



Government of **Western Australia**  
Department of **Treasury**

# Western Australia's Risk Management Policies and Insurance Strategies for Essential Public Assets

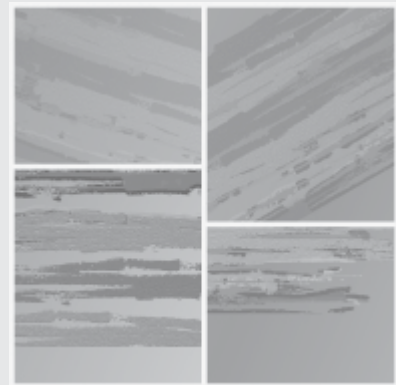
October 2011





Western Australia's  
Risk Management  
Policies and Insurance  
Strategies for Essential  
Public Assets

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Western Australia's Risk Management Policies and Insurance Strategies for Essential Public Assets  
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## Background

The *Natural Disaster Relief and Recovery Arrangements Determination 2011* (NDRRA) is a policy that details the type and level of Commonwealth assistance provided to jurisdictions to help pay for natural disaster relief and recovery costs.

Under the NDRRA, it is a condition of a State or Territory receiving funding that it submits an assessment of its insurance arrangements undertaken by an independent and appropriate specialist (NDRRA clause 4.6.1). The submission is required to provide 'commentary and evidence to support and substantiate a State's assessment of the adequacy of their insurance arrangements'.

The Commonwealth Department of Finance and Deregulation has provided a *Guide to Submission Requirements* (Commonwealth Guide), which outlines the requirements of the assessment. These requirements include the provision of risk data for the State's essential public assets, risk profile information, and details of insurance arrangements and strategic information relating to risk management policy and strategy (Commonwealth Guide, pp 1-2).

The Commonwealth Department of the Attorney-General will review the assessments to determine whether Australian jurisdictions are adequately insured in the event of a natural disaster. The following principles will guide the Commonwealth's review:

- a State has a responsibility to put in place insurance arrangements which are cost effective for both the State and the Commonwealth;
- the financial exposure borne by taxpayers (at both levels of Government) under the Determination should be minimised; and
- the onus is on a State to explore a range of insurance options in the marketplace and assess available options on a cost-benefit basis. (Commonwealth Guide, p. 1)

In light of the requirements under the NDRRA, the Western Australian Department of Treasury (Treasury) has coordinated a review of the State's insurance arrangements. Treasury has engaged the Western Australian Office of the Auditor General (OAG) to undertake the assessment, and the OAG has engaged Ernst and Young (EY) to assist.

Treasury, in consultation with RiskCover (the State's insurance fund) and the OAG, has identified the agencies and organisations likely to have State essential public assets which fall within the scope of the review.

Treasury has written to all the identified agencies and organisations, requesting that they provide the relevant insurance data and information as specified in the Commonwealth Guide. Treasury has also provided guidelines to agencies outlining the specific information required of them. Information collected by Treasury was checked for completeness prior to being passed on to the OAG and EY for assessment.

The Treasury Guidelines specifically requested that agencies provide information that describes their risk management policy and strategy in relation to managing financial risk, associated with damage and/or destruction of essential public assets, as a result of natural disaster.

In addition to the information provided directly to Treasury and attached to this report, EY met individually with most relevant agencies to review and clarify the information provided, and to seek further information where necessary.

The objective of this paper is to address the key requirements of the review process that deal with the adequacy of the State's insurance arrangements. In particular, this paper provides:

- a comprehensive overview of Western Australia's risk management and insurance strategies for essential public assets;<sup>1</sup>
- an overview of the insurance arrangements for essential public assets not insured with RiskCover; and
- a summary of how the State's risk management policies and insurance strategies are implemented.<sup>2</sup>

It should be noted, that this paper provides details for the insurance arrangements of State Government essential public assets.<sup>3</sup> An assessment of the local government insurance arrangements will be provided prior to the 31 March 2012 deadline for the local government component of the assessment.

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<sup>1</sup> As required by the Commonwealth Guide, p. 4.

<sup>2</sup> Against the criteria contained in Commonwealth Guide, p. 1.

<sup>3</sup> The University of Western Australia and Murdoch University have not been included in this paper, but will be provided in the near future. Curtin University and Edith Cowan University are members of RiskCover.



## **Western Australia's Risk Management Policy and Strategy**

The key feature of the State's approach to risk management policy is the use of a managed fund in RiskCover. RiskCover operates on a self-insurance basis, is underwritten by the Crown and is managed by the RiskCover Division of the Insurance Commission of Western Australia. RiskCover provides insurance for the majority of State Government agencies.

This section outlines the history and rationale for the creation of RiskCover and the main features of RiskCover's approach to risk management. The State's overall approach to risk management includes a number of policies and guidance notes to inform agencies of their requirements, which are also outlined.

### ***Report of the Committee Established to Review the Western Australian Government's Insurance Management Arrangements***

The *Report of the Committee Established to Review the Western Australian Government's Insurance Management Arrangements* (the Report) was released in May 1996. The Report was, in part, a response to the Auditor General's Report No. 3 – June 1994, which raised concerns that there was “no requirement for agencies to systematically assess risk and implement appropriate control mechanisms” in the Western Australian public sector.

In conducting the Review, the Committee:<sup>4</sup>

- identified appropriate or best-practice arrangements surrounding risk management, insurance, self-insurance and other risk-financing alternatives;
- reviewed the current insurance arrangements for the Western Australian Government;
- reviewed the insurance arrangements of other Australian jurisdictions, the Commonwealth and New Zealand; and
- recommended an approach to be used in Western Australia involving the introduction of a managed fund, outlining how the fund should be managed and the benefits of such an approach.

The Report identified a number of shortcomings with the pre-1996 Government Insurance Fund (GIF) and the overall insurance arrangements. Shortcomings that related specifically to property insurance included:

- a number of government agencies arranged insurance outside the GIF;
- some government agencies had no cover, and paid claims from operating funds;
- the Department of Health only covered buildings for a proportion of their depreciated value, and only for Fire, Storm and Tempest coverage, except in earthquake-prone areas; and
- all buildings for government departments were covered by the Building Damage Management Fund which was administered by the Building Management Authority. These buildings that were valued at \$5.4 billion in 1996 were totally self-insured, with no reinsurance, an arrangement that the Committee found unsatisfactory.

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<sup>4</sup> The Committee included representatives from the then Department of Treasury and Finance, and the former State Government Insurance Commission.

In the Report the Committee recommended that the State Government maintain a policy of self-insurance and create a managed fund to facilitate administration of all the insurable risks of State Government agencies. The reasons that supported this approach included:

- improved cost efficiencies and accountability by financially charging agencies according to risk. This would encourage improved risk management practices in State Government agencies;
- it was considered best practice in other Australian jurisdictions;
- coordination of risk management across the State Government is best managed centrally. This could be done through the managed fund; and
- it provided better value insurance coverage at a lower cost, resulting in savings to the State Government.

### ***Creation of a Managed Fund***

In response to the Report, the State Government agreed to adopt a managed fund approach to administer all insurable risks of its agencies, and RiskCover commenced operations on 1 July 1997.

All State Government agencies are required to participate in RiskCover unless specifically exempted by the Treasurer. Such an exemption would only be granted if the Treasurer is satisfied greater efficiency is demonstrated by an alternative arrangement. No exemptions related to essential public assets have been granted to State Government agencies.

As Government Trading Enterprises (GTEs) are required to act in a commercial manner to maximise returns, they are not required to participate in RiskCover. Universities are also not required to participate in the fund.

The main business activities of RiskCover, as defined by the *Insurance Commission of Western Australia Act 1986*, are:

- to manage and administer insurance and risk management arrangements on behalf of public authorities (Government Agencies); and
- to provide services, facilities and advice to public authorities in respect of the management of claims against them or against funds maintained or administered by them under any written law.

## **RiskCover**

RiskCover provides insurance arrangements for the majority of Western Australia's agencies. RiskCover's property and motor combined risk and catastrophe insurance arrangement involves RiskCover retaining the first \$20 million of losses, and purchasing reinsurance protection for losses above the retained amount.

The amount of cover purchased is based on catastrophic modelling that, in the event of an earthquake, projects a probable maximum loss of 3.5 per cent of the total insured value of the property located in the Perth area (ICA Zone 22). Calculated on this basis, RiskCover's probable maximum loss for 2011-12 is \$956 million. Therefore, the reinsurance protection purchased for 2011-12 is \$936 million (\$956 million less \$20 million retention). RiskCover has provided a substantial amount of information to support and explain its current arrangements.

## **Access to 'other capital' to fund the costs from natural disasters**

The State has considerable capital reserves to call upon in the event of a natural disaster. As noted above, the majority of the State's agencies insure their essential public assets through RiskCover. In the event of a natural disaster affecting assets covered by RiskCover, funding is available to cover the costs of damage up to \$956 million (RiskCover currently retains the first \$20 million in losses and purchases \$936 million in reinsurance).

In cases where the losses to assets insured through RiskCover exceed the insured amount, RiskCover would look to fund the loss above the reinsurance limit from its available reserves.<sup>5</sup>

There are some essential public assets not insured through RiskCover. In the event that a natural disaster damages these assets (for example, some road and rail infrastructure), the resultant costs may be met from agencies' existing budget allocations or operating expenses. Where these funds are insufficient, funds may be allocated from the Consolidated Account or through other financing arrangements such as agency borrowing programs.

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<sup>5</sup> In 2006, the State Government gave approval for the RiskCover Fund to maintain a separate Prudential Reserve equivalent in value to an APRA Prudential Margin sufficient to achieve a 75 per cent likelihood of adequacy with respect to the provision for outstanding claims. RiskCover have indicated that they have significant assets that could be used to fund such losses.

Western Australian public sector finances are on a sound and sustainable footing (reflected in the State's ongoing triple-A credit rating assessments from both Moody's and Standard & Poor's), with the State able to consider increases in borrowings and/or reprioritisation of existing spending plans to accommodate unexpected events. This flexibility is based on the achievement of operating surpluses across all sectors of government in recent years, accompanied by a considerable strengthening of the public sector balance sheet.<sup>6</sup>

Operating surpluses are projected in the current forward estimates, while net debt is forecast to grow over this period to support the State's significant infrastructure program.<sup>7</sup> These measures are expected to remain within the limits of the State Government's whole-of-government financial targets and are consistent with key credit rating measures.

### ***Treasurer's Instructions***

Section 78 of the *Financial Management Act 2006*<sup>8</sup> provides that the Treasurer may issue instructions with respect to matters of financial administration. A 'Treasurer's Instruction' (TI) has the force of law and therefore must be observed by all agencies to which it applies. However, TI 104 'Exemptions' empowers the Treasurer to grant an exemption from the requirements of a TI where he or she considers it warranted.

Many of the TIs concern risk management within State Government organisations, however TI 812 and TI 825 specifically deal with risk management and insurance. The TIs are included in the State's *Financial Administration Bookcase*.<sup>9</sup>

TI 812 on Insurance states:

*The accountable authority shall, having regard to any government policy with respect to insurance, ensure that there is an appropriate level of insurance cover over all insurable risks of the agency, and shall review insurance arrangements in respect of an insurance policy or class of policies, where practicable, before the renewal of each policy or class of policies.*

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<sup>6</sup> The public sector balance sheet has been strengthened through early retirement of borrowings, and the availability of operating surpluses as a non-debt source of funding for large public works such as railways and public hospitals.

<sup>7</sup> Western Australia's public sector infrastructure spend was \$2,780 per capita in 2010-11. Based on estimated outturns for 2010-11 spending in recent budgets, this is significantly higher than the estimated \$2,015 and \$1,702 per capita infrastructure spends by the New South Wales and Victorian public sectors respectively in 2010-11.

<sup>8</sup> [http://www.slp.wa.gov.au/legislation/statutes.nsf/main\\_mrtitle\\_333\\_homepage.html](http://www.slp.wa.gov.au/legislation/statutes.nsf/main_mrtitle_333_homepage.html)

<sup>9</sup> <http://www.treasury.wa.gov.au/cms/uploadedFiles/Treasury/Legislation/FAB.pdf>

TI 825 on Risk Management and Security states:

*The accountable authority shall ensure that:*

- i. there are procedures in place for the periodic assessment, identification, and treatment of risks inherent in the operations of the agency;*
- ii. suitable risk management policies and practices are developed;*
- iii. an appropriate level of security is maintained over money, public and other property of or under control of the agency, including information held and intellectual property developed and controlled by the agency; and*
- iv. these procedures, policies and practices are documented in the financial management manual or other relevant policy manuals.*

### **Public Sector Commissioner's Circular on Risk Management**

The Public Sector Commissioner's Circular (formally a Premier's Circular) of 8 May 2006<sup>10</sup> states:

*All public sector bodies must practise risk management, regularly undertake a structured risk assessment process to identify the risks facing their organisations, be able to demonstrate the management of risks, and where appropriate, have continuity plans to ensure they can respond to and recover from any business disruption.*

All public sector bodies have been required to submit details of their risk management policy, assessment processes and continuity plans to RiskCover. Public sector bodies must ensure that risk management policies and continuity plans are maintained and reviewed on a regular basis.

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<sup>10</sup> <http://www.publicsector.wa.gov.au/AgencyResponsibilities/PSCCirculars/Lists/Circular/Attachments/263/2009-19%20Risk%20Management%20and%20Business%20Continuity%20Planning.pdf>

## ***Western Australian Government Risk Management Guidelines***

The *Western Australian Government Risk Management Guidelines*<sup>11</sup> were published by RiskCover in 2007 to assist State Government agencies to develop and implement effective risk management processes, in accordance with the former Premier's Circular. These guidelines provide an overview and explanation of the risk management process, and guidance on how to apply the process within State Government agencies.

RiskCover are also available to assist and provide advice to State Government agencies with their risk management strategies.

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<sup>11</sup> [http://www.riskcover.wa.gov.au/riskmanagement/pdf/rm\\_guidelines.pdf](http://www.riskcover.wa.gov.au/riskmanagement/pdf/rm_guidelines.pdf)

## Arrangements for essential public assets not covered by RiskCover

RiskCover provides insurance arrangements for the majority of Western Australian Government agencies. However, not all of the State's essential public assets are covered through RiskCover.

GTEs and Universities are not compelled to participate in RiskCover, and generally tend to have their own arrangements, whilst some State Government agencies have chosen not to purchase insurance for certain types of assets. These tend to be large infrastructure assets (such as roads and rail infrastructure), where it has been a long standing practice to not purchase insurance.

### *Other essential public assets*

Treasury, in consultation with RiskCover, identified State Government agencies and GTEs that are likely to have essential public assets which are not insured by RiskCover.

Each agency that was identified as potentially having essential public assets not insured through RiskCover is listed below,<sup>12</sup> along with a brief description of its insurance arrangements including the value of uninsured assets.<sup>13</sup>

- Department of Environment and Conservation
  - The Department of Environment and Conservation insures all of its essential public assets, with the exception of its road network, bridges and culverts. The total replacement value of all uninsured assets is approximately \$1.3 billion. The Department of Environment and Conservation does not insure these assets based on a historical precedent and the belief that the cost would likely be prohibitive.

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<sup>12</sup> Gold Corporation and Synergy were initially identified as having essential public assets, however they advised Treasury that they hold no such assets.

<sup>13</sup> The value of the uninsured assets reflects either the replacement cost old for new to meet existing standards, or the depreciated replacement cost, as provided by the State Government entities.



- The Department of Environment and Conservation stated that it has not experienced an event that has led to a claim exceeding \$1 million through the NDRRA.
- Horizon Power
  - Horizon Power insures all of its essential public assets, with the exception of its transmission and distribution lines. The total replacement value of all uninsured assets is approximately \$1.3 billion. Horizon Power has advised that the transmission and distribution networks cannot be covered by insurance because it is industry wide practise to exclude these assets.
  - Horizon Power indicated it has incurred losses from natural disasters of \$11.1 million between April 2006 and September 2011.
- Department of Housing
  - The Department of Housing insures all of its essential public assets through RiskCover, with the exception of its domestic residential property assets. The total replacement value of all uninsured assets is approximately \$11 billion.<sup>14</sup> The Department of Housing does not insure these assets because obtaining insurance is not considered cost-effective.
  - The Department of Housing indicated it has incurred losses from natural disasters of \$9.2 million between 1996-97 and 2010-11.
- Department of Indigenous Affairs
  - The Department of Indigenous Affairs insures all of its essential public assets through RiskCover, with the exception of some properties in remote aboriginal communities. These assets are not insured because insurance was deemed to not be cost-effective by the State Government.
  - The Department of Indigenous Affairs indicated it has not incurred any losses from natural disasters greater than \$1 million between 1996-97 and 2010-11.
- Main Roads WA
  - Main Roads WA insures all of its essential public assets through RiskCover, with the exception of its road network, bridges and culverts. The total replacement value of all uninsured assets is approximately \$23.6 billion. Main Roads WA does not insure these assets due to long-standing practice and the belief that the cost would likely be prohibitive.

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<sup>14</sup> Includes \$1.2 billion of properties managed on behalf of the Department of Indigenous Affairs.

- Main Roads WA indicated it has incurred losses from natural disasters of \$33.1 million between 2005-06 and 2010-11.
- Public Transport Authority
  - The Public Transport Authority insures all of its essential public assets through RiskCover, with the exception of the rail system including rail stations, systems and rolling stock. The total replacement value of all uninsured assets is approximately \$9 billion. The Public Transport Authority advised that it is a long-standing position not to seek insurance for these assets.
  - The Public Transport Authority indicated it has incurred losses from natural disasters of \$122,000 between 1996-97 and 2010-11.
- Verve Energy
  - Verve Energy insures all of its essential public assets. It has not incurred any losses from natural disasters greater than \$1 million between 2006-07 and 2010-11.
- Water Corporation
  - The Water Corporation insures all of its essential public assets, with the exception of water pipes, water meters, drains and channels, bores and catchments. The total replacement value of all uninsured assets is approximately \$20.8 billion. Water Corporation's decision to not insure these assets is based on risk assessments of the assets, benchmarking with other water utilities, claims history and value for money in respect to insurance costs versus the likelihood and value of losses.
  - The Water Corporation indicated it has incurred losses from natural disasters that were claimed against insurance of \$18.1 million between 1996-97 and 2010-11.<sup>15</sup>
- Western Power
  - Western Power insures all of its essential public assets, with the exception of its transmission and distribution lines. The total replacement value of all uninsured assets is approximately \$5.4 billion. Western Power does not insure these assets because it is a standard market exclusion following the reinsurers' exit from the market.
  - Western Power indicated it has incurred losses from natural disasters of \$6.1 million between 1996-97 and 2010-11.

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<sup>15</sup> Cyclone, storm and flood losses were not recorded for the entire 15 year period.

## Implementation of the State's Risk Management Policies and Insurance Strategies

This paper has provided a comprehensive overview of the State's risk management policies and insurance strategies for essential public assets.

As noted above, the key feature of the State's approach to risk management is the use of a managed fund in RiskCover. The establishment of RiskCover followed a comprehensive review of the State's existing arrangements, which at the time were considered inadequate.

Following the commencement of RiskCover, all State Government agencies were required to participate in the fund unless exempted by the Treasurer.<sup>16</sup> It is important to note a Treasurer's exemption is only granted if the Treasurer is satisfied greater efficiency is demonstrated by an alternative arrangement.

The State's overall approach to risk management includes a number of policies and guidance notes to inform agencies of their requirements including:

- TIs 812 and 825;
- *Public Sector Commissioner's Circular on Risk Management*, and
- *Western Australian Government Risk Management Guidelines*.

As described above, not all the State's essential public assets are covered through RiskCover. There are a number of State agencies that do not participate (mainly GTEs that have pursued their own arrangements) and agencies that do not insure some assets.

In undertaking this Review, Treasury requested all agencies that were identified as potentially having essential public assets, which were not covered by RiskCover, to outline and justify the agency's approach to insurance.

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<sup>16</sup> As GTEs are required to act in a commercial manner to maximise returns, they are not required to participate in RiskCover.

Specifically, these agencies were requested, in the context of TIs 812 and 825, to describe the agency's risk management policy and strategy in relation to managing financial risk associated with damage and/or destruction of essential public assets as a result of a natural disaster. Agencies were also requested, in cases where essential public assets were not insured, to provide information supporting this approach and the mechanisms used to finance any losses resulting from natural disasters.

Where agencies have not insured essential public assets, it has tended to be a result of insurance for a particular asset type not being available, or that after review of the available options, it has been not been cost-effective to do so.

For example, both Western Power and Horizon Power have been unable to obtain insurance for its transmission and distribution lines. Reinsurers stopped offering coverage for transmission and distribution lines in 2000-01, which has "made cover for transmission and distribution lines at best uneconomical and in the majority of cases unavailable".

Since July 2004, the Department of Housing has not insured the residential properties that it owns, primarily because obtaining insurance for these assets was not considered cost-effective. This decision was based on a thorough assessment of the available insurance options and included advice from the Insurance Commission of Western Australia supporting not insuring, approval from the Department of Treasury and Finance, an independent catastrophe modelling report from Benfield, and approval from the Minister for Housing. The Department is currently undertaking another review of its insurance arrangements for residential property to determine if they are still appropriate.

MainRoads WA and the Department of Environment and Conservation (road infrastructure), and the Public Transport Authority (railway infrastructure) do not insure all significant essential public assets and have done so for a number of years. The decision not to obtain insurance for these assets has, in general, been based on historical precedent and an understanding that insurance obtained on a commercial basis would be cost-prohibitive.

The decision not to insure these assets may well be appropriate given the difficulty and high cost of obtaining insurance for these types of assets. However, in the course of undertaking this review, it has become apparent that there has not been any recent formal assessment of the appropriateness or cost-effectiveness of these arrangements.

In light of these findings, Treasury is currently considering undertaking a review of the processes underpinning the decision to not insure large State essential public assets.

Overall, it is considered that the State has adequate natural disaster insurance arrangements in place.

