

28 March 2012

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

Email: floodinsurance@treasury.gov.au

Dear Sir/Madam

RE: CONSULTATION PAPER – REFORMING FLOOD INSURANCE

RACQ Insurance (RACQI) was established in 1971 and is wholly owned by the Royal Automobile Club of Queensland (RACQ).

The events of 2011 presented unprecedented challenges to the community, insurers and Governments. Valuable lessons were learned from these challenges and RACQI welcomes the opportunity to contribute to the formulation of the reforms to the provision of flood insurance.

RACQI had embedded a culture of continuous improvement into its operations and has already embarked on the journey of implementing flood coverage as standard in its home building and home contents policies from mid 2012, along with the adoption of the standard definition of flood.

Further, a new Household PDS is to be released in July which will be written in plain language and will utilise visual aids and cues where possible in exchange for text. A key objective of this project is to ensure that consumers have access to a PDS that embrace strong design principles and provides them with a document that is simple to read.

AVAILABILITY AND AFFORDABILITY OF FLOOD COVER

1. As a result of heightened consumer expectations, a large number of personal lines insurers, including RACQI, have either made available or are in the process of making available flood coverage as part of their domestic home building and home contents policies.
2. The ability for insurers in the past to offer coverage for flood as standard, has been constrained by a lack of available flood data and mapping that was of an appropriate quality to allow for the assessment and pricing of the risk of flood at individual property level.
3. By way of example, RACQI has previously examined twice, proposals to implement flood coverage as standard without success, due to the inadequacies of flood data and mapping in Queensland.
4. The methodology which underpins the compilation of flood data should be consistent and not limited to artificial boundaries such as Local or State Government areas.
5. Flood studies ideally should be conducted on a catchment by catchment basis and data should be compiled at individual property levels. It should examine the effects of terrain, along with the frequency, intensity and duration of rainfall on the flow of water across land.

6. RACQI contends that with the improvement of flood data, the availability of home insurance products that are inclusive of flood coverage will continue to expand and therefore the mandating of coverage for flood would be unnecessary. Market forces have successfully driven the solution.
7. Improved flood data and modelling are also a critical elements for insurers demonstrating to the global reinsurance market that there is a robust capability in place to assess and price flood risk. Low reinsurer confidence would potentially lead to reinsurers withdrawing capacity or applying large risk margins to their program pricing.
8. Inevitably these outcomes would flow on to consumers in the form of price increases or the lack of available products in the marketplace offered by direct insurers, due to a lack of access to affordable capacity from reinsurers.
9. Insurers should be able to operate in an open market and deliver product offerings that are consistent with their risk appetite, chosen strategy and consumer demand. Care needs to be taken not to reduce the level of competition over time.
10. We believe that consumers should be able to continue to have access to insurance products that are affordable, clear in their scope of cover and allow for an appropriate level of choice based on the customers own needs and objectives.
11. RACQI proposes that insurers have the option to offer both policies that clearly do not offer flood cover at all (including not offering 'flash flood'), along with policies that have flood cover as a standard inclusion (ie no ability for the consumer to opt out). This approach would allow consumers to make clear choices about the level of cover provided.
12. For many consumers, the affordability of insurance products ultimately drives their choice of cover. The table "Distribution of flood risk in Australia and estimated flood premium" contained within the consultation paper, clearly demonstrates the affordability issue that will emerge for properties that are exposed to high and extreme levels of flood risk.
13. For example, the average extreme flood risk premium shown in this table is \$5,496. This amount is exclusive of reinsurance premium and claims handling expense loadings along with Government taxes and charges. Potentially the premium that would apply to the flood component of these policies would be in excess of \$7,000 once these factors have been taken into consideration.
14. In the absence of any scheme that subsidises premiums of this magnitude (or higher), home insurance products will be unaffordable for the majority of these consumers and any choice to purchase a product that does not include coverage for flood will be made on this economic basis alone.
15. This basis for decision making is concerning, as ultimately it is these consumers who are most at risk in terms of both the frequency and severity of flood events.
16. Furthermore, the lack of an appropriate 'community' subsidisation scheme will force insurers to cross-subsidise across larger sections of their portfolio, for longer periods of time, in order to balance the need to collect the premiums required to meet the annual technical risk cost of flood with the commercial realities surrounding managing brand image in the marketplace.
17. Though not explicitly addressed in the consultation paper, RACQI supports in principle the NDIR recommendation to establish a flood reinsurance pool to assist "at risk consumers" with the affordability of flood insurance. We look forward to contributing further to the examination of this proposal in the future.

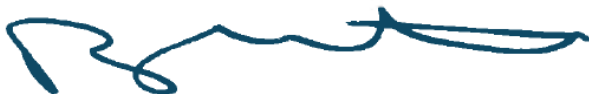
18. The ability of insurers to have the flexibility to offer sub-limits or variable excesses specific to flood cover may assist in addressing the affordability issue for some consumers in the absence of an effective flood reinsurance pool scheme.
19. However, it should be acknowledged that the ability for some policyholders to pay a high excess after a natural disaster event may be limited and in fact, only 'defers' the issue of affordability. Similarly, placing a sub limit or 'cap' on the level of flood coverage provided may lead to issues surrounding under-insurance.
20. Mandating insurers to offer flood cover as part of all home policies will limit choice for consumers. This could force a group of consumers either into non-insurance or having to purchase insurance policies that are in excess of their needs and at an additional cost.

OPERATION OF THE PROPOSAL

21. RACQI supports the draft standard definition of flood that was articulated in the Insurance Contracts Amendment Regulations 2011. Our submission to Treasury dated February 3, 2012 relating to these amendments supports this position.
22. We agree that it is critical that property owners, as well as insurers, should have access to appropriate data and mapping that allows them to assess their own risk of flooding.
23. However, RACQI believes that a requirement to inform the consumer if they have a flood risk at their property, 'opt out' of flood cover would place many insurers in breach of the conditions of their Australian Financial Services Licence (AFSL) under the Corporations Act.
24. A large number of personal lines general insurers hold an AFSL where that licence prohibits them from providing consumers with "personal advice" based on that customer's own particular circumstances. It is our view that advising consumers of the existence of a flood risk at their particular property would constitute 'personal advice' as defined under the Corporations Act.

We hope that this submission has been of assistance and confirm that RACQ Insurance is happy to provide further assistance as required.

Yours sincerely



Bradley Heath
Chief Executive Officer
RACQ Insurance Limited