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Climate Change

In the face of increasing natural disaster and climate change-related claims, what strategies should the insurance industry adopt to balance affordability, coverage, and sustainability?

Balancing Affordability, Coverage and Sustainability in Australia's Insurance Industry amid Rising Natural Disasters

By Sophie Power

Introduction

Australia is increasingly exposed to the physical and financial impacts of natural disasters. As the climate changes, events such as floods, bushfires, storms and cyclones are becoming more frequent, more intense, and more costly for households, businesses and insurers alike. For the Australian insurance industry this raises a profound challenge, how to maintain broad coverage and fair affordability while ensuring long-term sustainability in the face of mounting claims and risk.

This essay examines the rising scale of natural disaster risk in Australia, the cost pressures this creates for both policyholders and insurers and two potential strategies that offer a pathway for the industry to navigate the tension between rising risk and the demand for accessible insurance.

Increasing Natural Disasters in Australia

According to the *Insurance Council of Australia* (ICA), insured losses from declared extreme weather events have more than doubled in the last five years compared to prior decades, with average annual extreme weather claims exceeding AUD 4.5 billion.¹ In the first half of 2025 alone, losses from three declared events exceeded AUD 1.8 billion.² Further, the 2022 South-East Queensland and New South Wales floods,

¹ Australian Business Roundtable for Disaster Resilience & Safer Communities (2021) Update to the economic costs of natural disasters in Australia

² Insurance Council of Australia (2025) Extreme weather losses in 2025 exceed \$1.8 billion

estimated at around AUD 6 billion in insured losses was the most extreme weather event in Australia's history according to ICA figures.³

Beyond insured losses, the broader economic cost of natural disasters in Australia is vast and rising. As estimated in a recent report by the *Australian Business Roundtable for Disaster Resilience & Safer Communities*, even under a low emissions scenario the average annual cost of natural disasters to the Australian economy could rise to approximately AUD 73 billion by 2060.⁴ These figures reflect not just asset damage but also disruption to business, infrastructure, livelihoods, and communities. From an insurance perspective, such rising exposure places additional pressure on premium levels, capital requirements, reinsurance costs and the viability of offering cover in high risk zones.

Further, Australia's geographic setting and development patterns also compound the risk. Many homes and businesses lie in bushfire-prone vegetation zones, floodplains and coastal regions exposed to cyclones or storm surge. Combined with population growth and ageing housing/infrastructure stock, the base level of exposure continues to increase.⁵

Impact on Policyholders and Insurers

This escalating risk environment has significant implications for both policyholders and insurers. On the policyholder side, the rising cost of claims translates into upward pressure on premiums, higher excesses, reduced availability of cover in certain areas, and an increased likelihood of underinsurance or no insurance. This creates potential "insurance deserts" where it becomes very difficult or expensive to obtain suitable cover.

From the insurer's perspective, the rise in frequency and severity of claims places strain on capital, reinsurance costs, profitability and long-term viability.⁶ The ICA notes that while premiums collected by insurers in Australia rose from AUD 50 billion in 2012 to AUD 86 billion in 2023, insurer profits have not kept pace over the same period.⁷ Thus, insurers face a thinning margin between premium income and claims plus overheads. Additionally, insurers may respond to rising cost and uncertainty by tightening policy terms, increasing deductibles, or excluding certain perils all of which reduce the attractiveness or accessibility of cover to customers.

The interplay between policyholder affordability and insurer sustainability therefore becomes a critical tension if premiums rise too fast, uptake falls and markets shrink. If cover is weakened or withdrawn, policyholders

³ National Insurance Brokers Association (NIBA) (2022) ICA estimates cost of recent disaster events exceed \$7.43 billion

⁴ Australian Business Roundtable for Disaster Resilience & Safer Communities (2021) Update to the economic costs of natural disasters in Australia

⁵ Australian Broadcasting Corporation (2025) Australia among the world's most disaster-exposed nations, Insurance Council finds

⁶ PWC - Climate risk and insurance: the case for resilience.

⁷ Insurance Council of Australia (2024) New data shows long-term cost of extreme weather in Australia

are exposed to large losses. For insurance to fulfil its societal role of spreading risk and facilitating recovery, the industry must find ways to maintain accessibility of cover and financial resilience.

Strategy 1: “Build-Your-Own” Cover

One practical way the industry can adapt to climate change related claims is by introducing “build-your-own” insurance cover. Under this model, rather than offering a “standard” home or property insurance policy covering all or a certain range of perils at one premium, insurers provide a flexible menu of cover. Policyholders choose which perils they want to cover (e.g., flood, bushfire, cyclone) and select optional features (contents only, building only, specified contents only, excess levels). By doing so, customers can tailor their cover to their budget and risk profile. While some Australian insurers have started to introduce ‘flexible levels’ of cover and optional extras, a fully modular peril by peril system is what is needed to ensure affordability and sustainability in an era of escalating climate change.

One of the benefits is that affordability improves by allowing customers to drop cover for very low probability or remote risk perils, or by choosing higher excesses or narrower cover, premiums can be reduced. This then allows stepping stone cover options for households currently priced out of full cover. Second, coverage becomes more transparent and customised rather than one size fits all, policyholders can align cover with their perceived need and capacity to pay. Further, from an insurer’s viewpoint this strategy helps segment risk more effectively and price more granularly at the peril level.

A practical example is where an insurer might offer a building and contents policy for standard perils, with optional add-ons for flood cover and bushfire. A homeowner in a low flood area might choose to omit flood cover and reduce premium; conversely, someone in a high flood zone could select the flood add on and accept a higher premium. Similarly, the insurer might offer higher excess for flood or bushfire, thereby lowering premium and sharing risk with the policyholder. This approach also encourages clearer communication as policyholders can see how much each risk module adds to their premium, making the cost / risk trade-off more transparent.

Implementation of this form of cover would require insurers to invest in flexible product platforms, improved underwriting models and pricing systems at granular levels as well as Regulators and industry bodies support. Although this may sound like costly exercise for insurers, with AI advancements, implementing such a system is more feasible than ever before.

Strategy 2: Mitigation Discounts and Resilience Incentives

A second practical adaptation is to link premiums and coverage terms to policyholders’ risk mitigation actions via mitigation discounts and resilience incentives. In this model, insurers reward property owners who take verifiable steps to reduce risk. An example of this is a homeowner installing flood resistant flooring, raising power outlets above flood level, reinforcing roofs for cyclones and maintaining clearance around vegetation.

Insurance policies then reflect the reduced expected losses through lower premiums, reduced excesses or enhanced cover terms.

For policyholders, mitigation discounts lower ongoing premium costs and provide tangible incentive to invest in resilience. For insurers, the result is fewer or smaller claims, lower severity of losses and improved portfolio stability. From a societal perspective, this approach also promotes the shift from purely reactive insurance to proactive resilience building a key necessity given climate change.

To implement this effectively, insurers must design clear criteria for eligible mitigation actions, provide guidance and verification mechanisms (for example, inspections or digital certification), and communicate the link between mitigation and premium reduction. For instance, an insurer might offer a premium discount for households in moderate risk zones that complete approved flood proofing work. In high risk zones, insurers might require certain mitigation actions as a condition of cover. Over time, this creates improved resilience, fewer claims, slower premium growth and broader affordability.

Conclusion

With natural disasters and extreme weather now imposing billions of dollars of loss annually, the dual pressures of rising cost and the need for accessible cover are intensifying. Policyholders find premiums and excesses climbing and some areas becoming harder to insure. Whereas, insurers face increasing claims, higher reinsurance costs and tighter margins. Balancing affordability, coverage and sustainability is not optional, it is essential for the future of the market and for the resilience of communities.

Ultimately, the industry must evolve from a passive payer of losses to an active partner in resilience. By creating products that recognise and reward mitigation, and by empowering customers to tailor cover to their needs and budgets, insurers can help maintain access to protection, share risk transparently, and preserve financial viability. In doing so, the Australian insurance industry will be better placed to meet the challenges of increasing natural disasters, protect households and businesses, and support the transition to a climate resilient future.

Thought Leadership

Reflecting on your Part A response, what leadership qualities are most important in addressing this issue and driving meaningful change within the insurance industry?

Leadership Qualities for Building a Resilient and Affordable Insurance Future

As Australia faces an escalating cycle of floods, bushfires, and storms driven by climate change, the insurance industry stands at a pivotal crossroads. Insurers must find ways to balance affordability, coverage, and sustainability in an increasingly volatile environment. Meeting these challenges requires strong, future focused leadership. Among the many qualities needed, strategic foresight and collaborative leadership stand out as the most essential for guiding the industry through this transformation.

Strategic foresight is the ability to anticipate emerging risks, recognise long-term trends, and shape proactive responses before crises occur. In the context of climate change, traditional actuarial approaches that rely on past loss data are no longer adequate. Insurance leaders must think decades ahead, integrating climate modelling, urban planning, and technological innovation into their decision making. Foresighted leaders recognise that the problem of affordability is not simply about adjusting premiums, it is a systemic challenge tied to infrastructure resilience, government policy, and community preparedness.

For example, the introduction of “build-your-own” insurance products requires anticipating how customers with different risk profiles and financial capacities will respond to flexible coverage options. Similarly, implementing mitigation discounts relies on understanding how homeowners can be motivated to invest in property resilience. Leaders with strategic foresight connect these innovations to broader goals including reducing long-term claim costs and strengthening resilience to extreme weather. Ultimately, foresight enables insurers to move from reacting to disasters to shaping a more resilient future.

However, the insurance industry cannot resolve the affordability and coverage crisis in isolation. Collaboration between insurers, governments, reinsurers, and communities is essential to create solutions. Within organisations, collaborative leaders need to foster teamwork between underwriting, sustainability, and claims divisions to ensure coherent, customer centred responses to climate risk. This inclusive style of leadership not only drives innovation but also builds public trust which is an essential asset for any industry.

In conclusion, strategic foresight and collaborative leadership are the twin pillars upon which the Australian insurance industry’s climate adaptation must rest. Foresight enables leaders to anticipate change, while

collaboration ensures collective capacity to act on it. Together, these qualities will allow the industry to remain resilient and protect Australian communities while ensuring that insurance remains affordable, accessible, and sustainable in an increasingly unpredictable world.

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