUTION (unfccc.int)>
[31] *Climate Change Act 2022* (Cth), s 12(1).
[32] Productivity Commission, *Select Committee on the Impact of Climate Risk on Insurance Premiums and Availability: Productivity Commission submission* (online, July 2024).
[33] Commonwealth Bank of Australia, *2024 Climate Report* (online, 2024) 11.
[34] KPMG, *Resilience in times of change: General Insurance Industry Review 2023* (online, March 2023).

above, make it incumbent on the Australian Government to continue assessing the appropriateness of insurance market regulatory settings. The Hazard Insurance Partnership is one example of this type of public–private partnership between the Australian Government and the insurance industry, which we believe is a step in the right direction as it is geared towards mitigation initiatives to improve insurance affordability.[35]

Recommendations

27. The Law Council notes that mitigation- and adaptation-oriented government initiatives to improve insurance affordability might include changes to existing legal and policy settings as follows:

    a. CRFD regime: As noted in point 3a above, the Law Council supports the introduction of a CRFD regime in Australia, which will help to ensure that climate risks are properly managed and disclosed by private enterprises, including insurance companies. We note the introduction of the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 into Parliament,[36] which includes a CRFD regime for Australia. The Australian Securities and Investments Commission will play a key role in providing regulatory guidance to businesses on the CRFD regime, and there could be benefit in having sector-specific guidance for the insurance industry.[37]

    b. National Construction Code revisions: The National Construction Code is an important tool to improve, and ensure greater compliance with, building standards.[38] A review of the Code from a climate risk lens could help to ensure that any newly constructed buildings would be better able to withstand exposure to climate-related extreme weather events, and existing buildings could be appropriately retrofitted to reduce their risk in relation to such events.

    c. Land use and planning law reform: The LSNSW has noted the benefit of a whole-of-government approach to climate change and suggests that the role of governments in land use and planning is important in mitigating climate-related risks and achieving affordable premiums. This might include legislative mandates prohibiting new development in high-risk areas such as floodplains and bushfire zones.

    d. Consumer law reform: There are a number of ways in which insurers' outward impacts can be managed in contractual provisions, including with impacts on consumers as policy holders, particularly in relation to home and contents and motor-vehicle insurance. In this regard, the Australian Competition and Consumer Commission (**ACCC**) has a role to play in developing standardised clauses with the insurance industry and Enforceable Code Provisions on which the Insurance Council of Australia is currently engaging with the ACCC, for example, in relation to fair wear and tear and maintenance provisions in response to the 2022 Victorian floods.

[35] National Emergency Management Agency, *Senate Select Committee on the Impact of Climate Risk on Insurance Premiums and Availability: National Emergency Management Agency Submission* (online, 2024) 6.
[36] See also Law Council of Australia, Submission to Senate Economics Legislation Committee, *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill* (online, 22 April 2024).
[37] For example, the TCFD has provided supplementary sector-specific guidance to the insurance industry, including recommending the disclosure of risk models used to manage climate-related risks in relation to product development and pricing.
[38] World Economic Forum, How climate change is causing an insurance crisis in Australia (< Climate change is causing an insurance crisis in Australia | World Economic Forum (weforum.org)> 10 June 2022).

Thank you again for the opportunity to contribute to this inquiry. Please contact Dr Tanj Ganguly, Senior Policy Lawyer, [redacted] should the Committee wish to discuss any aspect of this submission.

Yours sincerely



Greg McIntyre SC
President