Reforming Flood Insurance: A Proposal to Improve Availability & Transparency

Submission Paper

By Assetinsure Pty Ltd

Assetinsure Pty Ltd
ABN 65 066 463 803
44 Pitt Street Sydney NSW 2000

PO Box R299
Sydney NSW 1225
Australia

T (02) 9251 8055
F (02) 9251 8061
www.assetinsure.com.au

1 Introduction

This submission responds to the questions posed in the Reforming Flood Insurance: A Proposal to Improve Availability and Transparency consultation paper released in November 2011.

Providing consumers with flood cover for all home building and home contents insurance policies based on a standard definition of flood with the option to 'opt out' of flood cover, is one of the key recommendations of the Natural Disaster Insurance Review (NDIR) Inquiry into flood insurance and other related matters.

This submission states the position of Assetinsure with respect to some of the key aspects of the consultation paper. This submission deals specifically with the challenges of providing mandatory flood cover in rural and regional Australia.

1.1 About Assetinsure

Assetinsure Pty Ltd (ABN 65 066 463 803) is a general insurance company licensed by the Australian Prudential Regulation Authority (APRA). This brief summary is to provide an overview of major corporate features with respect to its products and distribution models. Please refer to our website for further information: www.assetinsure.com.au

1.2 Products & Distribution Model

Assetinsure or the agents acting on Assetinsure's behalf mainly serve its insured customers through a panel of independent brokers. Whilst Assetinsure mainly provides corporate insurance, through its connection with Insure That Pty Ltd (ABN 98 088 296 324) it also underwrites home and contents insurance products.

This business strives to meet most of the general insurance needs of its customer base under a single policy by offering them insurance packages for their homes, contents and motor vehicles. As a result, Assetinsure has a significant portfolio of home buildings and home contents in regional and rural Australia. Through its Farm Protection package policies, home and contents protection is often provided in conjunction with the insurance for the insured's cars, farm vehicles and machinery, farm property and livestock.

With this background in mind, we focus in our submission on some key challenges facing the Australian insurance industry and on specific aspects of the consultation paper instead of covering it in its entirety.

2 Submission

Assetinsure generally supports the Federal Government's initiative to comprehensively review flood cover for home buildings and home contents insurance policies. Assetinsure supports the following initiatives:

- Greater investment by governments at all levels in effective flood mitigation through construction of levees, dams and other engineering and civil works

- Setting up of a central, nationwide flood mapping database developed to a set of common standards and made available to insurers and the wider community

- Introduction of a Key Facts Sheet aimed at improving the consumer understanding of their home and contents insurance cover and enabling them to assess its suitability with respect to their individual circumstances

- Introduction of a standardised definition of flood across all insurers, thus making the home and contents insurance policies more transparent for the consumers

While supporting the initiatives listed above, Assetinsure strongly believes that the basis of the discussion on flood insurance so far has been the consumers living in metropolitan regions. It implicitly assumes that the insurance needs of consumers in metropolitan regions regarding flood insurance can then be applied to the rest of Australia. Thus, the discussion does not consider adequately the inherent challenges in providing flood cover to consumers in regional and rural communities.

This submission consists of two parts – Part A and Part B.

In Part A of the submission, Assetinsure highlights the general challenges faced by all insurers in providing flood cover across Australia. It also highlights the challenges faced by Assetinsure in establishing flood cover for rural and regional households and reiterates that any decision regarding flood cover should adequately address the complexity and the challenges of the rural and the regional markets.

Part B of the submission contains Assetinsure's responses to some of the questions as specified in the consultation paper.

2.1 Part A – Key Challenges for Insurers

2.1.1 Flood Mapping

Availability of high-quality flood maps developed to a common set of standards and their efficient dissemination is absolutely critical for the insurers to identify the flood risks and price them accordingly.

At present, flood maps for a few local government areas (LGAs) across Australia exist. However, these maps do not conform to a common set of standards which makes their interpretation and comparability extremely difficult thereby compromising their usefulness. Further, these flood maps are mainly focussed on metropolitan regions and the larger regional centres thus resulting in large gaps in the flood mapping of smaller regional and rural communities.

Thus it is absolutely imperative that a common, robust, effective, easily accessible, nationwide flood mapping database be developed in accordance with a common set of standards before making it mandatory for insurers to offer flood cover for all residential home buildings and their contents across Australia.

In the absence of high quality flood maps, any attempt to make insurers offer flood cover mandatorily will result in insurers limiting their exposure to low flood risk regions or worse still, exiting the regional home and contents insurance market altogether.

Neither of them is a desirable outcome from a consumer's perspective as it will reduce the overall competition within the industry and may result in higher premiums for the consumer irrespective of their level of flood risk.

2.1.2 Data Quality, Maintenance & Accountability

The National Flood Insurance Database (NFID) is currently considered as the most comprehensive database for determining flood risk for properties in Australia. Leaving aside the fact that the database does not yet have the flood risk assessment for all the home buildings in Australia, there are also some serious doubts about the quality of the flood risk assessment for the existing ones.

Our detailed internal analysis following the flooding of Brisbane River in 2011 shows that many of the properties that were classified in NFID as either no or low flood risk were in fact submerged in flood waters. The NFID data was erroneous on both the Annual Recurrence Interval (ARI) as well as the flood depth for some of the addresses analysed.

The current state of data quality leaves a lot to be desired if the insurers were to provide full cover for flood across Australia. Good quality data is vital for insurers to assess the flood risk of a property and charge the right premium. Without the availability of accurate and verifiable data and in the absence of alternative databases, insurers are likely to offer flood cover only in the low flood risk regions.

Any natural or human activity, whether planned or not, along the length of the main water bodies of a region can significantly alter its flow dynamics and thus, may alter the flood risk profile of the region. Insurers would like to see key accountabilities defined for the relevant government bodies and the processes put in place to re-assess the flood risk through comprehensive flood modelling for the region and then updating the NFID database if required.

Insurers should have some recourse available to them if it can be established beyond doubt that the data within the NFID database on which the insurers based their decisions, was incomplete, inaccurate or out of date and that it contributed significantly to the adverse outcome as experienced by insurers.

2.1.3 Regional & Rural Properties

Unlike the homes in metropolitan regions, properties in regional and rural locations can be very heterogeneous on account of their size, terrain and their risk exposure. It is extremely important for insurers to be able to determine the precise location of the home building on the property to determine its risk profile and charge the right premium.

The Geocoded National Address File (GNAF) can provide the exact co-ordinates for a home building in Australia based on its street address. In metropolitan areas, the street address can be used as a proxy for the home building location with a high level of confidence.

However, adopting the same approach in the case of rural and regional properties is not very effective due to the following reasons:

- For a large property spread over multiple acres and with varied topography, GNAF will return the co-ordinates of the centre of the property; which is not necessarily the location of the home building and thus, the flood risk information remains inaccurate;

- Rural and regional properties sometimes have only Roadside Delivery Address (RSD), Royal Mailbag Location (RMB) or just its name as the address; the flood risk for such properties cannot be accurately determined.

Without knowing the exact location of the home building with respect to its terrain, the pricing for flood risk for such properties will be inherently complex and inaccurate.

2.1.4 Consumer's Choice & Attitude

Rural communities in Australia generally pass on their properties from one generation to the other. The next generation does not only inherit the property but also has a good knowledge of historical weather patterns and the risks posed by them.

Over years, such consumers have self-managed the risks by proactively undertaking construction of flood levees and check dams, by building their homes on higher grounds and through various other initiatives.

Responsible consumers who have invested their time, effort and capital in reducing the flood risk to their home buildings, are likely to be sensitive to being forced to pay additional flood premium. An indication of consumers' unwillingness to pay for flood cover is provided by Assetinsure's own experience.

For more than 12 months before the wet 2011 summer, we have asked a specific question for our brokers in rural and regional Australia to respond to:

Do you require Flood cover for the Home Buildings or Home Contents sections?

This question was and continues to be nearly unanimously answered to in the negative reflecting consumers' choice in avoiding a cover they perceive as very expensive will little or no relevance in terms of their individual circumstances.

While we do not dispute that the 2011 summer would have increased the community's awareness to flood risk overall particularly in the high-density metropolitan areas, we don't believe that the general attitude of 93% of the homeowners with very low flood risk and 7% of homeowners with very high to catastrophic flood risk has altered significantly.

Homeowners with very low flood risk are not willing to pay for a "luxury" they do not need while the ones exposed to high flood risk weigh up carefully their options – risk management or risk mitigation by themselves, or risk transfer to an insurer albeit at a significant cost.

Flood cover for home buildings and home contents continues to be available to Australian consumers but at a price.

2.1.5 Increased Operational Costs

Forcing insurers to price for flood cover will result in a significant increase in operational costs for all insurers. The costs will be particularly high for insurers serving the rural and regional markets as they will need to undertake individual property surveys to:

- Determine the flood risk of a property by establishing reliable GNAF co-ordinates for each home building

- Assess the mitigation initiatives undertaken by property owners as their impact on the flood maps will not be evident

Insurers will need to perform these surveys for their existing books of business and any new business that they write unless the GNAF data is conveniently and exactly available for individual buildings on large acreages.

Forcing insurers to provide for mandatory flood cover will entail increased costs for insurers on account of changes to the systems and business processes, development of flood underwriting and pricing mechanisms, hiring of personnel with specialised skills and increased training and compliance costs.

The increase in operational costs due to mandatory flood cover will lead to higher premiums for all consumers irrespective of their flood risk. This may potentially result in either under-insurance or non-insurance – outcomes that are both unintended and unfavourable to the insurance industry.

2.1.6 Reinsurance

Reinsurers provide the necessary capacity for the insurers to underwrite business and thus, have a considerable interest in the quality of the business being written. Providing full flood cover based on ineffective mapping coupled with increased operating costs for the insurer and with risk assessment and pricing prone to errors, is likely to lessen the reinsurers' appetite for risk.

Consequently, the reinsurers may choose to withdraw capacity, increase reinsurance rates or introduce exclusions, each of which by itself or in any combination will have a significant negative impact on the insurers' capacity to write business. There is a heightened risk of insurers withdrawing from the already under-serviced rural and regional markets particularly the ones which have known high flood risk.

2.1.7 Summary of Assetinsure's Position & Possible Impact for Customers

As a matter of prudence and corporate responsibility, Assetinsure will not provide a cover where the basis for assessing and pricing the risk is unreliable. Put it simply: If you don't understand a risk, don't write it.

If providing flood insurance becomes mandatory for insurers without having access to flood risk data that is accurate, effective and reliable, Assetinsure will have to make the unfortunate decision of exiting the regional and rural insurance market for home and contents insurance.

Other smaller insurers will probably follow suit as they too are likely to face similar considerations. Reduced competition in the market will be an undesirable outcome for the consumers especially at a time when the insurance costs on the rise due to the impact of past catastrophic events.

Large insurers may continue to provide cover but will too pass on their increased costs to the consumers. The end result for the consumers will be a reduced choice of insurers and covers, and higher premiums.

2.2 Part B – Responses to Specific Questions

2.2.1 Operation of the Proposal in Practice

What other ways could insurers implement the proposal?

The two key aspects of the flood cover proposal are the availability of the flood cover for all home and contents insurance policies and the increasing the awareness of the flood risk and the flood cover among the consumers.

Assetinsure supports the key proposals aimed at improving the awareness of the flood risk and the flood cover. It is our firm belief that the implementation of the Key Fact Sheet and the standardised definition of flood will play an important role in making the flood risk and the flood cover transparent for the consumers.

The availability aspect of the flood cover proposal, in our opinion, is fraught with unfavourable outcomes i.e. good intentions resulting in unintended consequences.

Leaving aside the flood data issues, forcing insurers to provide mandatory flood cover across Australia will lead to an increase in premiums for all consumers irrespective of their flood risk. This increase will be due to increased operational and reinsurance costs and in our opinion, unfair to 93% of the property owners who have no flood risk whatsoever. The unintended consequence of this action is the increased propensity of the consumers underinsuring their homes and contents or not insuring them at all as they try to beat the rising cost of living.

Further, we believe that the flood insurance take up by consumers will reduce drastically as the flood risk to their property increases – again a perverse outcome. We opine that the consumers with high or extreme flood risk are most likely to opt out of flood cover partly due to its unaffordability and partly due to the flood risk management / mitigation strategies that might already be in place. NRMA's experience as cited in the consultation paper supports our thinking.

We strongly believe that the mandatory flood cover, while noble in its intention, does not serve the interests of the consumers especially the most vulnerable ones nor is it in the best interests of insurers.

We therefore, propose that just as the consumers have a choice regarding the take up of flood cover based on their circumstances, in the same way insurers should be allowed to decide on offering flood insurance depending on their commercial interests. We believe that this approach is in the insurers' best interests and also in the best interests of the 98% of the consumers who have no or low flood risk. For the remaining 2% with high or extreme flood risk, risk management and mitigation strategies are likely to be more cost effective method of managing the flood risk.

We believe that the proposed solution will greatly assist in keeping the insurance market healthy and competitive and thus, will benefit the consumers in the long run.

What other ways could insurers inform consumers about flood risk? How could this be implemented?

Assetinsure supports the initiative to increase consumer's awareness about the flood risk to their property and enable them to assess the suitability of their insurance policy with respect to their individual circumstances.

The insurers can inform the consumers about flood risk in a number of ways which we list below:

i. By providing the URL of the portal to be hosted by Geoscience Australia in all our correspondence

ii. By providing the details of the flood risk as per the flood risk database on the Certificate of Insurance

iii. By providing the Key Fact Sheet and the Product Disclosure Statements to the consumers

iv. By sending annual reminders to the consumers through email and SMS services as well as regular mail

v. By asking the customer facing personnel and brokers to advise the consumers on their flood risk based on the flood risk database

In order to implement these initiatives, issues regarding the accuracy, reliability and availability of flood risk data as raised under sections 2.1.1, 2.1.2 & 2.1.3 of Part A must be resolved first.

We also believe that having flood risk information on the local council rate notices will act as a regular reminder to the consumers about their flood risk.

2.2.2 The Storm / Flood Distinction

What initiatives might assist to resolve, in a timely fashion, disputes about whether damage has been caused by storm or flood?

At Assetinsure, we take a sympathetic yet a fair view of our policyholders who have the misfortune of suffering a major loss due to a natural event. In the past, Assetinsure has appointed third party assessors and hydrologists to determine the weather event that led to the claim and the extent of damage caused by it. From our experience, most of our policy holders have agreed with the assessor's / hydrologist's findings about the cause of the damage and its extent.

We believe that this approach works well in most cases and thus, should be persisted with. We can also consider the warnings issued by Bureau of Meteorology and their classification – whether storm warning or flood warning, when determining the cause of the damage although we concede that such warnings are issued for a wider region and thus, may not be applied in all cases.

The simplest and the cost-effective way of resolving any disputes in ascertaining the cause of the damage would be to educate customers about the need to take photos and video footage that clearly establishes the cause of the damage. With built-in cameras and video recorders in most mobile phones, we expect that an overwhelming majority of customers will be able to provide such footage to the insurers in the cause of an event.

We can reasonably expect a massive reduction in the number of disputes arising out of storm / flood distinction once this initiative is implemented. We will also see a faster and fairer settlement of claims by the insurers leading to higher customer satisfaction and cost savings.

Assetinsure can provide the draft guidelines for customers for taking photographs and / or video footage in case of a claim, if requested by the Treasury.

2.2.3 Industry Capacity to Underwrite Flood

What particular issues need to be addressed before all insurers could be required to offer flood cover?

Please refer to Part A of the submission for the key issues that need to be addressed before offering full flood cover is made mandatory for all insurers.

What is the likely impact on overall premiums of systems costs?

We anticipate significant costs to be incurred in updating our systems and as such, may not be able to absorb them internally. In all likelihood, the systems costs will be passed on to the consumers along with increased reinsurance and operational costs, resulting in higher premiums for all consumers irrespective of their flood risk.

We can expect the problem of underinsurance or non-insurance to get aggravated further under the mandatory flood cover proposal.

Would affordable reinsurance protection be available for all insurers who take on flood risk? What factors would influence whether affordable reinsurance is available? Would there be any difference between the availability of affordable reinsurance for large and small insurers?

Like the insurers, the reinsurers will perceive mandatory flood cover as an increase in risk for them and thus, are likely to force up the insurance rates for all insurers.

We cannot provide a detailed comment on the affordability aspect of the question as the definition of affordability is likely to vary from insurer to insurer. However, given the small size of their portfolio and its susceptibility to volatility, it can be easily assumed that the smaller insurers will find reinsurance less affordable in a mandatory flood cover scenario when compared to the large insurers.

We anticipate reinsurance capacity to be available for all insurers. However, the reinsurance premium to be charged is dependent on a number of factors, the important ones being the past performance of the portfolio, the geographical distribution of risks and the underwriting, and thus will vary from insurer to insurer.

In our opinion, small insurers are likely to lose out to the large insurers in the battle for reinsurance due to their smaller portfolios. A small portfolio of risks does not give the insurers enough diversification or a customer base large enough to efficiently spread their fixed costs; limits their pool of premium; and can make their performance volatile – attributes that viewed unfavourably by the reinsurers.

What other costs might insurers face as a result of the requirement to offer flood cover in all home building and home contents insurance policies?

Please refer to point 2.1.5 under Part A of this submission for a detailed analysis of anticipated increase in operational costs under the mandatory flood cover proposal.

How will smaller insurers be affected by this proposal? Are they likely to engage in defensive pricing? Are they likely to exit the market entirely in certain areas?

Small insurers need to undertake the same journey as a large insurer in order to offer flood cover to all consumers. However, the key challenge for the small insurers is to do so with very limited resources – both human and financial.

A smaller consumer base to spread the increased operational and reinsurance costs will see an above average increase in the average premiums for smaller insurers thereby making them uncompetitive in the market. Any attempt by the insurers to absorb the costs internally severely compromises their profitability.

One way for the small insurers to survive is by pricing themselves out of the market in the regions exposed to flood risk thereby limiting their exposure to flood risk in anticipation of favourable reinsurance terms in the following years. However, if all insurers were to follow suit in the high flood risk areas, this proposal is most likely to fail in meeting its objective.

We anticipate a cycle of consolidation within the insurance industry in the medium to long term as struggling small insurers will either quit the market or will be acquired by the larger insurers. This will reduce competition in the home and contents insurance market – an outcome detrimental to the interests of the consumer.

2.2.4 Transition Period

Is two years a sufficiently long transitional period to enable insurers to build the underwriting capacity required to offer flood cover on all home buildings and home contents insurance policies?

We refer to our fundamental reservations as stated under Part A of the submission. In any case however, we do not agree with the proposal that the two year period commences from the date the legislative changes are effected. We believe that the two year period should commence from the date by which the government organizations responsible for flood mapping can start providing accurate, verifiable and standardised flood mapping for all the home buildings in Australia including the ones in regional and rural communities.

If the Government proceeds with implementing the proposed measure, is there a case for aligning the commencement date of the transitional period of the proposal measure with the commencement date of the Key Fact Sheet?

We opine that it is not necessary to align the two aforementioned dates. On the contrary, we believe that the Key Fact Sheet (KFS) should be commenced within 120 days of the commencement date of any required legislative change, for the following reasons:

i. The KFS initiative is a critical step in improving consumers' understanding of home and contents insurance policies and will enable them to assess its suitability with respect to their insurance needs

ii. The KFS initiative is relatively easy and inexpensive to implement for all insurers as it does not entail significant changes to systems and processes, nor does it have any impact on the reinsurance and capital requirements of the insurers

iii. The KFS initiative is not affected by the challenges highlighted in Part A of the document

2.2.5 Assets to be covered by the Proposed Opt Out Regime

Should insurers also be required to offer flood cover in relation to strata title insurance policies? What issues would this raise?

We do not favour mandatory flood cover for strata titled properties, the reasons being the same as that against the mandatory flood cover on detached dwellings.

Further to that, strata and community titled properties are unique in that they have unlimited legal liability against any financial loss. A mandatory flood cover for strata title insurance would dramatically increase the liabilities and the obligations of the office bearers.

The strata title insurance market is characterised by a small number of insurers offering a complex product. The market is currently under considerable strain particularly in North Queensland which has seen premium increases as high as 800% in some cases. Including automatic flood cover to the existing product will worsen the situation for many of the body corporates who forced by its compulsory nature, cannot opt out of insurance. This may viewed as a discrimination against the Body Corporate members when compared to the individual customers who still have a choice to opt out under the mandatory flood cover.

We also believe that that the introduction of compulsory flood cover may lead to the ultimate withdrawal of insurers from the strata title insurance market. This will be an undesirable outcome as it will reduce the choice of available insurers and may reduce the range of benefits available to the customers.

3 Conclusion

Assetinsure supports certain aspects of the flood cover proposal as listed in the consultation paper, particularly the one aimed at increasing the consumer's awareness about their flood risk and the suitability of their home and contents insurance policy with respect to their individual circumstances. The introduction of Key Fact Sheet and the standardised definition of flood are welcome initiatives in this direction.

We believe that the providing flood cover to all consumers is a proposal fraught with unintended results. While raising the premiums of all consumers irrespective of their flood risk, this initiative is unlikely to meet its objective as the most vulnerable consumers are likely to opt out of it. It may also lead to underinsurance or non-insurance as customers try and beat the rising cost of living.

Providing flood cover in rural and regional communities is not practical at this stage due to a number of challenges in determining the flood risk. We have seen reduced competition in this market as a number of insurers have exited citing performance challenges. We therefore strongly advocate that the insurers be allowed to decide on offering flood insurance in line with their commercial interests.

Assetinsure would be willing to meet and consult on any of the points discussed in this submission paper.