

20 March 2012

The General Manager
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: floodinsurance@treasury.gov.au

Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the *Consultation Paper – Reforming flood insurance A proposal to improve availability and transparency* (November 2011).

If you wish to discuss the issues outlined in the submission or make further inquiries please contact David Welfare, Senior Adviser, Economics & Policy on (02) 9292 8593.

Yours sincerely



Carolyn McCann
Group General Manager
Corporate Affairs & Investor Relations

Insurance Australia
Group Limited
ABN 60 090 739 923

388 George Street
Sydney NSW 2000
Australia

T +61 (0)2 9292 9222
www.iag.com.au



REFORMING FLOOD INSURANCE: A PROPOSAL TO IMPROVE AVAILABILITY AND TRANSPARENCY – SUBMISSION TO CONSULTATION PAPER

March 2012

INTRODUCTION

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite over \$8 billion of premium per annum and pay around \$6 billion in claims per annum. IAG employs more than 13,000 people of whom around 9,000 are in Australia. Across our portfolio of brands IAG insures 6.9 million cars, 2.4 million homes, 92,800 farms, 121,100 employers and 375,200 businesses. IAG had more than 16.2 million policies in force in financial year 2011.

IAG's Direct Insurance business provides personal insurance products as well as business insurance packages targeted at sole operators and smaller businesses in NSW, ACT, Queensland and Tasmania primarily under the NRMA Insurance brand. SGIO is the primary brand in Western Australia, and SGIC in South Australia. In Australia, IAG also has a distribution agreement with RACV (underwritten by Insurance Manufacturers of Australia – owned 70% IAG; 30% RACV) in Victoria. Products are distributed through branches, call centres, the internet and representatives.

IAG's intermediated insurance products are sold nationally, primarily under the CGU Insurance and Swann Insurance brands through a network of more than 1,000 intermediaries, such as brokers, agents, motor dealerships and financial institutions. CGU is also a leading provider of workers' compensation services in Australia.

IAG'S INTEREST IN THE REVIEW

As an insurer, we are committed to assisting our customers manage and reduce their risks and, in the event of unexpected loss, we support customers and communities in recovering and rebuilding.

IAG supports the introduction of a workable standard definition for flood as well as increased disclosure through greater transparency. IAG will continue to work with the Federal Government to achieve a more sustainable and comprehensive approach to managing the impact of natural disasters on the community. While these processes are ongoing, through its Australian businesses IAG is expanding its flood insurance products during 2012 to offer flood cover as a standard inclusion in its personal lines products (not commercial or farm products).

The private insurance market remains the most effective and economically sustainable solution to ensuring the maximum number of Australians choose to cover themselves for their risks. The market already provides flood solutions to a large proportion of the Australian population. Insurers should therefore be encouraged to compete further to offer flood products that meet individual customer needs. We believe a market based solution, in a framework where there is clear and unambiguous product information provided to consumers, will address the issue of accessibility to flood cover.

GOVERNMENT'S PROPOSAL

IAG notes the proposal outlined in the *Consultation Paper* requiring all insurers to offer flood cover in home building and home contents insurance policies. **The proposal would require insurers to offer flood cover in all home building and home contents policies, with insurers being able to choose whether to give consumers the option to “opt out” of flood cover.**

It is important to remember that approximately 93 per cent of Australian households have no flood risk (*Consultation Paper*). Under the proposal, insurers would automatically cover these households for flood. As the *Consultation Paper* notes:

“For the remaining 7 per cent of homes which are subject to flood risk, there would be higher premiums if flood cover is provided. The flood risk premium for the majority of these homes is likely to be modest and most would be expected to take up flood cover. For the 2 per cent of homes at high and extreme risk of flooding, flood risk premiums are likely to be significant and this is expected to impede the take up of flood cover.

For high and extreme flood risk homes, various mitigation and adaptation measures may be a more cost effective method of managing risk than insurance.” (p.4)

Indeed, as highlighted in the Attorney-General’s Department submission to the Productivity Commission *Inquiry into Barriers to Effective Change Adaptation*:

“The policy challenge for the Government is to ensure that the community takes a holistic approach to adapting to the impact of climate change and does not rely on insurance as a single solution. As risk from extreme weather events and rising sea levels increases, insurance will not remain available and affordable unless risk is mitigated through better land use planning, appropriate adjustments to building standards and other measures directed at the long term structural adjustments that is considered appropriate as a result of climate change” (p.17)

Importantly, any legislative or regulatory response should be proportional to the size of the problem.

The proposal will improve the availability and transparency of flood insurance and, ultimately, flood insurance penetration. The proposal allows consumers to confront the flood risk they face by way of insurance premiums, and to be provided with information which they can use to make an informed choice about whether to purchase flood insurance. However, IAG believes insurers should have the flexibility not to offer flood cover. The industry is clearly moving to include flood insurance in most policies and in various forms eg standard inclusion, “opt-out” or “opt-in”.

IAG’s Direct Insurance business expanded its flood cover during January 2012 and now offers flood insurance **as a standard inclusion** in home and contents policies in all States (with the exception of Buzz Insurance). From 1 February 2012, IAG’s intermediated personal lines insurance policies automatically included cover for flood in home and contents policies on renewal. All customers were informed that flood cover (personal lines products) was available from 1 February 2012.

Details of IAG’s operating businesses flood product options for home and contents policies are outlined below:

GOVERNMENT'S PROPOSAL (CONTINUED)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
Direct insurance	Opt out+	No opt out	No opt out	No opt out	No opt out	Opt out+	No opt out	Opt out+
Intermediated	No opt out	No opt out	No opt out	No opt out	No opt out	No opt out	No opt out	No opt out
Buzz Insurance*	Opt in	Opt in	Opt in	Opt in	Opt in	Opt in	Opt in	Opt in

+ Customers can choose to remove flood cover if we have identified their home is prone to flooding.

* The customer can only take out Home Insurance on-line. The customer has a choice of Base Cover, Central Cover or Buzz Plus cover. The Base Cover does not include a flood option. The Central Cover includes a 30% of sum insured flood option. The Buzz Plus Cover includes 100% flood option.

The decision by IAG's operating businesses to offer flood insurance as a standard inclusion in their home and contents policies is twofold. It addresses the community's feedback that it wants greater clarity around insurance for different types of water damage. It is also based on our experience in NSW. In that State NRMA Insurance provides flood cover automatically to 98% of its customers. The remaining 2% of customers in high risk areas have the ability to "opt-out" of flood cover.

Flood cover as a standard inclusion will provide all our customers with absolute certainty and confidence that they are covered for both stormwater and flood damage. The best way to make sure our customers have protection and to maximise the number of people covered is to automatically include flood cover in the premium.

IAG notes the views of consumers outlined in the Paper commissioned by Treasury – *A Consumer Perspective on the NDIR Paper* (September 2011):

"... consumer representatives believe that automatic flood cover (with no opt out) will deliver the best outcomes for consumers" (p.5)

IAG believes customers should have the opportunity to choose the type of insurance cover that suits their individual needs.

INDUSTRY CAPACITY TO UNDERWRITE FLOOD

IAG believes insurers should have flexibility. Forcing insurers to offer flood cover or "opt-out" flood cover would be potentially damaging if flood products were beyond a particular insurers' risk appetite. This may actually work to reduce competition in the insurance market.

IAG notes the Consultation Paper statement that "requiring all insurers to offer flood cover may result in some companies defensively pricing flood cover or simply 'redlining' flood prone areas. This could have a negative impact on competition in the insurance market, at least in areas exposed to flood risk" (p.10)

GOVERNMENT'S PROPOSAL (CONTINUED)

THE STORM/FLOOD DISTINCTION

There are two aspects to this distinction. These are:

Whether the customer will understand the distinction

Having a standard definition of flood across home and contents policies offered by insurers will make it easier for customers to understand the distinction. However while the flood definition should be standard across relevant policies IAG is concerned that section 37D of the Insurance Contracts Amendment Bill 2011 may limit the capacity of insurers to offer water damage cover where flood is excluded. This is because the effect of sections 37D(1),(2) and (3) is to deem the insurer to have offered flood cover as defined by the Regulations if one aspect of their storm cover is captured by that definition. It is submitted an insurer should be able to offer cover under storm without fear that by doing so it will be forced to cover everything under the flood definition.

If this issue is not resolved insurers will likely draft their storm damage event cover very narrowly to prevent them being captured by section 37D. This in turn will lead to less water damage cover to a customer.

How does one determine whether storm or flood caused the damage where this is not clear on its face

When flood is excluded from a policy but storm water run off is not it can sometimes be necessary to obtain expert evidence as to the source of the water that caused damage. Such expert evidence is usually in the form of a hydrologists' report. Depending on the circumstances it may be necessary for hydrologists to attend individual properties to determine the source of damage. There is a limited supply of hydrologists and therefore reports can take time to obtain. There is no easy solution to this issue. However, one of the amendments to the General Insurance Code of Practice to require insurers to ask experts to provide reports within a specific time timeframe and to require the insurer to keep the customer informed as to the progress in obtaining the report as a positive development. Further moving forward adequate government involvement in mitigation strategies aimed at limiting the impact of flood in high risk areas and the availability of adequate flood mapping should assist in reducing those customers exposed to flood. If this occurs the storm/flood distinction should become less of an issue.

INSURANCE CONTRACTS ACT

Whether an insurer will be compelled to offer flood cover as defined by the Regulations but with a choice to give customers a right to opt out is relevant to the position insurers may take in respect of various provisions of both the *Insurance Contracts Amendment Bill 2011* and the associated Regulations. Therefore the Bill and Regulations and *Consultation Paper* should be considered as one parcel.

IAG supports the Insurance Council of Australia submissions in relation to the Insurance Contracts Amendment Act and Regulations.

DATA REQUIREMENTS

The challenge for insurers in providing cover to date has been a lack of data and lack of consistency in that data.

GOVERNMENT'S PROPOSAL (CONTINUED)

In responding to this issue the insurance industry has argued that the provision of flood insurance relies largely on the availability of adequate flood mapping and other information to enable the underwriting of risks. In partnership with each of the State Governments, the general insurance industry has developed and licensed the National Flood Information Database (NFID). NFID is an address database containing property addresses, overlaid with the known flood risk according to Government flood mapping. NFID is used by insurers to determine the flood risk to individual properties. Presently, not every flood prone area in Australia is covered by the NFID. IAG welcomes the Government's announcement that it will provide a single access point to existing flood mapping data to be hosted by Geoscience Australia.

IAG is an active participant in the general insurance industry's considerable work towards developing greater access to residential flood products for Australian communities. Through the ICA, the industry is developing a national flood mapping tool to support better understanding of the risks to the community. Cooperation and data sharing with government is essential to ensuring that the risks can be mapped and understood, and significant solutions are yet to be implemented.

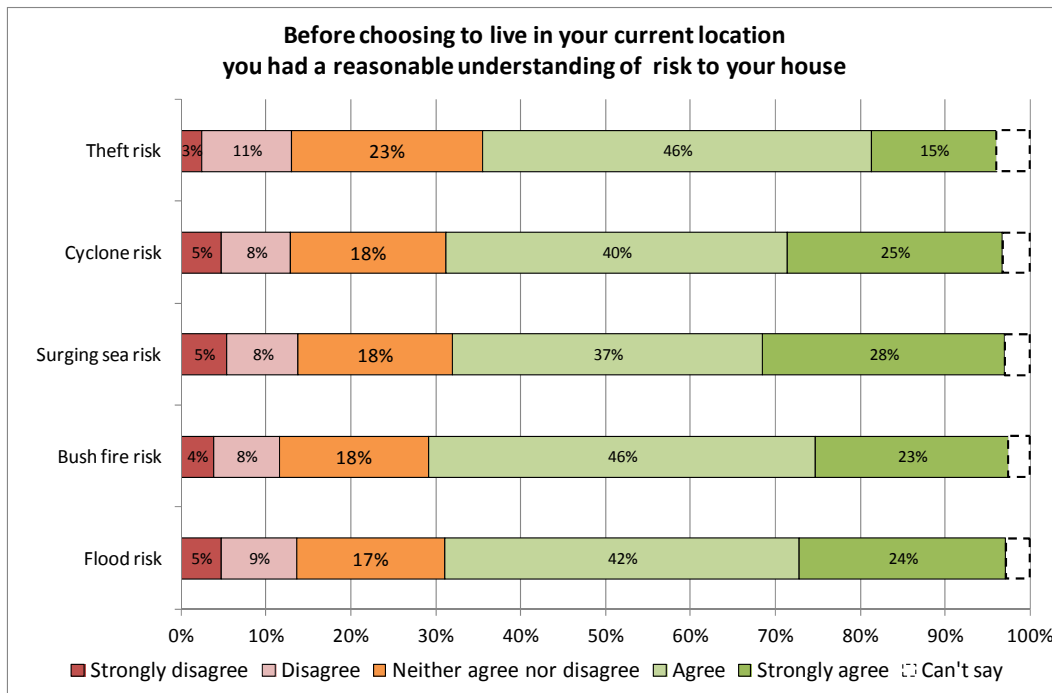
IAG contends that flood maps represent information that is of significant public interest and importance and that it would be inappropriate for governments to restrict in any way public access to flood map data. All parties with a legitimate interest in a property – including potential purchasers, tenants, residents, developers and insurers – should have access to up-to-date flood risk mapping data. This level of transparency is essential in reducing consumer confusion and encouraging people to take steps to manage their risk (such as understanding the flood risk of a property they are buying and purchasing appropriate insurance cover). A flood database would make decisions about mitigation measures, planning and building standards easier for local councils and ensure consumers were more aware of the likely impact of their geographical location on costs such as land value and insurance premiums.

It would be inappropriate and impractical for insurers to take on the role of communicating this risk to the public, which is properly the domain of local government. Consumers should be made aware of flood risk when they are making a decision whether or not to purchase a property or to rent a property. This way a consumer is making an informed decision before they lock themselves into living or having a property in a flood risk area.

Indeed, a common concern is that people have invested in a home unaware of the risks to their home and the associated financial consequences. As part of an IAG commissioned research report (*Sapere Research Group – Australian Household Insurance: Understanding and Affordability to be published 2012*) respondents were asked about the level of understanding of the risks prior to choosing to live in their current location. For all risks, between 12 and 14 percent of households disagreed or strongly disagreed that they had an understanding of the risks before choosing to live in their current location. In particular, over 20 percent of respondents who assessed themselves as relatively highly exposed to flood considered that they did not understand the risk prior to choosing to live in their location.

GOVERNMENT'S PROPOSAL (CONTINUED)

Level of understanding of risks prior to moving to current location



Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (to be published 2012).

Ultimately, the goal is to ensure that communities, planners, emergency services, individuals, property owners and insurers understand the flood (and indeed other natural peril) risks that they face, and that effective risk mitigation measures can be undertaken. Only appropriate mitigation, planning laws and building codes can reduce the risk of flood damage.

As the Attorney-General's Department outlined in its submission to the Senate Standing Committee on Environment and Communications Inquiry into Emergency Communications (2011):

“Providing communities with information empowers them to make more informed judgements. Key to this is the availability and accessibility of transparent, accurate and trusted information sources in various forms and providing the tools to help communities understand and act on the material provided. While providing information and warnings is important, educating people how to respond is equally important.” (p. 7).

As the ICA notes in their submission to the NDIR:

“Without a national repository of publicly funded flood maps, where it can be guaranteed that all possible information has been made available, a gap analysis completed, and a national standard for future mapping established, there will always be an unknown element regarding the level of property risk nationwide. This unknown risk is a complicating factor for insurance companies when allocating capital and

GOVERNMENT'S PROPOSAL (CONTINUED)

reinsurance to cover potential losses and to establish an appropriate risk premium."
(ICA Submission to NDIR p.7)

INCREASING CONSUMER AWARENESS

IAG's product documents are explicit about what is and is not included in the cover being sold. Indeed, policy terms and conditions, including coverage and exclusions are clearly outlined in Product Disclosure Statements and communicated to customers. Importantly, IAG supports the industry commitment to simplify and improve insurance product disclosure statement summary arrangements to enhance consumer understanding of insurance cover.

Disaster risk awareness and risk reduction education are effective when the public, private, education, and community sectors collaborate. To involve these many stakeholders, cross-sectoral platforms such as disaster risk reduction task forces or networks can promote a collaborative process for the creation, implementation and dissemination of risk awareness and risk reduction education programs and strategies.

Many government-sponsored and community programs continue to place heavy emphasis on emergency response and civilian response-preparedness. While important, this focus often fails to emphasise the individual and collective actions that can be taken prior to a disaster and may even promote a sense of public helplessness. Risk awareness and education efforts should place emphasis on concrete risk reduction tools and strategies that can be adopted; moreover, to be fully effective and efficient, these efforts should take place at, and be targeted to, every level of society – at the individual, business, community, and governmental levels. As shown by recent events, the social and economic impact of large-scale catastrophes leads to human tragedy, and hinders growth and development. Building a comprehensive education/awareness program is widely recognised as a key plank in developing more resilient societies.

Simple fact sheets on suitable reputable websites should be prepared with lists of practical things people in at-risk areas could do to help safeguard their property and possessions from damage. These would be specific to the types of risk various communities face with different things provided for bushfire, flood, hailstorm, wind storm and storm surge.

It is in the insurance industry's interest to educate the community on how to become more resilient to increasingly severe weather events, as well as how to reduce their impact on the environment.

TRANSITION PERIOD

IAG supports the proposal that the transition to the new arrangements be two years from the commencement date of any required legislative change to allow insurers to implement appropriate system changes.

ASSETS TO BE COVERED

IAG believes that the standard definition should be restricted to home buildings and home contents insurance policies. Businesses have more diverse and complex needs and the potential scale of loss can be much greater. Businesses are more likely to seek specialised advice, for example through intermediaries, and buy a policy aligned to their needs. They are, therefore, also more likely to understand the policy they have bought. It is important that

GOVERNMENT'S PROPOSAL (CONTINUED)

commercial customers have choice and a range of products available to them, to help manage their risks appropriately.

Similarly, IAG believes that there are several challenges in providing flood cover for strata title properties.

As with home insurance, quality flood mapping data is required for insurers to price the risk of an individual property address and of a strata title building. However, even if flood mapping data was available, there are a number of factors relating to strata titles which present a unique challenge for the insurance industry:

- Tenants of strata title buildings are responsible for their contents insurance but the structure of the building itself and cabinetry, such as kitchen units, are generally covered by the strata title insurance policy;
- The potential scale of losses is greater for strata title buildings but the variety of risk and challenges of providing cover are greater;
- Strata title buildings are much more varied in their risk exposure compared to other homes. For instance, a development of ground floor level properties would have more residents exposed to flood than a high rise building, where only a few floors would be exposed to damage;
- Even though most tenants of high rise buildings do not have properties which are exposed to flood, damage to body corporate owned communal areas can affect all the residents of a building. The power, water and other utility supplies are often located in the basement of the building and if these are affected by floods there can be a loss of supply to the whole building. If the lifts are affected, residents of higher floors may not be able to access their apartments; and
- Much of the equipment relating to the running of the building is located in the basement, and this is an issue for understanding flood risk. Flood mapping estimates risk at a ground floor level, not below ground, and many strata title buildings have significant exposure at belowground level.

IAG looks forward to working with the government and other stakeholders on the development of the most appropriate options to achieve the social and economic policy objectives, and to support a move towards a more sustainable and comprehensive approach to managing the impact of natural disasters on the community.

Cover image: (c) Mouskie / www.fotosearch.com Stock Photography