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Premium price

The impact of climate change on insurance costs

Climate change is making insurance more expensive in Australia, with insured catastrophe losses reaching a record $7 billion in 2022. These costs are adding to inflation, increasing up to five times faster than the consumer price index. Costs are not shared equally, with some premiums in the north of the country double those in the south. Some households spend eight weeks of gross income on insurance per year, effectively working all of January and February, simply to pay their home insurance.

Discussion paper

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The Australia Institute - Research that matters

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Summary

Around the world, climate change is increasing the costs of insurance and Australia is no exception. Between 2022 and 2023, the average home insurance premium in Australia rose by 14%, the biggest rise in a decade.

Major floods in eastern Australia pushed insured losses in 2022 to a record $7 billion, almost double previous records. Perhaps more alarmingly, since 2013, insured losses in each year have exceeded the combined losses of the five years from 2000 to 2004.

Modelling from The McKell Institute estimated that the direct cost of natural disasters in Australia could reach $35 billion per year (in 2022 dollars) by mid-century, an average of more than $2,500 per household per year. However, such averages hide more than they reveal. In areas at high risk of extreme weather events, insurance costs are multiples of national averages.

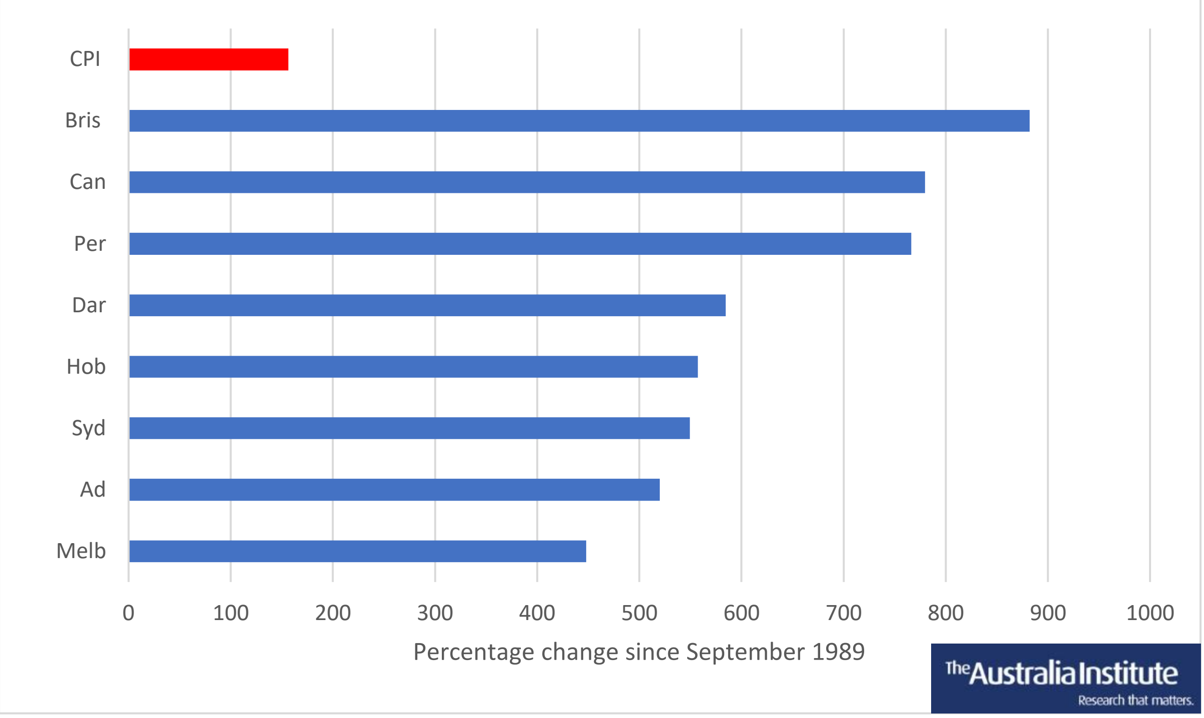
Research from the Actuaries Institute shows that nearly one in eight households – 1.25 million people – suffer home insurance affordability stress and pay more than four weeks gross income on home insurance premiums. One in 20 households pay more than seven weeks of gross income on home insurance. In other words, these households work from New Year's Day almost to the end of February, simply to pay their home insurance.

In northern Western Australia, home and contents insurance costs on average $4,395 per year, which is more than double the $1,779 per year cost for Australians in the southern two thirds of the country. It is also significantly more than the $3,069 that the average Australian household spends on electricity in a year. In the Northern Territory average premiums are $2,922, and in north Queensland $2,918, roughly 60% higher than the rest of the country.

Even considering only capital city insurance costs, the cost increases are significant, and place significant pressure on inflation. Over the past 35 years insurance costs in every capital city have vastly exceeded the increase in the Consumer Price Index (CPI). In Brisbane, insurance costs rose by more than five times CPI, while even in Melbourne, where the increase has been lowest, the rise in insurance costs was still 2.8 times CPI.

Figure 1 below shows how insurance costs in capital cities have exceeded the increase in CPI over the last 35 years.

Figure 1: Capital cities insurance component of CPI compared with CPI, change from 1989



Source: ABS (2024) Consumer Price Index, Australia, 31 July

The profitability of home insurance has declined significantly with many insurers and underwriters making substantial losses.

The most obvious policy response is to address climate change, both mitigating its magnitude and adapting to its impacts. Beyond this, specific policies to engage with the insurance market may be required but will need to be carefully calibrated and regularly reviewed. The Morrison Government's $10 billion fund to help address insurance affordability in cyclone-affected areas appears to have had only modest impact, with the Australian Consumer and Competition Commission reviews of the fund, finding:

> "It still may be some time before the full effects of changes to prices and choice are seen across the industry, and it may be difficult to isolate the effects of the pool from the range of other factors impacting insurance markets."

Careful policy responses will be required to ensure that Australians can insure their homes in a way that is equitable, affordable and without unintended consequences.

Introduction

Rising insurance premiums are the *here and now* cost of climate change. Between 2022 and 2023, the average home insurance premium in Australia rose by 14%, the biggest rise in a decade.[1]

Australia is not alone. Soaring insurance costs linked to climate change are a global phenomenon. In all parts of the world, since 2019, the price of property and casualty insurance has been rising in response to extreme weather events and heightened perceptions of risk stemming from climate change.[2]

Continued global heating and the attendant risk of more frequent disasters could make the price of insurance in many areas of Australia prohibitively expensive and whole suburbs or towns uninsurable. Insurance is based on the sharing of risk, however, as the climate worsens, major impacts for some areas will become not so much a risk, but a certainty. Insurance will be impossible to obtain in these areas. According to a recent analysis, the high annual risk of damage will render about one in 25 properties in Australia uninsurable by the end of the decade.[3]

This century, insurance costs have substantially exceeded the general rise in consumer prices, pushing up most measures of inflation. The response of the Reserve Bank of Australia to rising inflation is typically to increase interest rates, meaning that climate change, through insurance, is contributing to a wider range of economic challenges.

This requires careful policy response, starting with serious climate mitigation and adaptation, as well as more subtle monetary policy and targeted responses to insurance needs in different communities.

[1] Australian Prudential Regulation Authority (APRA), (2023), *Quarterly general insurance performance statistics,* August 2023, https://www.apra.gov.au/quarterly-general-insurance-statistics

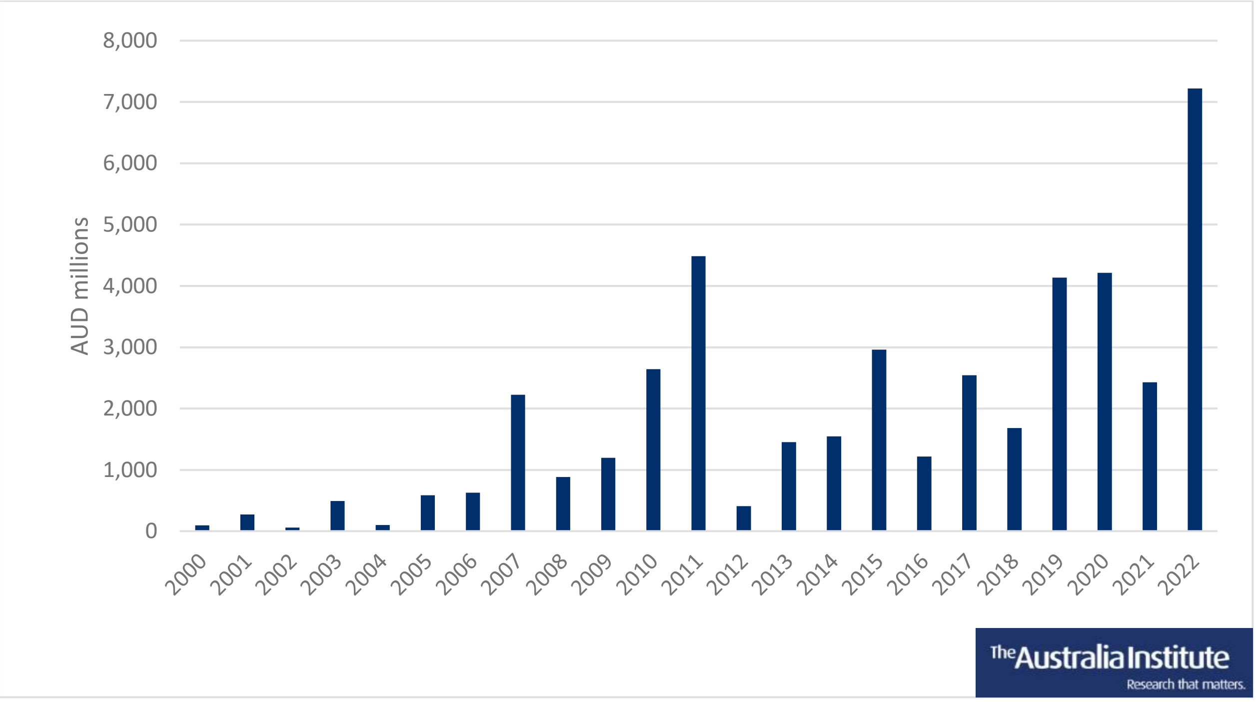
[2] Morningstar Research (2022) *Escalating costs of climate change contributing to higher insurance premiums*, https://dbrs.morningstar.com/research/402678/escalating-costs-of-climate-change-contributing-to-higher-insurance-premiums

[3] Hutley et al (2022) *Uninsurable Nation*, Climate Council, https://www.climatecouncil.org.au/resources/uninsurable-nation-australias-most-climate-vulnerable-places/

Rising insurance losses and costs

Insurance claims have been rising consistently since the start of the 21st century. Eastern Australia's floods pushed losses in 2022 beyond $7 billion, the worst year yet for insurers, as shown in Figure 2 below.

Figure 2: Insured loss estimates due to catastrophes



Source: Insurance Council of Australia (2023) ICA Historical Catastrophe List.

Figure 2 shows that not only was 2022 a record-breaking year for insurance payments, but since 2013, insured losses in each year have exceeded the losses in the first five years of this century combined.

It is not only catastrophe insurance that has increased, and there are weather and climate related events that are not classified as catastrophe. These include hailstorms and local floods, which have also increased in frequency.

Insured losses represent only part of the costs of climate-change related weather events. Further costs include uninsured losses, government spending on disaster relief and indirect costs such as higher food prices. After the eastern Australian floods, the Insurance Council of Australia commissioned modelling from The McKell Institute that estimated, that the direct cost of natural disasters in Australia will be about $35 billion per year (in 2022 dollars) by mid-century, an average of more than $2,500 a household.[4] However, such averages hide more than they reveal. In areas at high risk of extreme weather events, home, strata and small business insurance costs are multiples of national averages.

[4] Reinhard and Lefebvre (2022) *The Cost of Extreme Weather*, The McKell Institute, https://mckellinstitute.org.au/research/reports/the-cost-of-extreme-weather-1/

Insurance and inequality

Insurance companies can now tailor their cover and premiums so precisely that people living in the same city, or even the same suburb, might face substantially different costs.

Availability of data is allowing insurance companies to assess policy holders' risks with increasing granularity. As the Australian Competition and Consumer Commission (ACCC) notes, "a key development over the past decade has been the increasing sophistication and granularity of natural peril modelling" which can now "assess risk at the address level, rather than averaging risk at postcode or larger regional level."[5] The Actuaries Institute maintains that data is "so accurate insurers can now vary the cover and premiums between properties at different ends of the same street in flood prone areas."[6]

Higher risks and more granular targeting of costs will mean greater disparity in the price and availability of insurance. Fewer customers will be treated as "average" risk and charged average premiums. Instead, more of those seeking insurance will be judged as higher risk and charged higher premiums or denied coverage.[7]

This raises equity considerations. Research from the Actuaries Institute shows that nearly one in eight households – 1.25 million – suffer home insurance affordability stress and pay more than four weeks gross income on home insurance premiums.[8] One in 20 households pay more than seven weeks of gross income on home insurance. Those facing the most extreme affordability stress pay almost nine weeks of their income on home insurance. The Actuaries Institute explains:

> Areas suffering extreme home insurance affordability pressures are concentrated in Northern QLD, the Northern Rivers region of NSW and Northern WA. In these areas, half of the population pay more than a month of gross household income for their annual home insurance premium. The affordability pressures faced in these regions are driven by their high perils risk (cyclone for QLD and WA and flood for NSW) and may also reflect insurer actions to recoup high losses in recent years from natural peril events in these regions.

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[5] ACCC (2023) *Insurance Monitoring Report*, https://www.accc.gov.au/about-us/publications/serial-publications/insurance-monitoring-reports/accc-insurance-monitoring-report-2023

[6] Actuaries Institute (n.d.) *Actuaries in action*, https://www.actuaries.asn.au/microsites/see-what-we-see/in-action/case-flood/

[7] Actuaries Institute/Deloitte (2016) *Impact of big data on future insurance*, https://www.deloitte.com/au/en/Industries/insurance/perspectives/impact-big-data-on-future-insurance.html

[8] Actuaries Institute (2023) *Home Insurance Affordability Update, August 2023,* https://actuaries.asn.au/docs/thought-leadership-reports/home-insurance-affordability-update.pdf.pdf?sfvrsn=7737bcf4_4

Another way of looking at households facing extreme home insurance stress is that they effectively work from New Year's Day to the end of February, simply to pay their home insurance.

Two factors are driving the socioeconomic inequity: households facing high or extreme insurance costs are concentrated in areas heavily exposed to the risk of extreme weather events aggravated by climate change, and people living in these areas tend to have lower gross incomes than most Australians. For example, the median personal income in Lismore is $44,970 per year, compared with $52,338 across Australia.[9]

Many of the households facing affordability stress have little choice but to go underinsured or uninsured rather than pay prohibitive costs. Other households will have no choice; they will no longer be able to access insurance. This leaves Australian society facing a significant protection gap, the costs of which will be borne by many households least able to afford it, as well as governments and the wider Australian community.

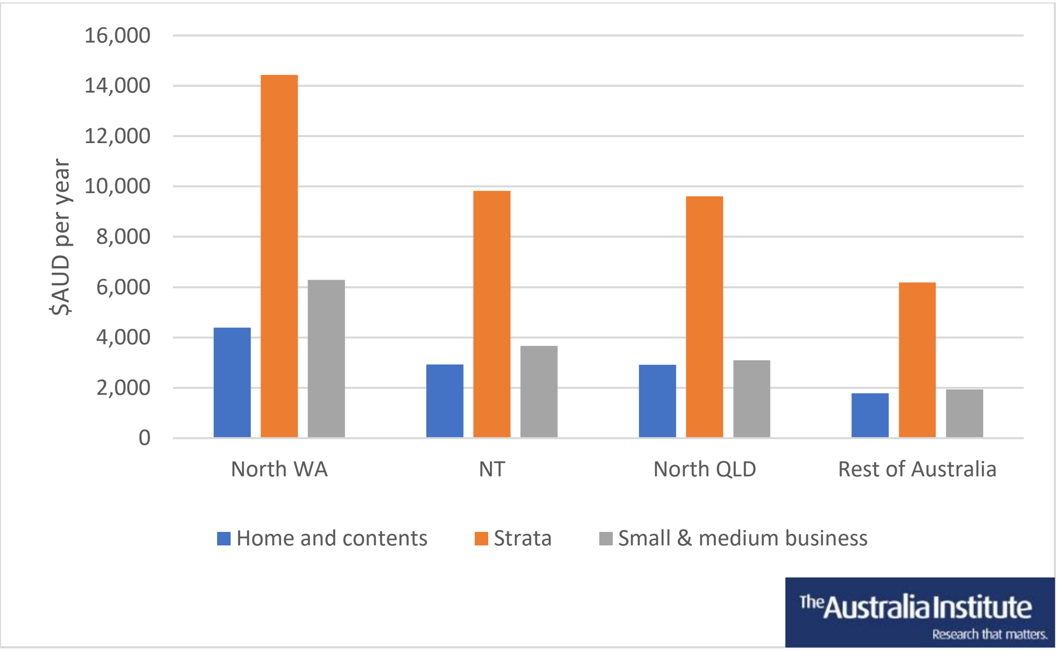
[9] ABS (2020), *Region Summary: Lismore*, https://dbr.abs.gov.au/region.html?lyr=sa2&rgn=112021248

Regional differences

In Australia, property insurance costs are characterised by a north-south divide. Because of the risk of cyclones, premiums in the north of the continent – above the Tropic of Capricorn - are far more expensive than in the south. The high cost of home and building insurance in northern Australia has contributed to high rates of non-insurance, with about 20% of homes in northern Australia uninsured, nearly double the rate in the rest of the nation.[10]

Figure 3 below shows that insurance premiums are especially high in the north of the country, with average home and contents premiums in northern WA approximately two and a half times more than they are in the rest of Australia.

Figure 3: Average insurance premiums across Australia 2022-23



Source: ACCC (2023) Insurance Monitoring Report

The largest costs in Figure 3 are premiums on strata insurance policies for apartment blocks and other forms of shared development. While it is not surprising that these are higher than for individual home and contents policies, the ACCC notes that strata insurance is particularly high in north WA, NT and north Queensland where properties tend to be large,

[10] ACCC (2019) *High premiums leading to rise in uninsured homes in northern Australia*, December 2019, https://www.accc.gov.au/media-release/high-premiums-leading-to-rise-in-uninsured-homes-in-northern-australia

older and “located in close proximity to the coastline, offshore islands, or in very remote postcodes.”[11]

In northern WA, home and contents insurance on average cost $4,395, which is more than the $3,069 that the average Australian household spends on electricity in a year.[12] In the Northern Territory average premiums are $2,922, and in north Queensland $2,918. In the rest of Australia, excluding these areas, policy holders paid an average $1,779 per year.

Small and medium businesses are also increasingly impacted by insurance cost disparity, with premiums in northern WA more than three times higher than the rest of Australia. These costs impact whole communities and are likely to continue rising as extreme weather events worsen across the country.

[11] ACCC (2023) *Insurance Monitoring Report*, p 75

[12] Australia Institute calculations based on CPI weight, total household consumption spending and number of households.

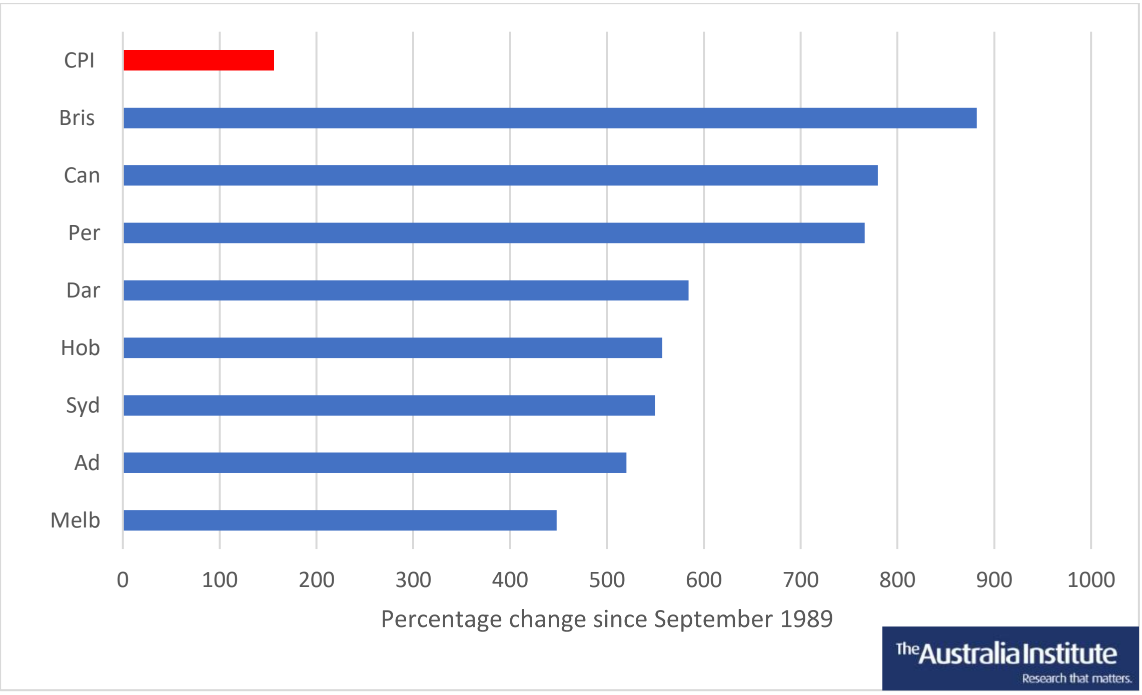
Insurance and inflation

The average increase in home insurance premiums in 2023 was 14%.[13] This enormous average rise was driven by extremely high increases for homes in high-risk areas, such as flood zones.

Price rises for insurance cover have outstripped the rise in general consumer prices since the March quarter of 2022. Brisbane, in the wake of the catastrophic floods, has seen the biggest increase in insurance prices.

Figure 4 below shows that over the past 35 years, in every capital city, insurance costs have far exceeded the increase in the Consumer Price Index (CPI) more generally. In Melbourne, where the increase has been lowest, the rise in insurance costs was still 2.8 times higher than general consumer price increases. Insurance price increases in Brisbane were more than five times the general rise in consumer prices.

Figure 4: Capital cities insurance component of CPI compared with CPI, change from 1989



Source: ABS (2024) Consumer Price Index, Australia, 31 July

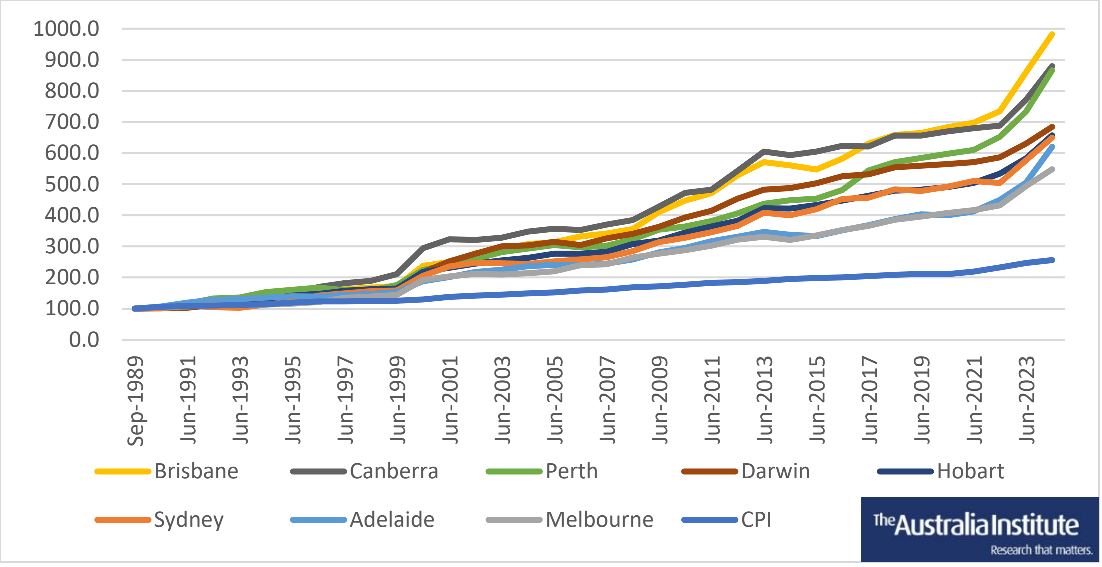
The rapid increase in consumer insurance costs has put upward pressure on CPI and contributed to consumer price inflation. Households are expected to pay more for

[13] APRA, (2023), *Quarterly general insurance performance statistics,* August 2023,

insurance, but they are also facing rising costs for all essentials, and are therefore less able to prepare financially for climate related disasters.

Figure 5 also shows how much faster insurance costs have risen when compared with CPI. Many capital cities experienced a spike in insurance costs in the last five years.

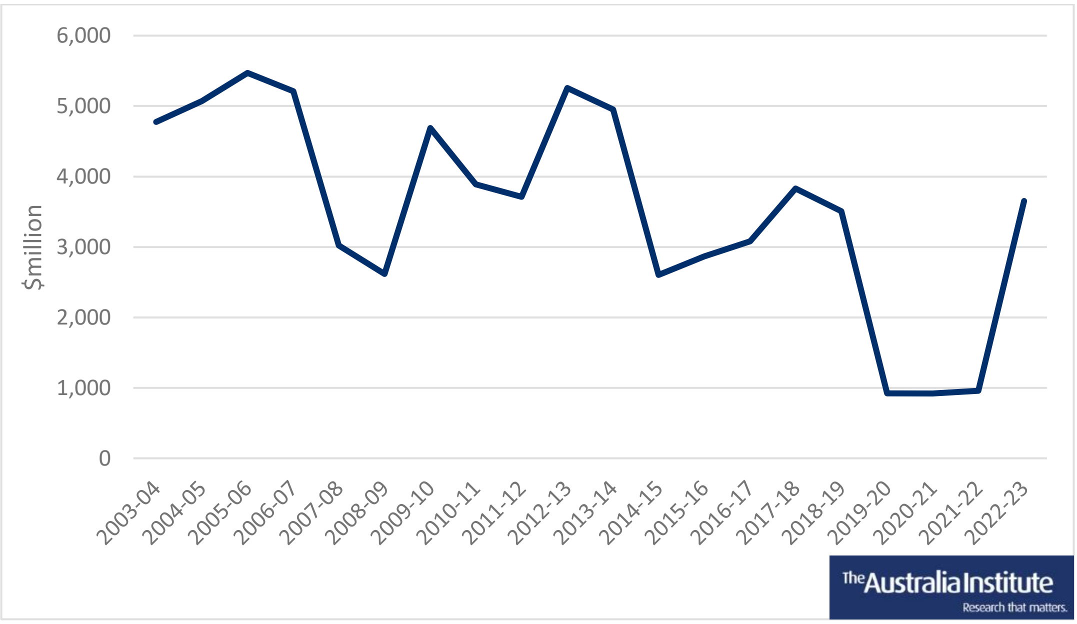
Figure 5: Capital cities insurance component of CPI compared with CPI since 1989



Source: ABS (2024) Consumer Price Index, Australia, 31 July

Despite increasing premiums, Figure 6 below shows that the profitability of general insurance has declined in recent years.

Figure 6: Profit and loss on general insurance



Source: APRA (2023) *Quarterly general insurance performance statistics*

The annual figures in Figure 6 obscure quarterly figures with significant losses. The Australian Prudential Regulation Authority's (APRA) data extends to examine the profitability of housing insurance underwriting, which has been negative since 2019-20. This data shows that while much of Australia's recent inflation has been driven by corporate profits,[14] this does not appear to be the case for home insurers. These insurers have been hit by a combination of higher building replacement costs, climate-change driven catastrophes, and higher reinsurance costs. As insurers look to improve their profitability after years of losses on home and contents polices, and to properly price for growing climate change risks, consumers are facing steep increases in premiums.

[14] Stanford (2023) *Profit-Price Spiral: The Truth Behind Australia's Inflation*, https://australiainstitute.org.au/report/profit-price-spiral-the-truth-behind-australias-inflation/

Conclusion

Climate change is driving more extreme weather events, imposing more damage on Australian homes and resulting in more expensive insurance. Insurance increases are so great that they are putting upward pressure on measures of inflation that contribute to a wider range of economic challenges.

The most obvious policy response is to address climate change, both mitigating its magnitude and adapting to its impacts. Australia should end fossil fuel subsidies, place a moratorium on new fossil fuel developments, crack down on excessive use of offsets and pursue genuine decarbonisation, and push for similar policies internationally. Far more investment and planning should go into climate adaptation.

Since May 2022, the Federal Environment Minister has approved seven new coal mines or extensions, with 1,513 million tonnes of lifetime emissions.[15] Over the last two years, 250 gas wells have also been approved. The approval of these fossil fuel projects will make the cost of insurance even higher, regardless of where they are built, as they contribute to deteriorating climate conditions.

Beyond climate mitigation and adaptation, fiscal and monetary policy need to align to ensure inflation is managed with more than just the blunt instrument of rate rises, which would have no effect on insurance price increases, and many of the other factors driving inflation.[16]

Specific policies to engage with the insurance market may be required, but will need to be carefully calibrated and regularly reviewed. In response to the high insurance costs in northern Australia, the Morrison Government created a $10 billion reinsurance fund to help underwrite the cost of natural disasters in cyclone-prone areas.[17] The Australian Consumer and Competition Commission conducts annual reviews of the fund, finding:

> There are many economic and environmental factors beyond the pool, both locally and globally, that are influencing the overall costs facing insurers and therefore the retail premiums facing consumers. In addition to making it difficult to isolate the

[15] The Australia Institute (2024) *Coal mine tracker*, https://australiainstitute.org.au/initiative/coal-mine-tracker/

[16] Jericho and Stanford (2024) *Opening statement to the ACTU Price Gouging Inquiry*, https://australiainstitute.org.au/post/opening-statement-to-the-actu-price-gouging-inquiry/

[17] Australian Reinsurance Pool Corporation (2024) *The Cyclone Pool: Improving insurance affordability for northern Australia*, https://arpc.gov.au/reinsurance-pools/cyclone/

precise impact of the pool on premiums, these factors may also mean that even consumers who are benefiting from the pool may still be experiencing premium increases overall.[18]

The Morrison Government's reinsurance scheme has only had a modest effect because it subsidises insurance, but does not directly assist homeowners. Those already priced out of the market or unable to access insurance are not assisted at all.

It is also important to consider the Morrison Government's $10 billion reinsurance fund in the context of the $14.5 billion Australian governments provided in subsidies and tax breaks to assist fossil fuel industries in 2023-24.

High insurance premiums work as a market signal to deter new investment, even as they trap low-income households in hazardous zones. Government intervention, such as through the reinsurance scheme, blunts this market signal, so other solutions that consider adaptation policies such as building standards and climate appropriate zoning are necessary.

As climate impacts become more severe, it seems likely that the existing cyclone reinsurance scheme will not be sufficient, and a range of insurance market interventions and wider housing policy initiatives may be required.

[18] ACCC (2024) *Insurance Monitoring Report 2024*, https://www.accc.gov.au/system/files/accc-insurance-monitoring-report-september-2024.pdf, p 1