14 July 2011

Natural Disaster Insurance Review
c/- The Treasury
Langton Crescent
PARKES ACT 2600

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Insurance Australia Group (IAG) welcomes the opportunity to make a submission to the Natural Disaster Insurance Review (NDIR) – Inquiry into flood insurance and related matters *Issues Paper* (June 2011).

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than $7.8 billion of premium per annum. It employs more than 12,700 people of which around 9,000 are in Australia. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

IAG's direct insurance products, which include personal insurance as well as business insurance packages targeted at sole operators and smaller businesses, are 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. 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.

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.

We look 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.

If you wish to discuss the issues outlined in the submission or make further inquiries please contact David Wellfare, Senior Adviser, Economics & Policy on (02) 9292 8593 or me on (02) 9292 9291.

Yours sincerely

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INSURANCE AUSTRALIA GROUP

SUBMISSION TO NATURAL DISASTER INSURANCE REVIEW INQUIRY INTO FLOOD INSURANCE AND RELATED MATTERS

JULY 2011

EXECUTIVE SUMMARY

The Natural Disaster Insurance Review *Issues Paper* has put forward three options:

1. Automatic flood cover (mandatory for all insurers);
2. Automatic flood cover with opt-out (also mandatory for all insurers); or
3. Maintaining the status quo.

IAG does not believe that any of these options are in the best interests of the consumer, the community, and the long term viability of the insurance industry.

IAG believes any approach to flood insurance must include:

- A private insurance market based solution;
- A single definition of flood for home building and home contents;
- Clear and unambiguous product offerings and information;
- Consumer education to provide the community with knowledge of individual risk;
- Informed customer choice; and
- Government action to reduce the risk of flood for properties in areas prone to a high risk of flooding.

More specifically, IAG proposes that:

- The private insurance market remains the most effective and economically sustainable approach to ensure the maximum number of Australians choose to cover themselves for their risks;
- A premium subsidy should be made available for the small number of customers (estimated at less than 2%) in flood-prone areas to ensure their take-up of flood insurance; and
- Any policy response must include measures to reduce and mitigate the impact of natural perils, including flood, in the future.

Encouraging a private market response

IAG does not believe there is market failure in the provision of flood insurance in Australia.

The private insurance market already provides flood cover to a large portion of the Australian population. Insurers should therefore be encouraged to compete further to offer flood products that meet individual customer needs.

Through its Australian businesses – NRMA Insurance, SGIC, SGIO and CGU Insurance – IAG is currently expanding its flood insurance products and aims to offer flood cover as a standard inclusion to all its home and contents customers in Australia during 2012 subject to the availability of appropriate data.

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. 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.

It's 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. Only a minority of flood prone customers choose to take that cover.

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.

However, IAG does not believe all insurers should be forced to offer flood cover, as such a move would be potentially damaging if flood products were beyond an insurer's risk appetite. This may actually work to reduce competition in the insurance market. Similarly customers should have the opportunity to choose the type of insurance cover that suits their individual needs.

In addition, a pool for natural disasters or flood risks would ultimately increase the cost of living for those at low risk, as they subsidise the costs of those with high risks. A pool would also involve the establishment of a new bureaucracy.

The price of insurance premiums provides an important signal that can help individuals and communities make decisions about development and risk management. Rather than distort this signal, through the establishment of an insurance pool, the private insurance market must be encouraged to provide flood insurance products.

Affordability for the areas of high flood risk

We recognise that there will inevitably be a small portion of homes – less than 2% – for which the flood premium is likely to be unaffordable. These are properties that have been built in the areas of high flood risk, and a key principle of insurance is that a customer's premium must reflect their individual risk.

The government may wish to assist these people obtain insurance; however, it is critical that government assistance is limited, so as not to encourage further development in the areas of most risk. Government assistance must be accompanied by the mitigation strategies outlined below, while remaining mindful of its impact on those people who have less flood risk.

In light of these considerations, IAG recommends the following solution:

- **Insurers** (who offer flood cover), underwrite 100% of the flood risk and it is therefore the responsibility of insurers to cover the risk, and pay legitimate flood claims when flooding occurs. There will be a benefit to government in that funding otherwise spent on emergency recovery is likely to be reduced.
- **Owners** whose property has been identified as having extreme or high flood risk are entitled to a subsidy from government for their home and contents policy if the policy includes flood.
- **The subsidy** be provided by government as a proportion of the determined flood premium for each applicable premium in excess of a price threshold. This is preferred to using the flood return period (such as 1:20, 1:50), as this may not reflect the cost of potential damage to a dwelling.
- **Insurers and government** agree on the premium subsidy rate for all determined flood premiums. This premium should be payable by government directly to insurers to subsidise individual premium calculations for properties identified with an extreme and high flood risk.
- **Insurers and government** agree to an actuarial review of the premium subsidy process and oversight of the flood pricing structure behind the flood risk premium charged – to be provided as a separate item on the certificate of insurance.
- **Government** to create a database of the properties affected by extreme and high flood risk.
- **Government** to recover the subsidy in a manner that encourages the implementation of mitigation works by local and state governments to reduce ongoing flood premium subsidies for that location. Premium subsidies should be funded by those who are responsible for the management of environmental hazards and planning of the built environment, which have created the flood risks to properties over time. This would present a targeted incentive for those governments to mitigate and reduce the exposure over time. Indeed, a levy based on local government rates, supplemented by the Federal Government, would meet this requirement and provide an incentive for all levels of government to mitigate risks and reduce the subsidy over the longer-term. IAG opposes any suggestion of applying a levy on insurance premiums which would reduce affordability, exacerbating the current state taxation impost on insurance products.
- **Properties** built or approved after an agreed date would not be eligible for the subsidy, to restrict further development in areas of high risk. It is important that all stakeholders are discouraged, through a risk price signal, from establishing new property in high risk locations.
- **IAG also supports the Insurance Council of Australia's** (ICA) proposal to provide a publicly available online portal for members of the community to view a representation of the

flood and other natural hazard risks in their area, and encourage them to consider the benefits of mitigation of the risk, insurance and emergency preparedness.

Commercial insurance and strata buildings

IAG believes that any policy in relation to flood cover for commercial customers should be considered separately to home and contents insurance policies.

Commercial insurance is sold predominantly through intermediaries. Businesses are more likely to seek specialised advice 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 commercial customers have choice and a range of products available to them to help them manage their own risk.

IAG believes that there are several challenges in providing flood cover for strata title properties. Given the diversity of risk and potential scale of losses in strata title buildings, IAG suggests that "opt-in" is the best type of flood cover for strata title customers.

A holistic solution – mitigating the risks

Most importantly, the policy response to recent natural perils must go beyond insurance and also focus on prevention. More flood products will not prevent floods from occurring in future. To truly build the resilience of our communities and reduce their exposure to significant natural peril risk, a broader response is required, encompassing:

- Higher quality planning standards required of local government, to ensure no further development is allowed in areas of unacceptable risk. Property owners in the areas of most extreme risk should be provided with incentives to move to safer areas, as has happened in Grantham and Christchurch.

- Building standards reflecting the need to protect property, as well as lives, against the risk of flood, bushfire and other natural hazards.

- All levels of government – led by the Federal Government – significantly boosting their low investment in mitigation infrastructure (such as levees and barrages) that will protect assets like homes and businesses, and lower the cost of risk. IAG is offering to work with local governments which experience natural hazards to assist in understanding the vulnerability of the risks and examine cost-effective mitigation measures.

- Greater transparency around the mapping and information that will help householders and businesses understand the flood risk in their location. This information has significant economic value, as it reduces risk, will benefit planning authorities, developers, banks and financiers and allows insurers to underwrite the risks with maximum certainty. IAG is developing a community awareness program that will assist Australians in understanding the risks they face in their environment and possible options for reducing that risk.

In summary

The crucial consideration for the Natural Disaster Insurance Review must be building the community's resilience to flood *in a sustainable way*.

IAG appreciates that the Federal Government is mindful of a general policy that has been adopted by successive Australian Governments in recent times, to the effect that where commercial markets, including insurance markets, operate efficiently and effectively on their own, the government should be reluctant to intervene. Indeed, the Federal Government has made clear, in the *Terms of Reference,* that the NDIR should be guided by the principle that government intervention in private insurance markets is justifiable only where there is clear failure by those private markets to offer appropriate cover at affordable premiums.

As far as possible, more insurers must be encouraged to provide flood insurance products and compete to cover customers. For the small number of households in flood-prone areas, a government subsidy could assist affordability. Any policy response must include measures to reduce and mitigate the impact of natural perils, including flood in the future.

INTRODUCTION

Recent natural disasters have understandably generated a national discussion of how we may reduce our vulnerability to natural hazard threats.

This discussion provides us with a unique opportunity to develop a more sustainable and comprehensive national approach to managing natural disasters and the outcome of the current debate is of critical national and economic importance to governments, businesses and individuals.

We are seeing increases in both the incidence of natural disasters, and our population (particularly around coastal areas which are prone to some types of natural disasters). This combination makes it all the more important that we increase our resilience to catastrophe so we spend less of our limited resources on rebuilding and more on investing in the future.

IAG believes the current circumstances present us with an opportunity to develop a national, long-term approach to managing catastrophe risk, through a co-ordinated response to natural hazards, including:

- building greater awareness among individuals of their own personal risk;
- encouraging a more efficient distribution of these risks via insurance; and
- adapting our built environment to reduce the impact of events when they do occur.

Such an approach will not only be of benefit in regard to flood, but will help make the community more resilient to a range of risks including bushfire, land subsidence and sea water damage. These and other natural hazards should be included in the approach which is ultimately adopted.

The focus in the NDIR *Issues Paper* is understandably insurance. However, insurance doesn't exist in a vacuum, and only comes into play after an event. The risks of weather volatility also need to be addressed before the event, through risk assessment and risk mitigation.

Importantly, IAG does not believe there is market failure in the provision of flood insurance in Australia. One fact which speaks to this is the increasing availability of flood insurance. The Insurance Council of Australia (ICA) notes that in 2006, only three of 58 insurers provided policies offering cover for flood. In 2011, 29 of 58 insurers provided cover for flood *(ICA submission to Queensland Floods Commission of Inquiry, April 2011)*.

Through its Australian businesses – NRMA Insurance, SGIC, SGIO and CGU Insurance– IAG is currently developing flood products and aims to offer flood cover as a standard inclusion to our home and contents customers in Australia during 2012 subject to the availability of appropriate data.

In considering the impact - or likely impact - of any government intervention in the provision of disaster insurance in Australia, the views of Ken Henry, former Secretary of the Australian Treasury are of note:

> *"…the fact that your industry won't insure certain things does not, in most cases, provide an argument for the government stepping in to do so. Yet it is the failure to appreciate this simple point that underlies most calls on the government to subsidise various forms of activity. For that reason, most such calls will be resisted.*
>
> *"The second thing that should be emphasised is that the best policy response to an instance of market failure depends on a range of circumstances. Rarely will the best response involve government provision, even government underwriting." (Ken Henry, Address to the Insurance Council of Australia Conference, 22 August 2002).*

IAG appreciates that the Federal Government is mindful of a general policy, adopted by successive Australian Governments in recent times, to the effect that where commercial markets, including insurance markets, operate efficiently and effectively on their own, the government should be reluctant to intervene. Indeed, the Federal Government has made clear, in the *Terms of Reference,* that the NDIR should be guided by the principle that government intervention in private insurance markets is justifiable only where, and to the extent that there is clear failure by those private markets to offer appropriate cover at affordable premiums.

BACKGROUND

IAG's Interest in the Inquiry

Flood is a persistent risk in the Australian community. It historically accounts for one third of natural hazard damage (*Bureau of Transport Economics 2001*). However, the vast majority of properties in Australia have little or no flood risk with only approximately 2.8% of properties having some risk of flooding *(ICA)*.

The ICA highlighted in its response to the Report to the Council of Australian Governments on Natural Disasters in Australia (2006):

> *"Insurance works on the principle of spreading risk over a large number of policyholders who face similar potential losses. Pooling the premiums of the many to pay the claims of a relatively few keeps premiums at a reasonable level. In general, premiums reflect the level of risk each policyholder brings to the pool. The small number of homes vulnerable to flooding means the risk is spread over a relatively small group and therefore the cost of cover for each home would be very high."*

Flood remains a significant and complex community issue, and floods are likely to become more common according to the various inundation predictions arising from current weather volatility models.

IAG believes that the social and economic impacts of weather volatility can be reduced in a society that has greater resilience to changed climate conditions.

How the Industry is Responding

The insurance industry is currently working in conjunction with the State and Federal Governments on a number of initiatives designed to address flooding in Australia. These initiatives vary from improved disclosure to improved community infrastructure, as there is no simple, single solution to flood risk mitigation.

A national policy approach is needed to better deal with a number of challenges presented by floods in those communities at risk.

The key objectives of the Australian insurance industry's plan are:
1. Standard definition of flood
2. Improved disclosure
3. Provision of adequate flood data
4. Removal of insurance taxes
5. Improved land-use planning
6. Improve building standards
7. Improve community infrastructure
8. Education and financial literacy campaign
9. Measure effectiveness of disaster relief payments
10. Better advice to consumers

Details of the Australian insurance industry's 10 point plan are available at:
http://www.insurancecouncil.com.au/Portals/24/Media%20Centre/2011%20Media%20Releases/ICA%20Release%20-%20Ten%20Point%20Plan%2027th.pdf

The Australian General Insurance Industry

According to the Australian Prudential Regulation Authority (APRA) there were 132 insurers licensed to conduct general insurance business in Australia (i.e. insurance other than life and health insurance) at 30 June 2010. Of these there were 118 direct insurers and 14 reinsurers. An overview of the general insurance in Australia is outlined in the Table below.

Gross Premium Revenue- Financial Year ended 30 June 2010 $ million

Class of business	NSW/ACT	VIC	QLD	SA	WA	TAS	NT	Total Australia
Houseowners/householders	1,918	1,122	1,115	331	473	98	15	5,071
Commercial motor vehicle	630	414	265	126	203	29	9	1,676
Domestic motor vehicle	2,469	1,674	1,197	389	632	101	17	6,478
Travel	314	59	44	48	35	4	1	505
Fire and ISR	1,305	816	428	197	283	51	12	3,091
Marine and aviation	267	96	96	32	60	10	7	568
Mortgage	372	234	275	59	115	16	11	1,082
Consumer credit	103	67	83	22	39	8	3	325
Other accident	360	218	169	100	112	16	5	979
Other	191	134	128	34	56	7	3	554
CTP motor vehicle	1,547	0	1,060	0	0	0	0	2,607
Public and product liability	889	451	284	126	187	27	7	1,971
Professional indemnity	567	286	166	66	122	12	5	1,223
Employers' liability	275	49	7	13	680	110	52	1,185
Total direct business	11,203	5,622	5,315	1,542	2,996	489	147	27,314

Notes:
Gross premium revenue in this table is reported according to the location of risk.

Source: APRA (2010)

Gross Incurred Claims by State Year ended 30 June 2010

Class of business	NSW/ACT	VIC	QLD	SA	WA	TAS	NT	Total Australia
Houseowners/householders	797	1,103	623	218	540	72	10	3,362
Commercial motor vehicle	524	377	198	114	187	26	7	1,433
Domestic motor vehicle	1,866	1,956	955	366	916	90	18	6,166
Travel	150	*	13	*	*	*	-1	210
Fire and ISR	429	556	107	96	181	21	4	1,394
Marine and aviation	157	57	51	13	38	6	2	322
Mortgage	100	61	37	10	18	2	2	230
Consumer credit	31	16	24	6	8	2	1	88
Other accident	161	115	66	49	50	5	2	448
Other	152	104	74	10	25	2	1	368
CTP motor vehicle	1,631	*	1,318	*	*	*	0	2,961
Public and product liability	593	236	107	23	30	6	56	1,051
Professional indemnity	436	305	76	26	111	6	2	961
Employers' liability	176	14	-3	-4	329	128	35	675
Total direct business	7,201	4,922	3,646	944	2,449	372	139	19,671

Notes:
Gross incurred claims in this table is reported according to the location of risk

Source: APRA (2010)

The Australian general insurance industry is viewed as having low barriers to entry in short-tail classes of insurance - limited to the national regulatory requirements, including APRA's minimum capital and solvency requirements and Australian Securities and Investment Commission (ASIC) licensing requirements.

Regulation of the Australian General Insurance Industry

General insurers are subject to the corporate regulatory regime that applies to Australian incorporated businesses generally. This includes the legislative regimes of the *Corporations Act 2001,* the

Competition and Consumer Act 2010 and, for public listed companies, the requirements of the Listing Rules of the Australian Securities Exchange.

General insurers are also subject to a range of industry specific regulations at Federal (eg *Insurance Act 1973*, *Insurance Contracts Act 1984)*, State and Territory levels. These regulations subject insurers to prudential supervision. They also deal with aspects of market conduct and consumer protection and the various statutory insurance schemes, which operate in each State and Territory. A detailed analysis of the regulatory arrangements associated with providing insurance in Australia was outlined by the HIH Royal Commission - http://www.hihroyalcom.gov.au/finalreport/index.htm.

The general insurance industry also adopts the Insurance Council's *General Insurance Code of Practice.* Industry self regulation provides a benchmark standard. Once this standard is set, there is a strong incentive for individual companies to exceed the benchmark in order to attract customers and expand market share.

IAG supports regulation that enhances, rather than stifles competition; protects consumers; encourages efficiency; and promotes and sustains public confidence in insurers and their products. The role of regulation should therefore be to support and enhance competition, not interfere with it.

As the Finance Industry Council of Australia (FICA) highlighted to the Australian Government's Regulation Taskforce (2005):

> *"...it needs to be recognised that the success of market economies is built on their ability to respond flexibly and in innovative ways to changing circumstances. Rigid regulations can harm this flexibility. Thus, the presumption should be to intervene only where there is a clear need and to do so in ways that minimise costs and distortions. Wherever feasible, policy-makers and regulators should aim to establish the objectives that the policy or regulations aim to achieve and then design regimes that allow these to be carried out in a flexible rather than prescriptive manner." (FICA submission to Australian Government Taskforce on Reducing the Regulatory Burden on Business, November 2005, p.1).*

Economics of Natural Disasters

IAG commissioned Sapere Research Group (Sapere) to provide an independent economic analysis of specific issues associated with flood insurance. The Sapere Report highlights:

> The most efficient and least distortive methods for governments to improve the affordability of insurance are to:
>
> - Remove the taxes on insurance;
> - Ensure that flood maps are available to insurers, so that they can price the insurance risk; and
> - Undertake community flood mitigation and promote household flood mitigation measures, which lower the cost of flood risk and thus the flood insurance risk.

It is also appropriate that governments consider means to improving the transparency of the flood risk for communities and consumers investing in flood risk areas.

Understandably, governments may consider that financial support to households in flood prone zones is appropriate, even where households invested with a clear understanding of the flood risk. If so, this support should be provided in a way so as not to distort decisions for the efficient management of risk or the efficient workings of insurance markets.

The Sapere report is at Appendix 1.

THE WAY FORWARD

Home Insurance Cover for Flood – IAG's Position

IAG looks forward to working with the government and other stakeholders on the development of the most appropriate options that achieve the social and economic policy objectives.

Accessibility of Home Insurance Cover for Flood

IAG does not support the concept of mandatory flood insurance or a national insurance pool for natural disasters. Both would distort the private sector insurance market and will result in households who have zero or extremely low levels of risk paying higher premiums to support those living in high risk areas.

As the Hon Desmond Derrington QC has recently stated:

> *"...An insured who builds substantial premises in a place precariously susceptible to flooding can hardly expect an insurer to accept such a risk without a choice. And even if there were mandated, such an insured can hardly expect to obtain cover for the same premium as that which would be paid by an insured in a safe location. The insurer must charge a premium actuarially adjusted to the risk, which would probably be prohibitive, or it would inevitably **suffer the HIH fate**.*
>
> *"Alternatively, if the premium of such an insured were to be kept lower by adjusting upwards the premiums of other insureds that would be **grossly unfair to the other insureds**. It is a well-accepted feature of insurance equity that an insured contributes to the insurance pool a premium that is fairly assessed according to the quality of the covered risk. To include in the premium of an insured with a certain risk a factor that is designed to meet the increased risk undertaken by another insured, perhaps irresponsibly, is alien to fair insurance dealing and conventional commercial standards. While the insured may be disadvantaged in this way, it is commercially impossible to expect insurers to grant flood insurance in all cases when it is applied for or to impose it on an insurer which has declined to include it in its cover and has clearly notified the insured in writing of its omission." (The Queensland Floods- Implications for insurers, insureds, brokers and the community at large, AILA Twilight Seminar Series 1 June 2011)*

IAG believes any approach to flood insurance must include:

- A private insurance market based solution;
- A single definition of flood for home building and home contents;
- Clear and unambiguous product offerings and information;
- Consumer education to provide the community with knowledge of individual risk;
- Informed customer choice; and
- Government action to reduce the risk of flood for properties in areas prone to a high risk of flooding.

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. Already there has been significant growth in flood coverage - five years ago only 3% of home and contents policies included any form of flood cover, today that figure is around 54%.

Through its Australian businesses – NRMA Insurance, SGIC, SGIO and CGU Insurance – IAG is currently expanding its flood insurance products and aims to offer flood cover as a standard inclusion to all its home and contents customers in Australia during 2012 subject to the availability of appropriate data.

The best way to provide full protection for customers is to provide the flood cover as a standard inclusion. Based on our experience in NSW, an "opt-out" flood product can result in a limited take-up of flood cover.

IAG's position also addresses the community's feedback that it wants greater clarity around insurance for the different types of flood. Flood cover as a standard inclusion provides all our customers with absolute certainty and confidence that they are covered for stormwater and flood damage.

However, IAG does not believe all insurers should be forced to offer flood cover, as such a move would be potentially damaging if flood products were beyond a particular insurer's risk appetite. This may actually work to reduce competition in the insurance market. Similarly customers should have the opportunity to choose the type of insurance cover that suits their individual needs.

In addition, a pool for natural disasters or flood risks would ultimately increase the cost of living for those with low risks as they subsidise the costs of those with high risks.

As outlined in the Sapere Report, the price of insurance premiums provides an important signal that can help individuals and communities make decisions about development and risk management. Rather than distort this signal, through the establishment of an insurance pool, the private insurance market must be encouraged to provide flood insurance products.

IAG welcomes the Government's initiative to introduce a workable standard definition for flood. However, to ensure the full understanding of cover is provided to consumers, IAG supports the inclusion of stormwater channels, highlighted below:

> *"Flood means the covering of normally dry land by water that has escaped or been released from the normal confines of:*
>
> *A. any lake, or any river, creek or other natural watercourse, whether or not altered or modified; or*
>
> *B. any reservoir, canal, or dam, or water channel whether altered, modified or purpose built."*

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

High Flood Risk Homes and Insurance Systems

Increasing Affordability for High Flood Risk Homes

We recognise that there will inevitably be a small portion of homes (<2%) for which the flood premium is likely to be unaffordable. These are properties that have been built in areas of extreme flood risk, and a key principle of insurance is that a customer's premium must reflect their individual risk.

The government may wish to assist these people access insurance; however, it is critical that government assistance does not encourage further development in areas of most extreme risk. Any assistance must be accompanied by the mitigation strategies outlined below, and take into account the impact on those people who have less flood risk.

IAG recommends the following solution for high risk flood areas:

- **Insurers** (who offer flood cover), underwrite 100% of the flood risk and it is therefore the responsibility of insurers to cover the risk, and pay legitimate flood claims when flooding occurs. There will be a benefit to government in that funding otherwise spent on emergency recovery is likely to be reduced.
- **Owners** whose property has been identified as having extreme or high flood risk are entitled to a subsidy from government for their home and contents policy if the policy includes flood.

- **The subsidy** be provided by government as a proportion of the determined flood premium for each applicable premium in excess of a price threshold. This is preferred to using the flood return period (such as 1:20, 1:50), as this may not reflect the cost of potential damage to a dwelling.
- **Insurers and government** agree on the premium subsidy rate for all determined flood premiums. This premium should be payable by government directly to insurers to subsidise individual premium calculations for properties identified with an extreme and high flood risk.
- **Insurers and government** agree to an actuarial review of the premium subsidy process and oversight of the flood pricing structure behind the flood risk premium charged – to be provided as a separate item on the certificate of insurance.
- **Government** to create a database of the properties affected by extreme and high flood risk.
- **Government** to recover the subsidy in a manner that encourages the implementation of mitigation works by local and state governments to reduce ongoing flood premium subsidies for that location. Premium subsidies should be funded by those who are responsible for the management of environmental hazards and planning of the built environment, which have created the flood risks to properties over time. This would present a targeted incentive for those governments to mitigate and reduce the exposure over time. Indeed, a levy based on local government rates, supplemented by the Federal Government, would meet this requirement and provide an incentive for all levels of government to mitigate risks and reduce the subsidy over the longer-term. IAG opposes any suggestion of applying a levy on insurance premiums which would reduce affordability, exacerbating the current state taxation impost on insurance products.
- **Properties** built or approved after an agreed date would not be eligible for the subsidy, to restrict further development in areas of high risk. It is important that all stakeholders are discouraged, through a risk price signal, from establishing new property in high risk locations.
- **IAG also supports the Insurance Council of Australia's** (ICA) proposal to provide a publicly available online portal for members of the community to view a representation of the flood and other natural hazard risks in their area, and encourage them to consider the benefits of mitigation of the risk, insurance and emergency preparedness.

A Holistic Solution – mitigating the risks

Most importantly, the policy response to recent natural perils must go beyond insurance. More flood products will not prevent floods from occurring in future. To truly build the resilience of our communities and reduce their exposure to significant natural peril risk, a broader response is required. IAG advocates:

- **Higher quality planning standards must be required of local government, to ensure no further development is allowed in areas of unacceptable risk. In addition, existing owners of property in high risk areas should be provided with incentives to relocate to areas with less risk. The New Zealand Government's initiative in reclaiming land in Christchurch is an important example in this regard;**
- **Building standards must reflect the need to protect property against the risk of flood and other natural hazards in certain locations, in addition to the current focus on protecting lives – the two go hand in hand;**
- **All levels of government – led by the Federal government – must significantly boost their low investment in mitigation infrastructure (such as levees and barrages) that will protect assets like homes and businesses, and lower the cost of risk. IAG is offering to work with local governments that experience natural hazards to assist in understanding the vulnerability of the risks and examine cost effective mitigation measures; and**
- **There must be greater availability of and transparency around the mapping and information which will help householders and businesses understand the flood risk in their location. This information has significant economic value, as it reduces risk, will benefit planning authorities, banks, financiers and developers, and allow insurers to**

underwrite the risks with maximum certainty. Again, IAG is developing a community awareness program that will assist Australians in understanding the risks they face in their environment and possible options for reducing that risk. IAG would support moves by the Federal Government to have:

- **All States and Territories take urgent steps to ensure the flood mapping data produced by local governments in their jurisdiction is made available to the insurance industry and other relevant stakeholders, including if necessary by legislation; and**
- **The Federal Government in collaboration with States and Territories progress longer term issues and develop a proposal for Government on a national approach to flood modelling, with costed options.**

Flood Cover and Other Types of Insurance

Flood Cover for Contents Insurance

IAG believes contents policies should be treated the same way as home insurance policies.

Flood Cover for Strata Title and Other Residential Property

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 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 a below-ground level.

IAG's intermediated business currently offers flood cover to strata title customers on an "opt-in" basis. The lack of flood mapping data and high variety in risk means that this can only be offered after an on site assessment by a hydrologist. This adds significantly to costs and timelines and leads to less take up of this type of cover from consumers.

If high quality flood mapping was to be made available, IAG could offer the cover as "opt-in" to more customers, as the site evaluation could be built into the site survey which is undertaken before insurance is arranged for any strata title customer. The current lack of flood mapping means that a separate hydrology report is required. This adds significantly to costs and timelines and leads to less take-up of this type of cover from customers.

Flood premiums may be prohibitively high for buildings in high risk flood areas. Whilst this is an issue for all properties, the potential scale of losses for a strata building means that this is more the case than for standard dwellings.

There is also the opinion of more than one resident to consider when a strata building is deciding whether to take out flood insurance. Some residents may be prepared to pay to cover a risk and others may not want to, but all would have to be charged the premium. Body corporates are likely to want greater flexibility to purchase the type of insurance which best fits the needs of their property and residents.

Given the diversity of risk and potential scale of losses in strata title buildings, IAG suggests that "opt-in" is the best type of flood cover for strata title customers.

The drawbacks of an "opt in" model could be managed through consumer education. Tenants of strata buildings should be made aware of the insurance cover on their building and understand the respective obligations of the body corporate and the tenant themselves. Tenants could then make informed decisions about their own insurance and whether to purchase a property in a strata title building.

Accurate flood mapping would increase insurer's ability to provide cover to this type of customer and increase the number of customers opting in.

Flood Cover for Business Insurance

IAG believes that any approach to flood cover for commercial customers should be considered separately to home and contents insurance policies.

Commercial insurance is sold predominantly through intermediaries. Businesses are more likely to seek specialised advice 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 commercial customers have choice and a range of products available to them, to help them manage their own risk.

Not all commercial customers need flood insurance and many may not want to pay for it. The diversity in scale and type of risk in commercial business means that these customers are not best served by standardised offerings. For instance, the insurance needs of a coffee shop in Brisbane will be vastly different to the insurance needs of a large industrial site in rural Victoria.

IAG's experience suggests that commercial customers would prefer to retain the flexibility to decide whether they want flood cover or not, and that caution should be exercised in making decisions which classify 'commercial insurance' as one category.

It is of note the NDIR *Issues Paper* states:

> "..*a decision by a small business to take out insurance is one of a number of business decisions that are made based on their overall business plans. Indeed the very low level of non-insurance of homes suggests that small business owners opt to insure their homes to a greater extent than their businesses. Many business premises may also be leased." (p.31)*

Moreover,

> *"By contrast, homes occupy a central place in the community. They provide basic shelter and for many people it is their main financial asset and a key component of their lifetime financial plans. This brief comparison suggests that it is less important to institute new or special flood arrangements for small business insurance than for home insurance." (p.32)*

Many of the challenges associated with providing flood insurance to businesses are similar to that of providing cover to homes. In offering flood cover for commercial properties, poor and inconsistent flood mapping means that insurers are not able to accurately price the risk of flood. However, there are also some considerations which are exclusive to various types of business customers, and which are detailed below.

Provision of high quality flood mapping would enable insurers to offer flood cover more broadly to business customers and encourage more customers to "opt-in".

Small Business

Micro or small businesses are less likely to buy an insurance policy through an insurance adviser than other commercial customers and therefore less likely to receive specialised advice. This group would therefore benefit from automatic inclusion of flood within policies in the same way homeowners would

- that is, they would be covered in the event of either storms or floods, and the confusion over the differentiation between storm and flood damage would be removed.

However, the disadvantage of including flood in policies for small business is that this is a highly price-sensitive customer group. Under or non-insurance is more predominant in this segment, partly due to the inherent financial challenges of running a small business. IAG's intermediated business has introduced monthly instalment billing to assist business customers overcome these issues.

The incentives to insure a home are higher than to insure a small business. For instance, most mortgage lenders require home insurance as a condition of providing finance. IAG is concerned that if flood was included in policies for small business, many would simply opt not to insure at all if there was an increase in the premium which reflected their flood risk. This would lead to those at higher risk of flood having no insurance at all, whereas an "opt-in" model would at least allow small business at risk of flood to be insured for other perils.

Medium Business

Medium size businesses are more likely to purchase a policy through an insurance adviser. The likelihood of a small to medium size business being unaware that they are not covered for flood is lower. The main issue with automatic inclusion of flood for this group is a combination of price sensitivity and the need for choice. This group is likely to prefer to purchase insurance which reflects their individual needs. Businesses which are at low risk of flood may not want to pay for flood cover and businesses at high risk may want to make an informed decision about whether to pay the premium to insure for that risk or not. Either way, they are more likely to be informed about their level of risk and the implications of insuring or not insuring for elements of that risk.

Large Business

As the size and sophistication of a business increases, the factor of choice becomes more important. Larger businesses are more informed about their risks, more likely to mitigate them and more likely to seek specialist advice. They are unlikely to want to pay for homogenous cover which does not reflect their needs, so the automatic inclusion of flood cover becomes less appropriate as the size of a business increases.

IAG's intermediated business currently offers flood cover to its larger business customers, where an on-site assessment can be conducted to consider providing such cover and to price the risk. Our intermediated business has many customers in rural and regional areas and flood mapping is poor to non-existent in the majority of these areas. An on-site assessment is currently the only way to assess risk to business in these areas. The nature of on-site assessment means it is costly in terms of time and resources. This has an impact on premiums and, therefore, on take up on this element of cover.

Impediments to Business Insurance in General

Additional impediments in providing flood insurance for business relate to insurers' lack of understanding of commercial flood risk and ability to price homogenous risks appropriately. This issue can be broken down further into a number of categories:

- Small businesses purchase a number of different covers, each with very different flood damageability depending on the business type. There is very little data, published material, or internal insurer research on the likely damage from a distribution of different flood depth impacts. Some examples of these differences, which result in very different damage per loss, are as follows:

    - Buildings (warehouse vs stand alone/strip shop, farm sheds, office block, etc);
    - Stock (book shop/wholesaler, iron sheet retailer, motor repairer and spare parts, textile manufacturer);
    - Contents machinery (farm machinery, dry cleaning, medical diagnostic equipment, photographic equipment, etc); and
    - Business interruption (often the largest cost for the insurer. Only occurs if the business cannot operate properly due to loss of buildings, stock or machinery).

- Business owners can significantly mitigate their flood risk. For example, by storing all stock on shelves one metre off the ground, or by ensuring the site has an effective drainage system, the risk of flood damage is reduced significantly.

- Business owners as a group tend to be more financially savvy than home owners, and are therefore more likely to take calculated risks. Given they play a significant role reducing the risk, there would need to be a significant amount of co-insurance (at least 20%) and a deductible of at least $5,000. It is likely that a business customer will only take insurance when they know the likelihood or cost of a loss is greater than the insurer has priced.

- The cost of full flood cover for small businesses in medium and high risk zones will be unaffordable (even more unaffordable for small businesses than for home due to the impact of significant stock, machinery and business interruption indemnity cover up to 24 months). This rules out the mandatory option unless limited cover is provided.

- Identification of the exact location (lat/long) of small business property. Sheds, warehouses, industrial estates will often be situated on a property. It requires a complex underwriting system and manual work-arounds to ensure the location can be identified adequately.

Business Interruption

As well as offering property insurance as a module within its business insurance policies, IAG's intermediated business also offers business interruption cover.

Within a policy, the causes of loss or damage under the 'property' section are generally also covered by the 'business interruption' section.

Business Interruption is an optional element of a business insurance policy and has a comparatively low take-up rate (around 30% of business customers elect to have this cover). This could be because businesses prioritise insuring their tangible assets, and do not see the immediate need or perhaps understand the cover it provides. It may also be as a result of a business only having a limited amount of funds to purchase insurance and this cover is not considered a necessity.

While the risk and extent of property damage could be established if adequate flood mapping was available, business interruption presents a bigger challenge because the potential for scale and length of business interruption as a result of flood could expose insurers to large and unpredictable losses, which would be reflected in unacceptably high premiums.

Much of this risk could be managed if insurers were afforded the flexibility to exclude flood from certain elements of business interruption cover. For example, policies include the term "customer and supplier premises", which covers businesses for interruption caused by damage to the business premises of their suppliers. Put simply, if an IAG business insured a fruit and vegetable shop in Melbourne which had problems with supplies of bananas from Tully in Queensland due to floods, the customer in Melbourne would be able to make a claim under their policy. Due to the scale, frequency and unpredictability of flood events, the aggregate risk to insurers of providing flood cover under this section is prohibitively high. To offer flood in this area of the policy an insurer would need to assess the flood risk of all of the business customers' suppliers, which is clearly impractical.

In summary IAG's response to flood and business insurance is that:

- Digital terrain mapping is essential if insurers are to make flood insurance available for the properties of more business customers;
- Provision of this data would make it more likely that insurers will include flood as an option under their business policies or elements of their business policies;
- If flood insurance is to be automatically included in some insurance policies we suggest this be limited to smaller businesses (sole traders to 3 employees or turnover up to $500,000);
- The nature of business insurance customers means that an 'opt-in' approach would be best to ensure the availability of flood cover to business customers, whilst managing price sensitivity and the possibility of non-insurance at the smaller end and the desire for choice at the larger end of this segment;
- The variation in susceptibility to risk and potential scale of losses is greater in businesses than in homes. Flexibility should be afforded to insurers in designing products which balance the desire for flood cover with the need for premiums to remain affordable;

- The 'opt-in' model should be balanced with initiatives to encourage small businesses to take up insurance and understand their risks, including underinsurance and the need to insure for full replacement value;
- Different types of businesses should be separately considered. The variety of needs in the business segment are broader and more complex than home; and
- Specifically, farms should be considered separately from other businesses.

Natural Disasters other than Flood

Actions of the sea include coastal inundation, storm surge (an increase in sea level that happens when there is an intense storm or cyclone), sea level rise and erosion. These types of risks have been historically excluded from insurance cover for similar reasons to flood.

Without adequate information, these risks can be difficult to price. Improved mapping and information will improve the ability of the insurance industry to cover these risks. Government needs to ensure that coastal risk areas and hazards are identified.

To do this, flood and coastal hazard studies must be updated and/or completed and mapping of land that may be vulnerable to actions of the sea including coastal inundation, sea level rise and erosion, must also be conducted. Adequate government funding for mapping and data collection is required to ensure appropriate implementation of this information into planning decisions. Assessment and evaluation of coastal risks, both current and future should be completed as a priority.

To support this approach, there should be an increased effort to integrate and update existing data and natural resource mapping and assessments that may exist across government departments into land use planning should occur. This will enable the government to provide a more informed and integrated approach to planning decisions and land management.

KEY CHALLENGES AND PRIORITIES

Measuring Flood Risk

An increase in underwriting capacity for flood, and further competition in the market, can be facilitated by a nationally coordinated approach to accurate flood mapping (and digital elevation mapping) which remains the province of governments.

The challenge for insurers in providing flood cover to date has been a lack of data and lack of consistency in that data. The national flood mapping database should contain the same level and type of information for each area in Australia. Additionally, digital elevation mapping is required.

The flood database should be available to the public so that individuals can understand their level of flood risk. 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.

There currently exists a public perception that insurers should inform customers of their level of risk and provide advice in relation to policies. 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. In addition, under existing laws, only licensed advisers can provide financial advice.

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.

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

Flood Risk Data/Mapping

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, overlayed 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 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.

Risk Mitigation and Insurance

IAG recognises the crucial role of government in providing a comprehensive and clearly-defined regulatory framework that promotes community resilience to risk and facilitates more affordable premiums and more predictable claim costs. Government has a particular role in encouraging and regulating risk-appropriate development of the built environment and providing an appropriate emergency services framework.

To further mitigate against risk, IAG believes there is a need for greater emphasis by government on community adaptation to extreme weather events, including stronger building codes to protect structures from extreme weather hazards; more risk-appropriate use of land; and greater emphasis on hazard mitigation infrastructure.

Moreover, individuals and communities need to take personal responsibility to understand what risks they are insuring against and individuals need to financially protect themselves against loss. As the COAG National Strategy for Disaster Resilience (February 2011), highlighted:

"Underpinning a disaster resilient community is knowledge and understanding of local disaster risks. We all share responsibility to understand these risks, and how they might affect us. By understanding the nature and extent of risks, we can seek to control their impacts and inform the way we prepare for and recover from them".

Areas of Government Responsibility

IAG is working with the ICA and governments on how to develop more effective and sustainable responses to disasters in Australia. IAG suggests that key areas of government responsibility include building standards and planning codes.

Building Standards

IAG's post-event analysis of building damage after a number of major natural disasters indicates there is a crucial role for government to support community resilience by ensuring that new buildings in "at-risk" areas are constructed to withstand hazards such as flood, cyclone, hailstorm and fire.

Until now, building code standards have focused in principle on protecting life and safety. IAG suggests there is scope to enhance building standards so that they also cost-effectively protect the property itself, and its owner's financial interest, without sacrificing safety performance.

Some of the strategies focusing on protecting life and built property are achieved through land use planning and zoning instruments. Strategies include:

- Minimum floor heights and structural requirements for foundations;
- Deep setback of buildings from rivers/shorelines;
- Relocation of buildings or infrastructure (including capacity for emergency relocation of demountable buildings); and
- Monitoring, emergency warning and evacuation procedures.

Examples of additional measures available include:

- Investment in permanent engineering structures such flood barriers, canals, dykes, pumps, levees, and importation of fill;
- Plantings (such as dune grasses, mangroves) to absorb water and/or stabilise erosion-prone surfaces;
- Sacrifice of land; and
- Land buyback schemes.

Improving the resilience of the built environment to severe weather and natural disasters, will also enhance the community's economic and social resilience.

IAG notes that severe weather events can cause significant and costly physical damage to ancillary structures such as fences and sheds that are not currently covered by building standards. There is scope for further data analysis and research in this area to inform a review of the current situation.

Planning Codes

Government has a crucial role to play in risk-appropriate land use planning and zoning. Land that is, or becomes, at unacceptable risk from hazards such as bushfire, flood or coastal inundation should not be zoned for residential or commercial use. Without sound and consistent government controls, there is little to prevent ongoing building in locations of extreme vulnerability.

This is a particular challenge for Local and State Government if not supported by a consistent Federal Government approach to such matters.

The example of the New Zealand Government offering to purchase land in the "red zone" of Christchurch is particularly relevant.

Non-insurance/Under-insurance of Homes and Contents

ICA research shows that nearly 25% of all Australian households do not have any form of home or contents insurance (*The Non-Insured: Who, Why And Trends*, May 2007, available at http://www.insurancecouncil.com.au/The-Non- Insured-Who-Why-and-Trends/default.aspx).

Households

A national telephone survey of 1,212 households, conducted in October 2001, estimated the incidence of home and vehicle insurance as well as explored the issue of non-insurance and under-insurance. From the survey, it is estimated that 8% of owner-occupied homes do not have contents or buildings insurance (5% reportedly only have buildings insurance, 1% only have contents insurance, and 2% have neither).

Australian Bureau of Statistics (ABS) data indicate there are approximately 7.4 million homes in Australia of which 70% or 5.18 million are owner-occupied. Applying the survey result, an estimated 414,000 owner-occupied homes do not have Buildings or Contents Insurance.

It is further estimated that 39% of homes rented or occupied rent-free do not have contents insurance. This translates into approximately 866,000 homes. In total, therefore, one in six homes do not have Buildings or Contents Insurance (414,000 plus 866,000 homes from the 7.4 million homes in Australia).

The most common explanation householders give for not covering their possessions by contents insurance relates to the cost of premiums. Survey data suggests that a substantial reduction in the cost of Contents Insurance would increase its incidence, particularly in homes which are not owner-occupied. Full survey details are at Appendix 2.

Small-Medium Businesses

A national research report Business Insurance: A National Survey of Small and Medium Size Businesses (July 2001) commissioned by NRMA Insurance, found that while the large majority of businesses have some form of insurance, close to half (47%) either do not have a relevant cover or have cover which is judged inadequate. The survey of 1,253 small/medium businesses across Australia was undertaken to provide a better understanding of the business insurance market.

A business may be either underinsured because its existing cover is inadequate, or it may fail to be covered for a significant risk, because the insurance required is unavailable.

Survey results indicate that:

- The majority of businesses have some form of insurance (91%);
- 47% of businesses do not have a relevant cover or have a cover which is judged inadequate;
- Overall cover for damage to buildings, contents and stock due to fire or other events such as storm, explosive, vehicle impact or vandalism was the most common insurance held by businesses (85% covered); and
- Cover for loss of profit due to damage from fire or other defined event was the least common (53%).

The most common reason why a business was not covered by an applicable insurance was the cost of premiums - 39% of businesses stated this as the main reason, while 11% stated they do not have enough time to arrange insurance. Full survey details are at Appendix 2.

Impact of Non-insurance

IAG believes individuals electing not to insure their assets place a burden on the community when governments, in the absence of private insurance, are faced with the position of taking on the responsibility of insurer of "last resort". While there may be an equity argument for individuals who are financially disadvantaged to access government assistance, open-ended assistance is inequitable when it is provided to individuals who are able to responsibly insure, but choose not to do so.

Open-ended government assistance further reduces the incentive for private insurance. Clearly there is a role for governments to ensure appropriate risk management policy settings do not crowd out the private insurance market. **Governments need to avoid interventions that promote dependence on government assistance and reduce incentives for self-reliance and personal responsibility.** Indeed, as the Productivity Commission's Draft Inquiry Report into Government Drought Support (2008) noted: "It is also important that governments do not blur the boundaries between risk management and equity objectives" (p.165).

If governments see a need to provide financial support to non-insureds, IAG considers that a counter-balancing policy setting, possibly using an income tax measure, is required to ensure there remains continued incentive for individuals to exercise prudent risk management by taking out private insurance.

The Australian Attorney-General has recently stated:

> *"Put simply it is counter-productive if government assistance acts as a disincentive to people taking steps to build their own resilience – such as taking out insurance. I believe we need to be more strategic and more ambitious than just getting people back on their feet – only to be knocked down again."*
>
> *"…disaster relief and recovery assistance should not supplant, or operate as a disincentive for, cost effective insurance or disaster mitigation. The Commonwealth is also working with the insurance industry on the identification of priority flood mapping needs. This has informed work that my department is undertaking with the states and territories to look at improving flood mapping. This will not only help with insurance coverage but also with better land use planning and emergency response." (16 May 2011)*

Taxation Reform

Australian Bureau of Statistics (ABS) data indicate that nationally, taxes on insurance totalled $4,505 million in 2008-09, up $255 million or 6.0% on 2007-08, and accounted for 1.3% of total taxation revenue collected in Australia in 2008-2009.

State taxes have an impact on insurance affordability and, in turn, non-insurance. The impact of combined Federal and State Government taxes and charges on insurance premiums is to increase an insurance premium in metropolitan areas by up to 77.9% for business insurance, and up to 44.0% for home insurance. In rural Victoria the impost is even higher. (*IAG submission to the New South Wales Independent Pricing and Regulatory Tribunal (IPART) Review of State Taxation, 20 November 2007.* This document is available at http://www.iag.com.au/news/gov_submissions/docs/20071123a.pdf.).

Details of taxes on insurance are outlined below.

	2003-2004 $m	2004-2005 $m	2005-2006 $m	2006-2007 $m	2007-2008 $m	2008-2009 $m	Change 2007-08 to 2008-09 %	Contribution to total taxes 2008-09 %
Taxes on Insurance	3 231	3 502	3 550	3 684	4 250	4 505	6.0	1.3

Source: ABS (2010), Taxation Revenue Australia 2008-09, Cat.No. 5506.0, April 2010.

Taxes on Insurance 2008-09

	NSW $m	VIC $m	QLD $m	SA $m	WA $m	TAS $m	NT $m	ACT $m	TOTAL $m
Insurance companies contributions to fire brigades	575	437	-	-	-	16	-	-	1 028
Third party insurance taxes	128	132	60	48	-	4	-	-	371
Taxes on insurance nec*	1 215	667	431	279	397	39	27	50	3 106
TOTAL	1 919	1 235	491	327	397	58	27	50	4 505

**nec not elsewhere classified*

Source: ABS (2010), Taxation Revenue Australia 2008-09, Cat.No. 5506.0, April 2010.

Governments should recognise the essential benefits of insurance to the economy and community generally and implement a taxation system which does not penalise insurance relative to other more discretionary purchases.

IAG therefore argues that there is a clear social and economic case for eliminating, or at least reducing, state insurance taxes and charges as a priority for any reform agenda.

Compulsory Insurance

While appearing to offer a simple solution to a complex problem, any compulsory scheme would present its own policy challenges. Compulsion requires an enforcement regime. Statutory compulsion mandates extensive regulatory intervention in pricing, distribution and service delivery.

Compulsion may result in a desire by government to include cross subsidies in the flood pricing structures to spread the costs away from a pure risk basis, to the broader community thus improving affordability in flood prone areas. This could reduce the awareness of the appropriate extent of risk across the community. Mandated minimum cover would reduce the incentive to understand risks and take out the appropriate form of insurance, which would be a major disadvantage. In this way, the community would potentially be less likely to take steps to reduce risk around their own properties.

Furthermore, compulsion is a disadvantage as it could risk smothering the innovation that comes with the drive for difference in a highly competitive insurance market. IAG via its operating brands is continually striving to improve the way in which we respond to each event, lifting the bar each time to surpass our competitors in terms of the quality of our disaster response and during claims time. Claims time for insurers is the moment of truth, and is arguably the most significant and important point of contact we have with our customers.

Cash Settlements

Following a natural disaster, customers can choose to rebuild their home following a natural disaster and have their insurer take care of the rebuilding of the property, using its reliable suppliers and tradespeople to complete the rebuild as quickly as possible.

Other customers prefer go through this process in their own time and in their own way. Cash settlement puts the onus on the customer to source whichever suppliers they would like to use, to conduct repairs now or later, rebuild the home or move elsewhere as they see fit, without the need to further consult with their insurer.

For instance, following the Victorian bushfires, it took some customers many months before they felt able to face starting repairs to their home and some wanted to move or rebuild elsewhere. To combine financial certainty with the flexibility to make these decisions in their own time, some customers wanted a cash settlement.

While customers can be offered cash settlement as an alternative, IAG's businesses will not try to influence the customer's take up of this offer and customers are always very welcome to work with us to rebuild their home if that is their preferred option. Customers' priorities, individual circumstances and preferences dictate how claims are settled. IAG believes it is important to retain this flexibility.

Accurate Levels of Cover

IAG continues to improve its ability to accurately identify risks at a geographical, suburb and even individual household level. NRMA Insurance, SGIC and SGIO, for example, have implemented a Home Buildings Sum Insured Calculator which enhances their ability to provide customers with a more accurate sum insured – or a dollar value to replace their home buildings. The calculated sum insured is based on data provided by an external supplier (Cordell Information) and is updated quarterly.

All customers taking out new policies are required to go through the calculator process. To help prevent underinsurance, we use our knowledge and years of claims experience to check that customer's sum insurance falls within a range that would be accurate for their type of building. If it looks like a customer may be at risk of underinsurance, they will need to go through a rigorous process of providing more information. If an accurate level of insurance cannot be agreed, we will consider declining to provide cover..

Sum insured policies provide clarity on values for the consumer, limiting insurers' potential loss, keeping the exposure stable for reinsurers and therefore keeping products more affordable for consumers. Furthermore, price signals are an important factor in consumers' aware of their risk.

NRMA Insurance has also recently introduced a new home and contents product called "Home Plus". Home Plus provides customers with a higher level of cover than the standard home product and gives them simple and flexible options to choose from when protecting their home and contents. We recognise that widespread disasters can lead to a high demand for building services which can increase rebuilding costs, as well as contents replacement costs. So, along with other key policy features, NRMA Insurance's "Home Plus" product offers a safety net of up to 25% on top of the sum insured for both the buildings and general contents sum insureds.

Consumer Awareness of Risk and Insurance

IAG and its operating businesses work proactively to educate the community on the risk of natural perils. Across the country we run joint campaigns with our community partners to encourage the community to prepare their homes to help prevent the risk of property damage through weather events. As part of this, we encourage consumers to check their level of insurance cover and participate with our organisation in ways other than just at sales and claim time.

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. IAG also supports reform efforts to include a common definition of flood in the *Insurance Contracts Act* for reference by insurers that offer flood insurance.

IAG's internal dispute resolution processes follow the guidelines established by the *General Insurance Code of Practice,* and are in line with the Financial Ombudsmen Services *Terms of Reference*, and ASIC Regulatory Guidance.

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.

It is in the insurance industry's interest to educate the community on how to become more resilient to increasingly severe weather events such as floods, as well as how to reduce their impact on the environment. This includes conducting and sharing research which can feed directly into building and zoning codes.

Education tailored to small business needs should be developed to improve the take-up of flood insurance and could include:

- The frequency of flood in their region and at their specific risk property;
- How much damage may occur if they get flooded (really understanding the business interruption component). Often business people think they can be up and running after a month or so, but it can take a number of years;
- What they can do to mitigate their risk. Insurance is just one of these options. There are much greater gains for the community through risk reduction; and
- Several insurers (including IAG) have often run education campaigns to help their customers. A national government and council campaign providing answers to the three questions above would go a long way to increasing customers' understanding of their risk and how to mitigate it.

The OECD has developed a comprehensive guidance paper for the development of a national education framework in respect of natural perils. Details of the OECD Paper are outlined in Appendix 3.

Processing of Claims

IAG's experience in large natural disasters – the Victorian bushfires, Melbourne and Perth storms, and Cyclones Larry and Yasi - affirms that our businesses, and more broadly the industry, respond in a timely and efficient manner during crises.

Our aim is to fast track as many claims as possible, to give our customers the certainty they deserve. While customers often contact us, we believe the onus should be on the insurer to make sure customers are informed on the process of their claim.

The latest ICA claims update notes that as at 24 June 2011 insurance companies had paid $1.23 billion to insured Queenslanders, with in excess of 99% of claims now having been assessed and determined. Details of IAG (NRMA Insurance and CGU Insurance) claims numbers arising from recent natural disasters are outlined in confidential Appendix 1.

IAG considers that the timelines in the General Insurance Code of Practice (GICOP) already meet reasonable consumer expectations and, in the vast majority of cases, IAG's operating businesses meet or indeed exceed these timelines.

The following GICOP standards apply to all claims where further information, assessment or investigation is required:

- Within 10 business days of receiving a claim, we are required to:
    - a) Notify the customer of the detailed information we require to make a decision on the claim;
    - b) If necessary, appoint a loss assessor/loss adjuster; and
    - c) Provide an initial estimate of the time required to make a decision on the claim.
- If we decide to appoint a loss assessor/loss adjuster and/or investigator, we will notify the customer within five business days of appointing them.
- We will keep the customer informed of the progress of their claim, at least every 20 business days.
- We will respond to the customer's routine requests for information within 10 business days.
- When we have all necessary information and have completed all investigation that was required to assess the claim, we will decide to accept or reject the claim and notify the customer of our decision within 10 business days.

IAG's internal dispute resolution processes are required to follow the guidelines established by the GICOP, and are required to be in line with the Financial Ombudsmen Service's *Terms of Reference*, and ASIC Regulatory Guidance. It must be recognised that the weather events this summer presented an unprecedented demand on claims departments as well as on resources such as claims staff, assessors and hydrologists. Even in this scenario, the vast majority of claims were settled within the guidelines in the Code of Practice.

Importantly, the Parliamentary Secretary to the Treasurer has also stated:

> *"…legislative and regulatory frameworks only take us so far. Consumers can always benefit from simple, effective and inexpensive avenues when seeking to enforce their rights and this is where Ombudsman services can play a critical role."*
>
> *"..Change to industry practices through the action of Ombudsmen fits well with the Government's preference for industry self-regulation over a more interventionist approach.*
>
> *"Governments have a limited armoury with which to effect change to industry practices and many of the tools in the armoury are fairly blunt instruments.*

> *"Self-regulation will usually result in more efficient economic outcomes as it is more accurately tailored to industry conditions and more adaptable to change than legislative approaches".(20 May 2011)*

Despite this claims performance, some claims require more extensive investigation where the cause of damage is uncertain or where the insurer is reliant on third parties or the individual for further information to be able to finalise the claim. Assessments and hydrology reports take time, particularly in large events where the demand for resources such as assessors and hydrologists is high. However, where flood cover is available in addition to storm cover, there is less contention in these claims and reliance on these reports to determine the cause of damage is reduced.

Interestingly, customer feedback during the Victorian bushfires indicates that some customers who had experienced trauma were not ready to make a claim and needed more time to go through the process as they did not want to rush into decisions such as whether to rebuild in the area or elsewhere.

Every event is different and it is important that insurers retain the flexibility to respond in the most appropriate way to a particular event.

Causes of Delay in Processing Claims

IAG pays an average of 98% of the claims it receives each year.

IAG settled its customers' claims arising from the Queensland floods in a timely manner. IAG businesses responded by:

- Providing and promoting a 24 hour claims hotline;
- Forming a dedicated local response team in Brisbane, utilising experienced claims staff, to deal specifically with claims from the Queensland floods;
- Setting up a specialized flood total loss assessing area to process total loss cars;
- Dividing claims into three categories according to level of damage and prioritising those customers who were most in need;
- Employing extra claims staff to deal with increased workload;
- Following a process to accurately assess claims and inform customers of the outcome as quickly as possible;
- Advising customers at lodgement, or within two days, whether they were covered, if we require d more information, or if an expert would attend their premises to determine cover;
- Forming an internal 'Flood Panel', from across the business, to determine more complex claims;
- Appointing service level agreements with our appointed builders which ensured customers were contacted within one business day; and
- Ensuring builders and assessors submitted their reports to us within three business days of attending clients premises or inspecting their vehicle.

After any major event, the key priorities from a claims assessment perspective are to accurately establish the cause and severity of the damage and to assist customers.

IAG assesses claims on a case-by-case basis. Accordingly, each claim may require a different level of information to assess. As part of this, we give our customers the benefit of extensive review before making a decision. This review can include additional on-site property assessment, aerial photography, external hydrology assessments and other information from third parties including police or coroner reports. On some occasions we may be waiting on information from the customers themselves.

Gaining access to some areas also causes delays in processing claims. Insurers are not able to visit affected areas after extreme weather events such as the Victorian bushfires and Cyclone Yasi. In fact on these two occasions, we were not permitted to enter until police and the coroner had completed their investigations.

Additionally, the size and complexity of the event can complicate claims processing. The 2010 Melbourne hail storms resulted in an unprecedented number of claims in one day. This was followed two weeks later by thousands of claims from the Perth hail storm. Additional employees and assessors were flown across the country and from New Zealand to help process claims and assess property. Events this large will impact resources and also, to some degree, our supply chain, particularly when they occur close together.

During large events, a key priority is to make it as easy as possible or customers to lodge claims. For example:

- We mobilise our Major Event Rapid Response Vehicles (MERRVs) to the most impacted areas, giving customers the ability to lodge their claim and receive emergency support at a location convenient to them;
- Repair, replacement and rebuilding work is allocated to assessors and builders, and we often fly in employees to support our recovery efforts. Our home assessors in the field prioritise customers' homes that are most severely impacted by large-scale weather events;
- We aim to make the repair process as simple as possible for customers once they have lodged an insurance claim. Emergency inspection centres, in addition to our assessment centres, are set up to assess damaged vehicles. This means there's no need for customers to have to get repair quotes themselves;
- To help motorists get back on the road quickly, we utilise the latest repair technology, including paintless dent repair, which uses specialist technicians and tools to remove dents rather the traditional panel beat and re-spray method;
- During the Victorian bushfires, we developed a unique process which used aerial photography to enable us to assess and settle over 85% of houses in Marysville weeks before access was granted. This enabled us to respond quickly;
- Identifying vehicles was particularly difficult given the extensive damage in the area. So we developed technology to allow our claims employees to complete "live" assessments allowing them to process claims immediately. This involved using wireless hand held assessing devices;
- During the Blacktown hail storms, giant crane borne canopies were developed to allow work on roofing to continue during incessant wet weather; and
- Post Cyclone Yasi, we were able to proactively contact our customers to lodge their claims by using the aerial photography process we'd previously used after the Victorian bushfires.

Although most claims were settled in a timely manner, a small minority of customers experienced delays due to the need to gather additional information to assess the claim and the pressure on finite resources such as hydrologists required to make this assessment. Storm and flood events are unique because damages can be caused by storm water (which is covered by most insurance policies), flood water (which is not covered by many policies) or a combination of both.

Similar delays do not occur in relation to events which are covered under insurance policies, such as cyclones and bushfires.

IAG engaged extensively with its customers in relation to the floods and listened to feedback about our processes and communication, making adjustments as a result.

While there is always room for improvement, what became clear in the course of these discussions is that the real issue is one of policy coverage. In other words, the customer is not as concerned about the time taken to assess the claim, or communication around the process, as much as the possibility that the claim may be denied.

It is important when setting future policy to recognise that the flood events earlier this year were the exception rather than the norm.

Communication with Customers Following a Natural Disaster

Customers vary considerably in what they consider to be an appropriate frequency of communication.

IAG provides updates in line with the General Insurance Code of Conduct. A SMS alert is provided to customers every three days. IAG will soon be able to provide automated email updates to customers.

IAG does not believe it is of value to provide generic updates to consumers as customers want information which is relevant to their own claim.

Any obligation to provide more frequent generic communication to customers would place further pressure on resources during a catastrophe without providing much in the way of benefits to customers.

Legislated claims timelines would not present an issue in the majority of circumstances and for the majority of claims. But in a catastrophe environment, where resources are stretched, there may be claims which take more time to assess.

If shorter legislated timelines were introduced the pressure on resources to assess claims would increase, and therefore, so would costs. This would in turn be reflected in premiums.

Alternatively, insurers may choose to make an initial determination on a claim more quickly, in order to meet the required timelines. Investigations such as hydrology reports are undertaken to find ways of paying a claim. If insurers were not given the time to undertake a thorough assessment of a claim this would disadvantage customers. Although customers may be satisfied with condensed timelines, the resulting impact on claims determinations would not be welcome and IAG believes the thoroughness of the assessment process is the most important factor to consider.

In summary in relation to claims handling:

- There are significant variations in what customers feel is appropriate in terms of process, timelines and communication;
- IAG provides regular, appropriate and relevant updates to customers and follows the guidelines in the GICOP as a minimum;
- There is no communication or process which makes bad news more palatable and many concerns about timelines and communication are understandably the result of anxiety about a possible negative outcome on the claim;
- Legislating claims timelines may sound appealing, but may be unworkable in some catastrophe scenarios, with unintended consequences for costs and premiums. This action also neglects the core of the issue, which is to enable insurers to provide flood cover under their policies, through the provision of accurate flood mapping data; and
- Enabling more insurers to cover flood under their policies will eliminate many of the issues experienced by the customers of insurance companies during the Queensland storm and flood event.

Resolution of Claims Disputes

IAG businesses provide customers with the details of both their internal dispute resolution (IDR) and the Financial Ombudsman Service (FOS) when they advise customers of the outcome of their claim, if that claim is denied. The outcome is provided verbally (by telephone) as well as in writing.

IAG's IDR departments function separately to the department where claims processing is managed. A dedicated team is given the task of undertaking a fresh review of the claim on an objective basis.

The IDR process provides the customer with a review of their claim independent of the original decision maker and the customer is offered the opportunity to present any additional information they feel may be relevant to the outcome of their claim.

Claims are sometimes overturned through IDR because new information comes to light or there has been an oversight in the process. These routes are helpful to customers who are dissatisfied with a decision and are an effective forum for debating whether a claim is valid under a customer policy. (For example, a customer is certain damage was caused by storm water not flood and wants to contest the decision).

The IAG business will, following a review by the IDR departments, give the customer 45 calendar days from receipt of the initial complaint, the customer may escalate their dispute to the FOS. IAG proactively provides information and support to customers to help them escalate their dispute if they choose to do so.

IAG believes all consumers should have the right to access free legal advice.

Broker and Client Disputes

The insurer is obligated by law to pay all claims which are valid under its policies. Brokers are required to provide customers with appropriate advice, to assist them in choosing a policy which best fits their needs.

There is no circumstance under which IAG would delay payment on a valid claim to a customer because a broker was involved in the process.

If a customer disagrees with IAG's determination on a claim, there are avenues the customer can pursue, such as Internal Dispute Resolution or the Financial Ombudsman Service. This process, associated timelines and outcome will remain the same, whether the customer chooses to follow this route or the broker acts as an advocate for them through the process.

Separately, a customer may consider that the advice provided to them by the broker when they purchased their insurance policy was not adequate. If this is a case a customer may consider taking action in relation to the advice provided by the broker when the claim was sold. Insurance advisers have professional indemnity insurance in place to protect them in this scenario. The insurer has no connection to this process.

There would therefore not be a disagreement between an insurer and a broker about liability. The insurer is responsible for the policy and the broker for the advice given when that policy was purchased.

If customers are of the view that their claim has not been paid due to a disagreement between their insurer and their broker, this is likely to be the result of miscommunication.

In summary in relation to claims disputes:

- The IDR option and process is actively communicated and undertaken in a timely, transparent manner;
- IDR is beneficial to customers where there is a dispute about whether a claim is valid under a policy;
- The option of seeking advice from FOS should continue to be promoted to consumers, with consideration given to extra resourcing for FOS in the event of natural disasters;
- Free legal advice should be available to all consumers;
- Caution should be exercised in creating a perception amongst consumers that legal advice will change an insurance company's right not to pay claims which are not covered by its policies; and
- The focus in future should be on ensuring consumers understand their policy coverage, and on providing high quality flood mapping data so that flood can be included in policies.

Funding Public Infrastructure

Natural Disaster Relief Framework

IAG welcomes the Council of Australian Government's (COAG) 2011 recommendations to improve Australia's ability to withstand and recover from future disasters. IAG notes COAG adopted the National Strategy for Disaster Resilience and agreed to take immediate steps to implement it. The Strategy focuses on the shared responsibility of governments, business and communities in preparing for, and responding to, disasters. IAG particularly welcomes the following measures:

- Heads of Treasuries reporting to the National Emergency Management Committee (NEMC) on strategies for maximising the role of insurance in fostering greater community and individual resilience; and
- NEMC reviewing all funding arrangements associated with relief in the resilience context, including the delivery of individual grants, public appeals and insurance, in shaping recovery policy, including provisions for betterment and mitigation.

International Comparisons

The provision of flood insurance is an issue in most OECD countries. Solutions have ranged from agreements between industry and government such as in the United Kingdom, to mandated coverage supported by government pools and a variety of options in between. International experience shows that any solution for flood must involve a partnership between industry and government. The US Congressional Budget Office noted (Federal Reinsurance for Disasters, 2002 Report):

> *"The federal government's experience with other insurance programs suggests that it has difficulty managing risk efficiently. In part, that is because the government has less of an incentive than private firms do to ensure that premiums cover costs and to control moral hazard (policyholders' incentive to change their behavior in ways that will increase losses from insured events) and adverse selection (the purchase of insurance disproportionately by people with the highest risks). One way in which that difficulty manifests itself is in oversimplified pricing; federal programs seldom tailor premiums to risks. For example, the federal flood insurance program charges premiums that are below expected costs for some properties and covers repeated losses for the same properties."*

It is relevant to note that the US National Flood Insurance Program is running a deficit of about US$19 billion.

The OECD (2003) Report *Flood Insurance* highlights in particular:

> *"Government compensation mechanisms to victims of flood damage and flood hazard mitigation strategies vary considerably from one country to another as a result of differing national priorities and local cultures. The national flood relief programmes include systems with no state compensation for citizens (Germany, Japan, Portugal, UK); government procedures providing compensation in hardship cases (Australia, Canada, Mexico, Slovak Republic, Turkey); government catastrophe programs applied to the floods when declared a national disaster (Belgium, France, Italy, Iceland, Norway, Netherlands, Poland, Switzerland, Spain, US)." (p.10)*

The OECD report is at:

http://www.oecd.org/dataoecd/51/9/18074763.pdf

Appendix 1

Sapere research Group – Flood Insurance: economics and issues

Flood insurance: economics and issues

Dr Richard Tooth

July 2011

About Sapere Research Group Limited

Sapere Research Group is one of the largest expert consulting firms in Australasia and a leader in provision of independent economic, forensic accounting and public policy services. Sapere provides independent expert testimony, strategic advisory services, data analytics and other advice to Australasia's private sector corporate clients, major law firms, government agencies, and regulatory bodies.

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Summary

Introduction

This document examines issues associated with flood insurance and considers key elements of proposals put forward in the National Disaster Insurance Review (NDIR) issues paper (Issues Paper).

It is important that policies developed reflect the nature of the insurance industry and underlying reasons for non-insurance. Some general considerations are:

- The insurance industry is a competitive industry. Any costs imposed on the industry will, over time, be passed through to consumers.
- Consumers are sensitive to the price of insurance, and as such, increased costs of insurance will lead to lower levels of cover.
- There are costs to regulation. These can include direct costs such as excessive administration requirements and many indirect costs such as unintended changes to behaviour and impacts on investment and innovation.

Flood insurance – economics and issues

Adverse selection and flood mapping

Flood insurance can be expensive. However, the high cost of flood risk does not, by itself, explain why flood risk is not universally covered.

The key difference between where flood insurance is and is not available, relates to the availability of information on flood risk. Information on flood risk is important, primarily to address the issue of adverse selection. Adverse selection can occur when insurers cannot accurately price insurance with the result that households who know they are a relatively low flood risk choose not to insure.

The problem of adverse selection can be addressed through flood mapping, which has been progressing. Of note, for purposes of addressing the adverse selection problem a high degree of accuracy is not required. Flood mapping only needs to be unbiased and provide better information than held by householders.

Flood maps are useful for a number of other public purposes. Regardless, it is efficient that the basic flood maps required for insurance purposes be government funded.

Taxes on insurance

Rather that subsidise home insurance to make it more affordable, currently Australian state governments impose taxes on home and contents insurance that make it less affordable.

In addition to GST, home and contents insurance is subject to a number of premium based taxes. These taxes include a stamp duty paid on the premium and a fire services levy (FSL) applied in NSW on insurance premiums. There is no economic rationale for

the taxes. These taxes are inequitable, inefficient and discourage the take-up of insurance. Removing these taxes would likely result in hundreds of thousands more households being covered for contents insurance and tens of thousands more for home insurance. The relative impact of taxes on the decision to take out flood insurance is likely to be particularly significant — in some cases the taxes on the flood insurance premium will be more than the average house insurance premium.

The impact of an insurance pool

This report examines the likely impact of a flood insurance pool that, as considered in the Issues Paper, subsidises flood insurance through higher premiums on other households.

In summary, the likely impact of the flood insurance pool would be to decrease overall levels of insurance. Intuitively this is because:

- The take-up of flood insurance would be limited as the subsidy is given to a small number of households, a number of who would already be insured.
- The subsidy is paid for by a penalty (akin to a tax) on a large number of insured households.

There are further unwanted complications of an insurance pool arrangement. In addition to many administrative issues, a subsidy on flood insurance can reduce incentives to lower the flood risk exposure in flood prone areas.

Conclusion and Recommendations

The most efficient and least distortive methods for governments to improve the availability and affordability of flood insurance are to:

- remove the taxes on insurance
- ensure that flood maps are available to insurers, so that they can price the insurance risk, and
- undertake community flood mitigation and promote household flood mitigation measures, which lower the cost of flood risk and thus the cost of flood insurance.

It is also appropriate that Governments consider means to improving the transparency of the flood risk for communities and consumers investing in flood risk areas.

Understandably, Governments may consider that financial support to households in flood prone zones is appropriate where households invested without a clear understanding of the flood risk. If so, this support should be provided in a way so as not to distort decisions for the efficient management of risk or the efficient workings of insurance markets.

1 Introduction and background

1.1 Purpose of this report

The recent disasters in Queensland have focussed attention on the levels of disaster insurance coverage in the community. Understandably, there is significant concern that many households are either uninsured or underinsured. Flood, unlike most other catastrophic risks, is not included as standard within a household insurance policy.

This report examines the economics of flood insurance and considers key elements of proposals put forward in the National Disaster Insurance Review (NDIR) issues paper (Issues Paper).

This report comprises four sections.

- The remainder of Section 1 builds a foundation by outlining some general points when considering regulation of home and contents insurance.
- Section 2 considers issues associated with flood insurance. The focus is on issues that are either not considered, or only lightly considered, in the Issues Paper.
- Section 3 examines the implications of a flood insurance pool as outlined in the Issues Paper.
- Section 4 draws conclusions and makes some recommendations.

In the interests of time and brevity, this report is limited in scope to focussing primarily on key issues which affect the demand, availability and affordability of flood insurance.

Of note, outside the scope of this report is the issue that there are different definitions of flood, which, along with consumer confusion in purchasing flood insurance, creates the concern that at least some consumers are inadvertently uninsured for flood risk. However, both the insurance industry[1] and Government[2] support key policy changes that

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[1] The Insurance Council of Australia has a ‗10 point plan to tackle disasters' (available at www.insurancecouncil.com.au) that includes a standard definition for flood, improved disclosure, education and financial literacy and better advice to consumers. Of note, the industry has for some time sought to obtain a standard definition of flood. In 2008, authorisation for a standard definition of flood sought by the Insurance Council of Australia was denied by Australian Competition and Consumer Commission (ACCC).

[2] In April 2011, the Commonwealth Treasury released the consultation paper ‗Reforming Flood Insurance: Clearing the Waters' which considers a standard definition of flood for use in insurance policies and short, simple, key facts summaries for insurance policies to be made available to consumers.

would help to address this issue. These changes include a standard definition for flood and improving disclosure to consumers.

1.2 Considerations in regulation

Some important broad considerations for regulation of the home insurance industry are as follows. First, costs imposed on (or conversely removed from) the insurance industry will, in the main, be passed through to consumers.[3] The insurance industry is a competitive industry.[4] Competition between insurers will mean that over time cost changes will be passed on to consumers and the industry will expect to receive normal returns.[5]

Second, consumers are sensitive to the price of insurance. There is strong evidence that the cost of insurance affects decisions about whether to insure and the amount of cover obtained. As such, any unnecessary costs imposed upon insurers will have the important and unwanted result of reducing the level of insurance.

Third, there are costs to regulation. A useful summary of the common costs of regulation is shown in Box 1 below. Regulation can impose direct costs through excessive administration requirements imposed on insurers and their policy holders. Regulation also has additional less obvious costs. It often has unintended consequences. Regulation can hinder innovation and investment by imposing, often unnecessary constraints (‗delays') on change and creating uncertainty.[6] Furthermore, regulation is often subject to ‗regulatory creep' — that is, unnecessary expansion of regulation.

For these reasons, a common guiding principle is that Governments should be cautious about regulation and should only do so where there is a clear market failure. This view is consistent with the Issues Paper's Terms of Reference, which includes the guiding principle that (Issues Paper, page 71):

> *Government intervention in private insurance markets is justifiable only where, and to the extent that there is clear failure by those private markets to offer appropriate cover at affordable premiums.*

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[3] There is strong evidence of this. For example, the removal of the fire services levy (FSL) in Western Australia was closely monitored. A compliance study undertaken (Sigma Plus 2008) concluded that insurers passed on the savings of removing the FSL to consumers.

[4] Of note, there are multiple insurers and there is significant price based competition between insurers (as evidenced by price based advertising). Furthermore, there appear to be no material barriers to entry which would prevent new brands from entering the market.

[5] In the short term, the cost burden may be borne by insurers. However, such regulations can increase the perceptions of regulatory risk and discourage future investment.

[6] A new entrant in personal insurance once reported to me that a substantial cost that had slowed their entry into Australia had been the variation in regulation by state.

Box 1

Types of Regulatory Costs (from IPART 2006)

"[...] existing regulations commonly impose unnecessary burdens on business and the community because they lead to:

- ***Uncertainty***. Stakeholders provided many examples where regulatory requirements are uncertain, or are interpreted inconsistently by enforcement officers, or where inadequate guidance on what is required to comply with regulations is provided to the regulated community.
- ***Unintended consequences.*** Stakeholders noted that the consultation and impact analysis that occurs when regulation is being developed is often inadequate, which results in regulation that produces unintended consequences or perverse outcomes.
- ***Inconsistency and duplication.*** Stakeholders argued that the existing regulatory requirements of other agencies and jurisdictions are often not adequately considered when regulation is being developed, which leads to variations in requirements and/or overlapping or duplicative requirements.
- ***'Regulatory creep'.*** Stakeholders believe that the significant external pressures on and incentives for Government to regulate are resulting in more and more regulation, some of which is unnecessary.
- ***Excessive requirements.*** Stakeholders face considerable information or reporting demands that can be excessive or unnecessary. These are rarely coordinated amongst different arms of government resulting in duplication, and the cumulative burdens are rarely assessed.
- ***Delays.*** Stakeholders complained of a lack of timeliness of regulatory decisions or approvals creating and prolonging uncertainty for business and individuals."

Source: IPART (2006), pages 1-2.

2 Flood insurance economics and issues

Any policy response to the current concerns with the flood insurance market should be based on a thorough consideration of the nature of the insurance industry and underlying factors that affect the availability and affordability of flood insurance. This section examines key aspects of the economics of flood insurance and some of the important features and issues currently surrounding flood insurance in Australia.

2.1 Symptoms and concerns

There are some frequently raised concerns about flood insurance. Most notably, unlike most other catastrophic risks (such as fire, storm and earthquake), it is uncommon for standard home and contents insurance policies to cover riverine flood risks.

Another concern is that there are different types of flood.[7] Damage from riverine flood, which generally refers to water rising up from flooding rivers and other catchments, is often excluded from home and contents insurance cover. Damage from other water inundation, such as a result of falling rains (which might be referred to as flash flood) or blocked drains, is generally covered as part of an insurance policy.

Flood insurance can be particularly expensive. The high cost of flood insurance is highlighted in Table 1 below (based on work conducted by the Insurance Council of Australia in 2006). This table shows the cost of flood risk by households organised by Average Recurrence Interval (ARI) — a measure of how often (in years) an area is flooded.

The table highlights the significance of the flood risk cost for households in areas subject to flooding. In extreme flood risk areas (ARI < 20 years), the average flood risk costs are estimated to be in excess of $4,000 per year. In contrast the average home insurance premium is estimated to be around $300 in 2006 prior to taxes.[8]

The table also highlights the high total cost of flood risk to the Australia. The estimated total cost of the flood risk in 2006 was $370 million, equivalent to around $50 per household.

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[7] In this report, flood refers to riverine flood unless otherwise stated.

[8] Based on the Australian Bureau of Statistics Household Expenditure Survey 2003-04 the average home insurance premium was around $340 per year including taxes including GST, stamp-duty and fire-services levies where applicable. The $300 amount is obtained by adjusting for the taxes and allowing for some growth in premium between 2004 and 2006.

Table 1

Cost of flood risk per property — Home Insurance							
	Dwellings Exposed		Loss Parameters			Total Cost	
ARI Band	Number (000s)	% of total	Frequency of risk	Average cost	Risk premium	p.a. ($m)	% Total
Nil	6,617	93.60%					
100 to 250	280	4.00%	0.20%	$31,600	$60	$17m	5%
50 to 100	53	0.70%	1.10%	$44,100	$500	$27m	7%
20 to 50	64	0.90%	3.00%	$43,400	$1,310	$84m	23%
<20	58	0.80%	7.00%	$59,700	$4,180	$242m	65%
Sub total	**455**	**6.40%**	**1.60%**	**$51,800**	**$810**	**$370m**	**100%**
Total	**7,072**	**100%**	**0.1%**	**$51,800**	**$52**	**$370m**	**100%**

Source: 2006 Insurance Council Flood Analysis as presented in Andrews et al. (2008).

2.2 Underlying issues

The high cost of flood risk does not, by itself, explain why flood risk, unlike like other risks, is not universally covered. Flood insurance is available in some states in all locations by one insurer and in some locations by multiple insurers.

It is not realistic to expect that all households will insure.[9] However it is a reasonable goal to ensure that the main issues that hinder markets working effectively are addressed. This section discusses the main issues, focussing on the issues that were lightly covered in the Issues Paper. A complete review of the reasons why people do not insure is beyond the scope of this paper.

A starting point for understanding demand for insurance is that when insurance is priced ‗actuarially fair' (that is the premium only reflects the expected claims cost) and consumers are both risk averse (i.e. they dislike losses more than they like gains) and rational (i.e. they make a considered choice that maximises their welfare), then they will fully insure a risk. There are a large range of departures from this starting point that can be used to help explain the lack of flood cover.

[9] People may choose not to insurance simply due to personal preferences.

Information on flood risk

The key difference between where flood insurance is and is not available, relates to the availability of information on flood risk. Information on flood risk is important, primarily to address the issue of adverse selection.[10]

Adverse selection occurs where the potential policyholders (i.e. households) know more information about their flood risk than the insurer.[11] Lacking detailed local information on flood risk, insurers must price flood insurance based on the expected claims cost averaged across many households with varying risk. Those households with relatively low flood risk (e.g. because their house is relatively elevated) may perceive the insurance as poor value and choose not to insure. Those with a relatively high flood risk are more likely to perceive the insurance as good value and choose to insure. This ‗adverse selection' results in an increased average cost of providing insurance for the insured policyholders, which in turn discourages more low-risk households from insuring. Thus a vicious circle is created with the potential result that flood insurance is simply not available in some areas.

Similarly, as noted in the Issues Paper (section 8.1), landslide and actions of the sea are also not usually covered by home insurance policies. Like flood, these are risks for which local knowledge is important and thus risks for which the potential policyholder will likely know more about the risk than the insurer.

Households may know more about their risks than insurers for a number of other risks. However, as there is close to uniform coverage of house insurance, the problem of adverse selection with respect to other risks is small. This may be because the expected cost for most other risks is small and thus there is little benefit for an insured opting out of a specific risk. For flood, the potential risk premium is very high and there can be a significant financial gain to households who know that their house is a relatively low flood risk to opt-out of insurance.

The problem of adverse selection explains why riverine flood risk is generally not covered but other types of flood risk are covered. Flash floods (and other water inundation from falling rains) are sufficiently random such that the household's local knowledge is not a significant contributor to adverse selection.

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[10] Improved information on risk can also help to lower the insurer's costs. Insurance companies themselves are not risk averse. Increased uncertainty over the distribution of losses increases capital costs for insurers. Regardless of the problem of adverse selection, where there is greater ambiguity, insurers will charge a higher premium.

[11] This is more commonly referred to as an issue of asymmetry of information.

Flood mapping

The problem of adverse selection[12] can be addressed by the insurer obtaining better information. With regard to flood insurance this can be achieved by insurers gaining access to flood maps that describe the locations with the greatest risk of flood. Of note, for purposes of addressing the adverse selection problem, a high degree of accuracy is not required. It only needs to be unbiased and better than the information held by householders. In discussing issues with US National Flood Insurance Program (NFIP), Michel-Kerjan (2010, page 177) noted:

> *If the maps are inaccurate, but their inaccuracies are not biased toward overestimating or underestimating risk, and private information is no better, then, while insurance based on such maps may run into difficulties, the issues of moral hazard and adverse selection should still be contained.*

Sufficiently accurate flood mapping has now been achieved and made available to insurers in most locations in Australia. As a result in these locations, flood insurance is available from a number of competing insurers.

There are however some locations where flood maps are required but not available. There is also a need to make sure that the flood mapping is updated as a result of changes to the built and natural environment and changing climate and weather patterns.

As flood mapping can be expensive, an important question arises as to whom should fund the costs of creating new flood maps and updating the existing flood maps when required.

Flood maps are used for a number of purposes such as planning and development and risk management. Although it would appear that the insurance industry is a ‗beneficiary', it is preferable insurers do not fund the flood mapping. If the cost of flood mapping was paid by insurers, then the cost would be ultimately passed on to consumers through higher insurance premiums, which can have the effect of further deterring people from purchasing insurance cover.

A single insurer would be reluctant to fund flood mapping without confidence that they would be able to recoup the value of their investment through higher insurance premiums. A key concern for insurers would be the risk that subsequent government intervention in providing maps would dilute the value of their investment.

Flood maps also have an important characteristic of a public good – the use of the flood map by one insurer does not prohibit the use of the flood map by another. Thus flood maps provided by public funds can be shared among all existing and potential insurers.

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[12] A related information problem to adverse selection is that of moral hazard, whereby the insured takes fewer precautions as a result of being insured. As the insurer does not know the extent of precaution the insured will take, it is difficult for the insurer to price this risk accurately. To address this issue the insurer may employ other strategies such as sharing the risk through charging an excess.

Providing access flood maps to insurers should increase the availability of flood insurance. This increase in availability (resulting in improved competition) would drive down the price of flood insurance in flood risk areas, to the benefit of consumers.

As a main driver of the need for flood mapping (for its range of uses) is urban development, it would be efficient and appropriate that new and revised mapping be funded through development charges. As it is in the community‘s interest that flood maps be developed and released, it is appropriate that they be funded from local public funds.[13]

2.3 Taxation of insurance

Rather that subsidise home insurance to make it more affordable, currently Australian state governments impose taxes on home and contents insurance that make it less affordable.

Home and contents insurance is subject to a number of premium based taxes. These taxes include a stamp duty (in most cases 10% but ranging from 7.5% in Queensland to 11% in South Australia) paid on the premium and a fire services levy (FSL) of 20 per cent applied in NSW[14] on insurance premiums.

There is no economic rationale for the taxes. These taxes are inequitable, inefficient and discourage the take-up of insurance. Successive reviews —the IPART review of State Taxes (IPART 2008), the Henry Tax review (AFTS 2009) and the Victorian Bushfire Royal Commission (VBRC 2010) — have recommended that they should be removed.

How the taxes are applied to insurance makes them particularly distortive. The primary service of insurance is to pool and redistribute funds. Unfortunately — unlike GST — these taxes are not just applied to the *service of insurance* but to the full insurance premium that also reflects contributions to the pool of funds used to pay claims. The application of the stamp duty and FSL is akin to a tax on a money transfer service that is applied not just to the service charge of conducting the transfer but also the funds transferred.

The implication can be seen in a simple example. Assuming a loss ratio (ratio of claims paid to premium collected) of around 60 per cent, the service (i.e. value added component) is around 40 per cent. Thus the impact of a stamp duty of 10 per cent is

[13] There is also a practical consideration in that local governments already have a significant level of information on flood maps and greater knowledge as to changes in the built and natural environment that may affect flood maps. In Australia, flood mapping has typically been the responsibility of local government or a floodplain management authority.

[14] Other jurisdictions had previously imposed a form of FSL but have replaced the FSL with other funding sources. Victoria is in the process of replacing the FSL with another source of funding.

similar in effect to a GST of 25 per cent (as 10% = 25% x 40%). Similarly the current NSW FSL of 20 per cent is equivalent to a GST of around 50 per cent.

The effect of these taxes is to increase the price of the insurance service for consumers and reduce consumer demand for taking out insurance. This lower demand could be seen in households either choosing not to insure; or choosing to under-insure i.e. reduce their premiums by partly self-insuring.

The effect of taxes on demand has been estimated by analysing how demand has changed in responses to variations in taxes across jurisdictions and time. The estimated impact (summarised in Sullivan, 2010) of removing the non-GST taxes from insurance premiums is an increase in the number of households without contents insurance by around 300 thousand and an increase in the number of owner-occupiers without home insurance by around 69 thousand.[15] Of note, based on Table 1 above, there are only 58 thousand houses in the very high flood risk areas and 175 thousand houses where the flood risk is greater than 1 in 50 years.

The relative impact of taxes on the decision to take out flood insurance is likely to be particularly significant. The potential amounts are large. For example, for an additional risk premium of $1,300 (the average flood risk premium of the 20 to 50 ARI band in Table 1 above) the non-GST taxes applied in NSW would be in excess of $400 — more than the average house insurance premium. Furthermore, the effective rate of tax for flood may be larger than that for other risks, given the relatively large claims costs against which the taxes are applied.

2.4 Other issues

The provision of flood maps and the removal of state based taxes on insurance are two significant issues, which, if addressed, could greatly improve the availability and affordability of flood insurance. There are, however, other factors and issues which affect the demand for flood insurance and the efficiency of insurance markets.

Household availability of information on flood risk

An important concern is that households are unaware of the risk of flood and its potential cost (either in risks to their house or the cost of insurance).

[15] There would also be an increase in the take-up of home insurance for non-owner occupied (primarily rented and holiday home) properties. This was not estimated due to a lack of available data. There would also be an increase in insurance coverage, particularly with regard to contents insurance. The size of the potential benefit will fall as Victoria removes the FSL from insurance premiums.

All else being equal we would expect that property values are lower where there is greater flood risk.[16] Conceptually it would be expected that the difference in property values would reflect the difference in insurance costs. There is some evidence of this. Bin et al. (2006) examined property values of houses exposed to flood risk and found evidence that the difference in the property values is consistent with the capitalized value of flood insurance for different levels of risk.

Lack of information by households on flood risk is concerning for a number of reasons.

- It can result in households investing in property when they are unaware of the flood risk and cost.[17] This may be a substantial financial risk for households and result in demands for compensation. Furthermore, households may not have budgeted for flood insurance with the result that households cannot purchase flood insurance without substantial hardship. Given the high costs of relocating, normally risk-averse households may find it rational not to insure for flood.[18]
- It can result in increased resistance by communities and residents for flood mapping information to be developed and released for fear of the impact on property values.[19]
- It can dilute the value of the price signal of flood insurance in providing incentives for flood mitigation and development.

Other reasons for non-insurance

As noted in the Issues Paper (page 53) ‗even where information is available, consumers may not make optimal choices.' Frequently raised concerns are that people do not take out insurance because they suffer from behavioural biases and/or have difficulties in making complex decisions.

Care is required in regulating on the basis of behavioural biases. While it is generally accepted that consumers do not always behave in ways that would appear to be rational, there are many different behavioural theories and thus there are risks that regulation on the basis of a behavioural theory is inappropriately formed. Behavioural economists

[16] There is, however, mixed evidence as to the extent that flood risk affects property values. See Yeo (2003) for a discussion.

[17] Chivers and Flores (2002) report evidence from a survey in Boulder, Colorado on the extent to which house buyers understood the flood risk at the time of purchasing a house. They found that the large majority were not aware of the flood risk or the flood insurance premium prior to price negotiations.

[18] In effect, the household is left to choose between the risk of very severe hardship (by being non-insured and losing the house) and certain hardship (through the cost of the insurance premium).

[19] See Yeo (2003) for a discussion on this issue.

concerned with behavioural biases tend to favour soft paternalistic policies — policies that attempt to influence, but not restrict, choice.

It seems possible that there are benefits to soft-paternalistic policies that encourage people to take out flood insurance and engage in mitigation activities. Such policies might include highlighting the flood risk, the importance of flood insurance and the value of flood mitigation activities to constituents in flood zones.

Of note, there would also likely be benefits from increased competition among insurers in the provision of flood insurance. When faced with complex decisions, consumers often resort to simple decision rules. One simple strategy is to shop-around and accept the most attractive offer on the assumption that competition ensures that the price is fair value. Consumers may have less confidence in such a strategy when competition is restricted.

Another commonly raised concern is that government support following a disaster will provide a disincentive for households to take out private insurance. While there is general recognition that this is a potential issue, there is limited empirical evidence as to the extent of the effect. It is reasonable to expect that this crowding-out effect (also known as the ‗charity hazard') would be more significant the larger and the more certain the level of post-disaster support.[20] To minimise the impact on flood insurance markets, it is important that any post-disaster government support is independent of whether people are insured.

Economic benefits of flood mitigation

Another strategy to reduce the cost of flood insurance is to undertake flood mitigation thereby reducing the cost of flood losses. Competition between insurers in the provision of flood insurance will mean that a reduction in expected costs of flood risk will be passed on to consumers in the form of lower insurance premiums.

There are a large range of flood mitigation measures to reduce flood losses. These can generally be categorised into:[21]

- flood modification (e.g. levees, diversions)
- property modification including land-use planning and building modification, and
- response modification (e.g. warning systems).

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[20] Raschky et al. (2011) use a survey of people's willingness to pay for disaster insurance in Germany and Austria to test how the design of Government relief programs impacts on crowding out. They find support that the assured partial relief scheme (in Austria) drives a stronger crowding out of private insurance than the uncertain scheme of full relief (in Germany). They also provide a useful overview of recent literature of crowding out.

[21] See BTRE (2002) ‗Benefits of Flood Mitigation in Australia'.

Economic studies of flood mitigation activities have generally found that flood mitigation is efficient with substantial benefits. The BTRE (2002) provides some evidence of the benefits in Australia by way of case studies. There is also some international evidence on the value of flood mitigation activities. Of note, Kunreuther (2008) estimates that structural modifications to properties would save over 50 per cent of unmitigated losses in Florida. Rose et al. (2007) examined the benefit-cost analysis of a sample of Federal Emergency Management Agency (FEMA) hazard mitigation grants across a range of hazard areas. The found that in the flood mitigation cases sampled (around 8% of flood related grants) that benefits exceeded costs and the average benefit-cost ratio was over 5:1.

There is also general recognition that households themselves can undertake significant mitigation measures to reduce potential damage. However, as noted by Kunreuther (2008) and Sutter (2008) consumer behavioural biases may contribute to a lower level of flood mitigation by households than is optimal. The behavioural biases of households may provide a justification for paternalistic policies that encourage the mitigation measures. However, the potential for the private market to address consumer behaviour should also be recognised. Through reduced insurance premiums for mitigation, insurers can provide an immediate price signal to households (see Sutter 2008).

3 The impact of an insurance pool

An option considered in the Issues Paper is a proposal to subsidise house insurance in high flood risk areas through an insurance pool arrangement. This section considers some of the implications of this proposed approach.

3.1 Impact on the demand for insurance

An insurance pool would, subsidise the flood insurance for some and raise the cost of insurance for others.[22] Consequently it is useful to consider the likely implications of the introduction of such a cross-subsidy.

The significance of implications will depend on the costs of the program and the responsiveness of demand to the cross-subsidies. A rough estimate of the magnitude of the insurance pool can be drawn from work by Insurance Council of Australia in 2006 presented in Table 1 above. As noted earlier in this table, the total annual average damage across all dwellings is estimated around $370 million (in 2006).[23]

The extent of the cost that would be passed on to non-flood risk households would depend on how much of a subsidy was provided and the extent of the take-up of insurance in flood prone areas. For example, if the flood risk was fully subsidised, then we might expect a near universal take-up of flood insurance in flood risk areas. In such a case the full flood risk cost would be shared across all households and, as suggested in Table 1, the average house insurance premium would increase in excess of $50 per household,[24] about a 15 to 20 per cent increase on an average house insurance premium of around $300.

The approach described in the Issues Paper is for a partially subsidised premium such that the insurance premium could be: (Issues Paper, page 20)

> *either perhaps 150 per cent of the non-flood premium (that is, the same premium for all high-risk homes irrespective of the level of risk) or, as a more risk-oriented approach, 150 per cent plus some amount, perhaps a proportion of 10 or 20 per cent, of the cost of flood cover beyond 150 per cent. These homeowners will therefore receive a discount against the full cover premium.*

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[22] As noted in the Issues Paper (paragraph 4.18), an insurance pool ‗could have an impact on the operation of the insurance market by increasing premiums for all policyholders, potentially creating an incentive for under-insurance or non-insurance.'

[23] For simplicity estimates in this section are based on year 2006 estimates.

[24] The size of the increase depends upon how the costs are shared. If shared across all households as shown in Table 1 then the amount would be around $50. If shared among just insured households not prone to flood risk the amount would be around $55.

Of the two approaches considered, the risk-oriented approach involves the lowest level of cross-subsidy and thus provides a lower bound of the impact on other insured households.

Using the information in Table 1 as a basis, the risk-oriented approach is modelled and presented in Table 2. The total average (pre-tax) premium for each ARI band is estimated by adding the $300 average house insurance premium to the flood risk premium. Using this amount, the value of the subsidy per household and the total potential subsidy is estimated. The analysis shown in Table 2 is highly simplified but provides a guide as to the overall effects. The total potential subsidy for the year 2006 would have been in the order of $299 million.

Table 2

Subsidies by ARI band under a risk-oriented approach

ARI Band	Number (000s)	Flood Risk premium	Total average premium	Receive subsidy?	Subsidised Premium	Average value of subsidy	Total potential Subsidy $m
Nil	6,617		$300	N/a	$300		
100 to 250	280	$60	$360	No	$360		
50 to 100	53	$500	$800	Most	$455	$345	$18m
20 to 50	64	$1,310	$1,610	All	$536	$1,074	$69m
<20	58	$4,180	$4,480	All	$823	$3,657	$212m
Total	**7,072**						**$299m**

Source: Adapted from Table 1. Note amounts are based on 2006 data.

The total level of the subsidy depends on the take-up of insurance. It is hard to imagine that households in the ‗<20 ARI' Band (average subsidy >$3,500) not taking out insurance and benefiting from the subsidy. However the experience from the US National Flood Insurance Program (NFIP) is that some households will not take out flood insurance despite subsidies. Michel-Kerjan, (2010, page 178) estimates that in the US, despite large subsidies, ‗perhaps half of residents living in floodplains do not have flood insurance'.

The extent to which the subsidy will increase the take-up of insurance depends on the current level of flood cover. Andrews et al. (2008) estimated (roughly) that around $100 million (i.e. 27%) of the $370 million flood risk cost was insured. It is difficult to translate this into numbers of households. If the rate of flood cover was constant across bands (i.e. at 27%) the number of households without flood cover that would be eligible for a subsidy would be around 127 thousand. However, it would be reasonable to assume that the rate of flood cover insurance is greater in the bands with the lower flood risk premium. A lower bound may be to assume the $100 million cover is drawn from a zero per cent level of flood insurance cover in the ‗ARI <20 Band' and equivalent proportions in the other flood risk bands (equal to 80%). In such a case, around 84 thousand households without flood cover would be eligible for a subsidy. As the penetration of flood insurance grows this number would fall.

If the program is successful in ensuring that all households receiving a subsidy take out flood cover, the cost of the program would be $299 million. The level of cross-subsidisation would need to be around $47 per insured household (estimated as 6.35 million households)[25] or around a 16 per cent increase on the average premium of $300.

The impact of the cross-subsidy on the demand for house insurance can be estimated using an estimate of the price elasticity of demand.[26] The demand for house insurance is inelastic but not zero. Tooth (2008) estimated the price elasticity of demand for house insurance for owner-occupied housing to be in the order of -0.1.[27] This estimate is based on variation in taxes (across jurisdictions and over time) on insurers and thus provides a useful basis for estimating how a cost imposed on insurers results in changes in demand.

Combining the analysis above, it is possible to estimate the extent to which the cross-subsidy would reduce the demand for house insurance. Applying the elasticity estimate (around -0.1), by the 16 per cent rate increase required across the 6.35 million insured households funding the subsidy provides an estimate of between 90 and 100 thousand less dwellings covered by home insurance (covering all risks).

Thus, if the insurance pool program was fully successful — in that all households who could receive a subsidy took out flood cover — then the number of households discouraged from taking out full house insurance cover due to the cross-subsidy required would be similar to the number of additional households taking out flood cover.

However, as demonstrated in the US experience, subsidised flood insurance does not result in full coverage. Even if the impact of the subsidy is small, the level of funding required may still be significant as the subsidy would be provided to existing policyholders of flood insurance. The implication is that unless the take-up in flood insurance due to the subsidy is very large, the impact will most likely be a reduction in the number of households covered by home insurance (for all risks) that is greater than the increase in the number of household covered for flood.

In summary, the likely impact of the flood insurance pool would be to decrease overall levels of insurance. Intuitively this is because:

[25] This is estimated as the 6.6 million households in non-flood zone areas less 4% to account for the number of uninsured households.

[26] The price elasticity refers to the responsiveness of demand to a change in price. A price elasticity of -.1 implies that a 10% increase in price will cause a 1% decrease in demand.

[27] Estimates varied depending on the specification used. The two main estimates were -0.062 and -.122 (average -0.091). Landry and Jahan-Parva (2008) estimate a higher elasticity.

- the subsidy is given to a small number of households, a number of whom would already be insured; and
- the subsidy is funded by a tax on a large number of households all of which are insured.

This indicative analysis highlights the risks of distorting the market for insurance. The following sub-section discusses further issues and complications.

3.2 Other considerations

In addition to the issues discussed above, there are other risks associated with the proposed regulation.

There are many administrative issues to consider. Inevitably there will be challenges, debates and costs associated with determining which properties should receive subsidies and how the funds will be recovered from other insurance policies. One issue will be how the insurance pool will interact with insurance-based taxes. For example, there is a risk that the subsidy does no more than offset the impact of state taxes.

An unintended consequence is that a subsidy on flood insurance in flood prone areas would reduce incentives to mitigate the flood risk exposure in those areas.

- Subsidies can dampen incentives to curb development in flood prone zones. While land development controls can control new development, it is more difficult to control the pace and type of redevelopment that occurs.[28]
- Subsidies can dampen incentives to undertake mitigation activities. For example, with subsidised flood insurance, householders have reduced incentive to make building changes that reduce the flood risk. Similarly, subsidising insurance can dampen community pressure for community based flood mitigation activities.

There are also other costs of regulatory intervention. These include the consequences of creating regulatory uncertainty and in particular the risk to investors that government intervention leads to further regulation. As summarised by Cummins (2006, page 371).

> *Several types of inefficiencies can arise from government insurance programs. Provision of subsidized insurance is likely to crowd out private attempts to enter the market, permanently locking in an inefficient solution to financing catastrophe losses. Government programs tend to develop constituencies that engage in intensive lobbying to maintain government support, strengthening concerns about rent-seeking by special interests. Subsidized insurance also tends to create moral hazard problems whereby policyholders under invest in loss prevention.*

[28] Kunreuther (2008) raises the concern that in the US, losses from natural disasters are increasing as a result of development in hazard prone areas.

4 Conclusion and Recommendations

The analysis above highlights some of the key issues associated with further Government regulation of insurance markets. The most efficient and least distortive methods for Governments to improve the availability and affordability of insurance are to:

- remove the taxes on insurance
- ensure that flood maps are available to insurers, so as they can price the insurance risk, and
- undertake community flood mitigation and promote household flood mitigation measures which lower the cost of flood risk.

It is also appropriate that Governments consider means to improving the transparency of the flood risk for communities and consumers developing in flood risk areas.

The price of insurance premiums provides an important signal that can help individuals and communities make decisions about development and risk management. Rather than distort this signal, a useful policy that would support the efficient working of insurance markets and management of flood risks, is to improve transparency of the flood risk through the insurance premium.

Understandably, Governments may consider that financial support to households in flood prone zones is appropriate where households invested without a clear understanding of the flood risk. If so, this support should be provided in a way so as not to distort decisions for the efficient management of risk or the efficient workings of insurance markets. If the primary purpose of the financial support is compensation, this may be most efficiently provided through a lump-sum amount that reflects the capitalised value of additional insurance premiums.

Governments may also consider financial support through subsidised insurance premiums as a means of encouraging greater take-up of flood insurance. While greater insurance coverage is desirable, this approach should be considered alongside other policies such as awareness campaigns that may provide a far greater return.

As has been discussed in Section 3 of this report, there are potentially significant unwanted consequences of using an insurance pool to provide financial support to subsidise insurance premiums. If insurance premiums are to be subsidised, then it is preferable funding is provided by government bodies that are best able to manage the flood risk through investment in flood mitigation activities. This would provide financial incentives for these bodies to undertake flood mitigation.

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Appendix 2

Household and Business Surveys

RESEARCH REPORT

HOME AND MOTOR VEHICLE INSURANCE: A SURVEY OF AUSTRALIAN HOUSEHOLDS

OCTOBER 2001

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CONTENTS

BACKGROUND AND OBJECTIVES

Earlier this year, a NIGL commissioned survey of small business operators estimated that close to half either did not have a relevant cover for their business or judged their existing cover inadequate. The main reason they gave for lacking adequate cover related to the cost of premiums.

The present research was commissioned to estimate the extent homes and passenger vehicles are left without insurance or are perceived to be inadequately insured.

A national survey of householders measured:

- Self-reported incidence of:
    - Home Buildings and Contents Insurance
    - Non-compulsory Motor Vehicle Insurance
- Reasons for non-insurance
- Impact of reducing cost of premiums on likelihood of taking out insurance
- Perceived adequacy of existing insurance cover with reasons
- Relevant classification variables

Topline results from the survey were presented on 25 October, 2001.

RESEARCH METHOD

A total of 1,212 telephone interviews conducted across the six States, the ACT and NT between 1 and 15 October, 2001.

- Interviews averaged 8 minutes in length.
- Householders aged 18 years and over randomly selected (using the "birthday rule") from randomly selected households.
- Broad quotas set for location, age and sex of respondent
- Interviews conducted and validated according to IQCA standards.

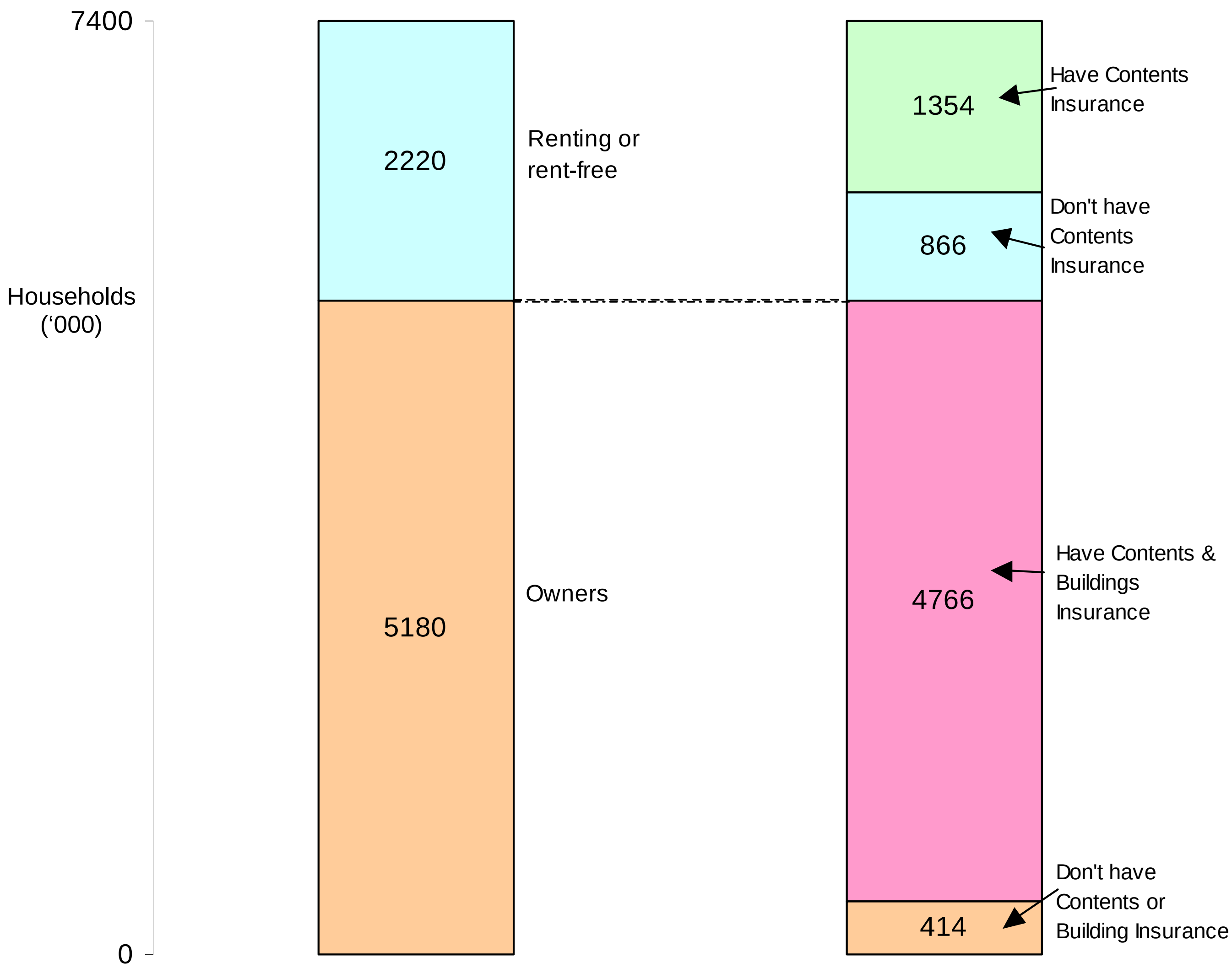
EXECUTIVE SUMMARY AND COMMENTARY

A national telephone survey of 1,212 households, conducted in October 2001, estimated the incidence of home and vehicle insurance as well as explored the issue of non-insurance and under-insurance.

From the survey, it is estimated that 8% of owner-occupied homes do not have Contents or Buildings Insurance (5% reportedly only have Buildings Insurance, 1% only have Contents Insurance, and 2% have neither). Australian Bureau of Statistics (ABS) data indicate there are now approximately 7.4 million homes in Australian of which 70% or 5.18 million are owner-occupied. Applying the survey result, an estimated 414,000 owner-occupied homes do not have Buildings or Contents Insurance.

It is further estimated that 39% of homes rented or occupied rent-free do not have Contents Insurance. This translates into approximately 866,000 homes. **In total, therefore, one in six of all homes do not have Buildings or Contents Insurance** (414,000 plus 866,000 homes as a percentage of the 7.4 million homes in Australia).

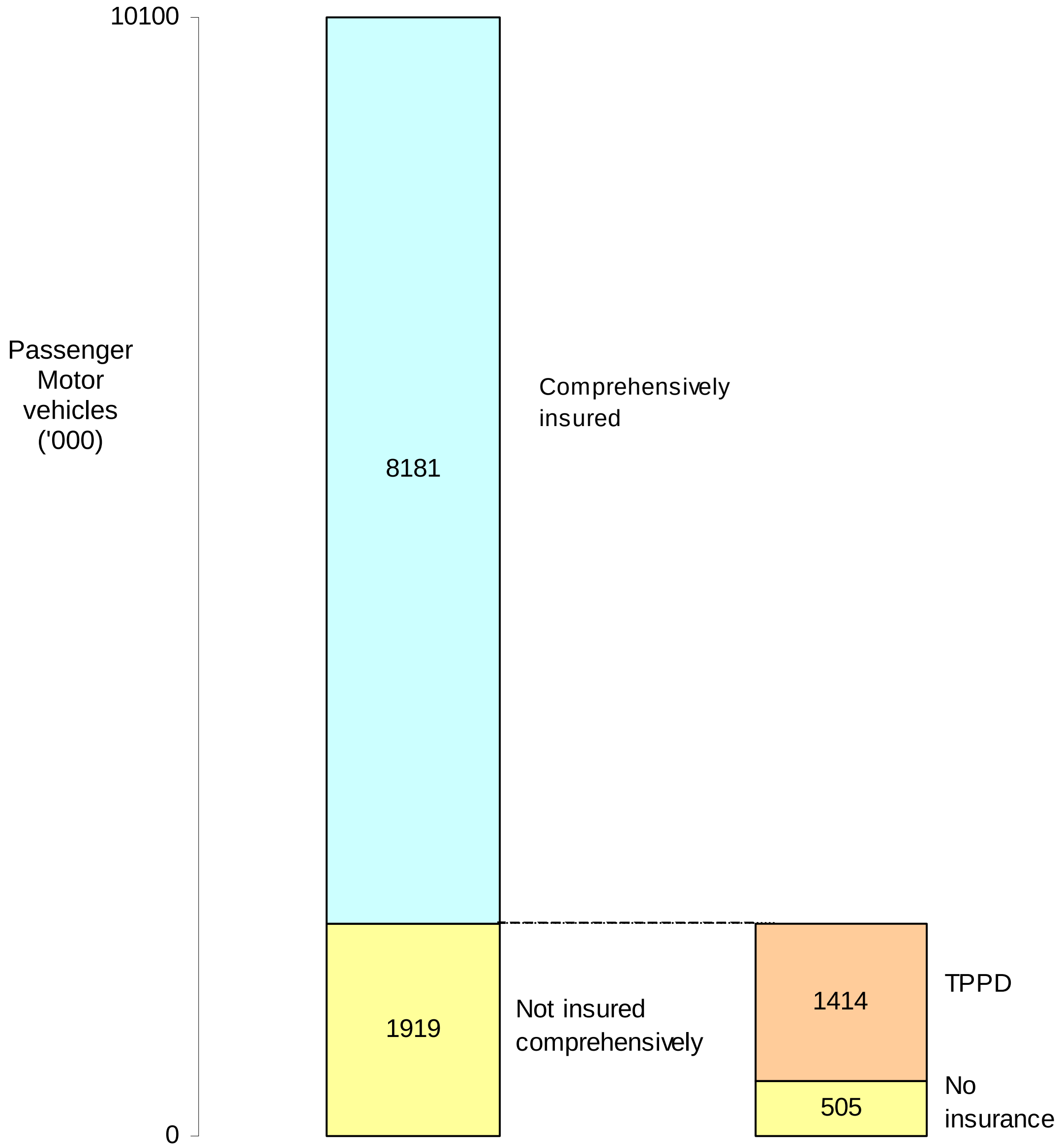
Base: Number of Households 2001 (from ABS data)



An estimated one in five passenger motor vehicles are not insured comprehensively: 14% have Third Party Property Damage (TPPD) and 5% do not have any non-compulsory insurance. These incidences, which vary significantly by State and household income, are also associated with passenger motor vehicle age. For example, one in three passenger motor vehicles in households earning less than $25,000 per year do not have Comprehensive Insurance and their age is well above the average.

There are just over 10 million registered passenger motor vehicles in Australia (from Motor Vehicle Census). Survey data therefore indicate that 1.9 million do not have Comprehensive Insurance of which 1.414 million have TPPD and just over half a million (.505 m) have neither Comprehensive nor TPPD Insurance.

Base: Number of Passenger Vehicles 2001 (from ABS data)



The most common explanation householders give for why their possessions are not covered by Contents Insurance relates to the cost of premiums. Similarly, the reason most frequently given by drivers for why their vehicles do not have Comprehensive Insurance or TPPD relates to the cost of premiums.

Survey data suggest that a substantial reduction in the cost of Contents Insurance would increase its incidence, particularly in homes which are not owner-occupied. They also suggest that a substantial reduction in the cost of vehicle insurance would raise its incidence. The young and drivers of older vehicles, in particular, are more likely to consider TPPD if they realise it has become more affordable.

Home Insurance

More than nine in ten homes (95%) are reported by their owners to have Buildings Insurance. The proportion does *not* vary significantly across Australian States or levels of household income. That Buildings Insurance is often required by lending institutions may partly explain its high incidence. It also suggests the large majority of owners recognise the importance of being protected in the event of such incidents as fire, water damage and theft.

The incidence of Home Contents Insurance is significantly less than that of Buildings Insurance. Even so, nine in ten home owners report having *both* forms of insurance. However, only 45% of householders who rent their home indicate they have Contents Insurance; and among those living rent-free, the self-reported incidence is 69%.

The following table shows that home owners in different States are always much more likely to have Contents Insurance than householders who are renting or living rent-free, although the difference is most pronounced in New South Wales.

	TYPE OF TENURE WITHIN STATE							
	NSW/ACT		VIC		QLD		SA/WA/ OTHER	
	Owned (292) %	Not Owned (134) %	Owned (208) %	Not Owned (94) %	Owned (159) %	Not Owned (61) %	Owned (196) %	Not Owned (63) %
Have Home Contents Insurance	89	43	95	49	94	56	93	73

While, averaged across type of tenure, four in five homes are reported to have Contents Insurance, the incidence is significantly lower among:

- Residents of flats or units (58%)
- Homes in NSW including the ACT (75%)
- Households with a total income $25,000 or less (71%)

The incidence of Contents Insurance remains high among home owners irrespective of their household income. This is not the case for homes which are tenanted or occupied rent-free where incidence rises with household income. This is clearly shown in the next table.

	TYPE OF TENURE WITHIN HOUSEHOLD INCOME							
	To $25,000		$25,001 to $50,000		$50,001 to $90,000		$90,001 +	
	Owned (159) %	Not Owned (81) %	Owned (249) %	Not Owned (98) %	Owned (209) %	Not Owned (76) %	Owned (129) %	Not Owned (53) %
Have Home Contents Insurance	89	37	93	47	95	67	94	70

Householders typically give one of four different reasons to account for why they do not have Home Contents Insurance. It is either considered too expensive or the contents of the home are not considered to be worth insuring. Less commonly, householders say they "*haven't gotten around to it*" or "*haven't thought about it*". Some judge the risk to their possessions so small as to not warrant insuring them.

Survey data suggest that a significant *reduction* in the cost of Home Contents Insurance would *increase* the incidence of homes with this form of cover. Two thirds of homes without Contents Insurance were judged to be *"a little more likely"* or *"much more likely"* to gain this form of insurance if its cost fell by 45%.

The large majority of householders are *"very confident"* or *"fairly confident"* they are adequately covered by their existing policy (91%); only 5% indicated they are either *"not very confident"* or *"not at all confident."* This result may be interpreted positively: in spite of economic uncertainties, consumers trust they are well protected by their policies and by their insurers. It may also be interpreted negatively: it may be a sign of complacency when the industry finds that a notable proportion of claimants are under-insured.

Lack of confidence in the adequacy of cover was explained in a number of ways. Some customers thought the policy would not adequately cover the loss (21% of the "unconfident") or believed the policy was out-of-date (6%). Customers also lacked confidence when they felt they did not understand the insurance policy (e.g. when it seemed ambiguous, 9%). Some lacked confidence because they did not trust their insurer (15%) or because they had a bad experience as a claimant in the past (15%).

Motor Vehicle Insurance

Almost nine in ten people aged 18 years and over drive a car or some other kind of passenger motor vehicle. The incidence of non-drivers is particularly high among:

- Residents of flats or units (30%)
- People living alone (24%)
- Householders with a combined income of $25,000 or less (24%)

Most drivers (again, nine in ten) use a vehicle which is owned either by themselves or by someone else in the household; the remainder typically drive a vehicle owned by their employer or business.

Four in five motor vehicles owned by householders are estimated to have Comprehensive Insurance (80%). The incidence of Comprehensive Insurance is highest in NSW/ACT (85%) which is where the average age of vehicles is relatively low. It is *higher* for vehicles driven by women than by men (84% vs 75%) and for vehicles of drivers well into adulthood (86% among those 35 years and over).

The incidence of Comprehensive Insurance is not significantly lower outside of the capital cities (78% -- however the proportion *may* be lower for vehicles owned by householders living outside of towns and semi-urban areas).

Of all passenger vehicles, 14% are only insured for Third Party Property Damage (TPPD) and 5% do not have any non-compulsory insurance.

The incidence of non-insurance is significantly higher among drivers who:

- Live in households with an income of $25,000 or less (10%)
- Live in Western Australia (10%)
- Live alone (9%)
- Are aged 18-34 years (9%)
- Are male (7%)

There is a strong association between age of vehicle and insurance cover. The average age of motor vehicles Comprehensively Insured was 7 years while those covered by Third Party Property Damage was 15 years. Vehicles without any non-compulsory insurance averaged 17 years.

Half of the drivers who have neither TPPD nor Comprehensive Insurance explain this by saying insurance is too expensive. Two thirds indicate the likelihood of their vehicle being covered would increase if the cost of insurance reduced by 20%.

Drivers who use a vehicle only insured for TPPD explain they do not have Comprehensive Insurance either because they consider it too expensive (38%) or because they do not believe the vehicle is worth this level of cover (41%). Around half indicate the vehicle would be more likely to have Comprehensive Insurance if the cost reduced by 20%.

Most householders are either *"very confident"* or *"fairly confident"* that the vehicle they drive is adequately covered (93%). While 5% of drivers of Comprehensively Insured vehicles are *"not very confident"* or *"not at all confident"*, one in five drivers of vehicles with only TPPD lack confidence in their cover. This is because those with TPPD believed their policy would not cover the total loss (37%).

Men and drivers from low income households were most likely to express a lack of confidence in their vehicle insurance because they were most likely to have only taken out TPPD rather than Comprehensive Insurance. There were no other significant subgroup differences on this measure.

Among the Comprehensively Insured, the most common explanation for lacking confidence in the adequacy of cover related to previous unsatisfactory experiences claiming on insurance (34%). Some also indicated their Comprehensive Policy would not cover them for their total loss (20%). They may have felt the agreed value was too low or perhaps counted the excess they would pay as a "loss".

RESULTS IN DETAIL

DESCRIPTION OF SAMPLE
Respondents By Location

Number of Interviews		LOCATION					
Gender & Age	**Total**	**NSW/ ACT**	**VIC**	**QLD**	**SA**	**WA**	**OTHER**
Men	578	196	142	110	49	58	23
Women	634	233	160	110	48	59	24
18-34	406	144	102	75	30	41	14
35-54	464	163	113	86	37	46	19
55+	342	122	87	59	30	30	14
Total	1212	429	302	220	97	117	47

DESCRIPTION OF SAMPLE
Household and Dwelling Characteristics

Base: Total Sample (N = 1,212)

Number of People in Household	%
1	17
2	33
3	19
4	19
5+	12

Number of Registered Motor Vehicles in Household	%
None	6
1	35
2	41
3	13
4+	6

Household Income	%
$25,000 or less	20
Over $25,000 up to $50,000	29
Over $50,000 up to $90,000	24
Over $90,000 up to $150,000	11
Over 150,000	4
Refusal/Can't say	12

DESCRIPTION OF SAMPLE
Household and Dwelling Characteristics

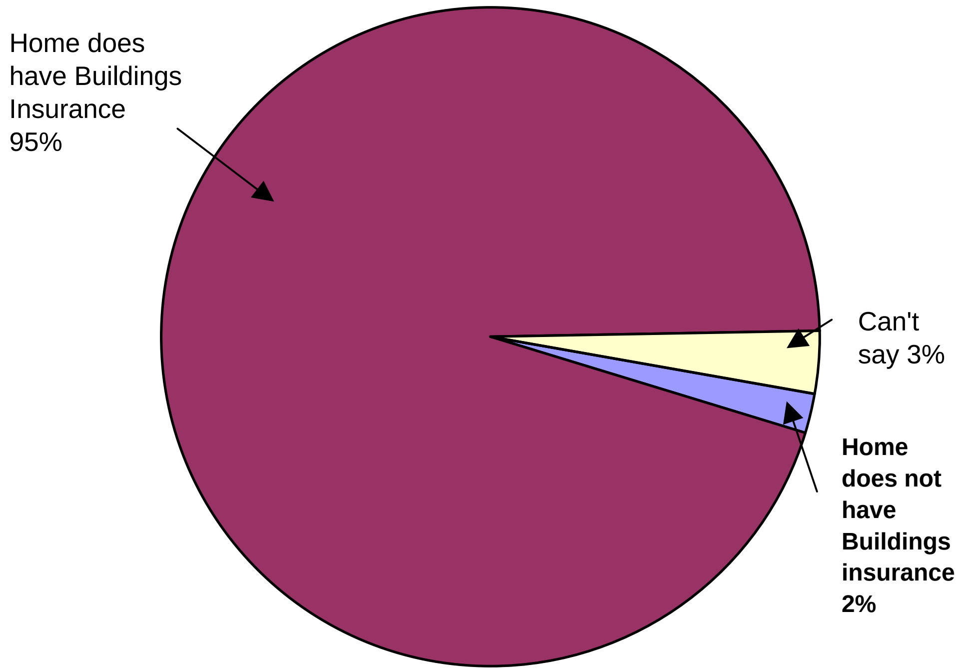
Tenure Type	**%**
Own home outright	40
Paying off home	30
Renting	20
Rent free	9
Refused	1

Dwelling Structure	%
Separate House	78
Apartment/Flat/Unit	14
Terrace house/Semi/Townhouse	7
Other	1

SELF-REPORTED INCIDENCE OF HOME BUILDINGS INSURANCE

Q. Home Buildings Insurance usually covers your home and all the fittings and fixtures in it. Is your home covered by Buildings Insurance?

Base: Homes owned outright or being paid off. (N = 855)



	Location					
	NSW (292) %	**Vic (208) %**	**Qld (159) %**	**SA (78) %**	**WA (83) %**	**Other (35) %**
Home has Buildings Insurance	93	97	96	92	99	94

	Income				
	≤$25,000 (159) %	**$25,001 to $50,000 (249) %**	**$50,001 to $90,000 (209) %**	**$90,001 to $150,000 (94) %**	**Over $150,000 (34) %**
Home has Buildings Insurance	93	97	98	94	94

SELF-REPORTED INCIDENCE OF HOME BUILDINGS AND CONTENTS INSURANCE

Q. Home Buildings Insurance usually covers your home and all the fittings and fixtures in it. Is your home covered by Buildings Insurance?

Q. Home Contents Insurance usually covers loss or damage to your furniture, furnishings, domestic appliances and so . Are the contents of your home covered by insurance? In other words, do you have Contents Insurance?

Base: Homes owned outright or being paid for.

		Dwelling Type		
	Total (855) %	**Separate House (726) %**	**Flats/Unit (69) %**	**Terrace/ Townhouse/ Semi (55) %**
Have **both** Buildings and Contents Insurance	90	92	75	85
Have **only** Buildings Insurance	5	5	7	11
Have **only** Contents Insurance	1	1	6	-
Have **neither** Buildings **nor** Contents Insurance	2	1	1	4
Can't Say (either Buildings or Contents)	2	1	11	-

SELF-REPORTED INCIDENCE OF HOME CONTENTS INSURANCE

Q. Home Contents Insurance usually covers loss or damage to your furniture, furnishings, domestic appliances and so . Are the contents of your home covered by insurance? In other words, do you have Contents Insurance?

Base: Total households (N=1,212).

	Type of Dwelling (N= 1,212)			
	Total (1,212) %	Separate House (948) %	Flats/ Units (168) %	Terrace/ Townhouse/ Semi (87) %
Home has Contents Insurance	81	86	58	72
Home does **not** have Home Contents Insurance	16	11	38	24
Can't say	3	3	4	4

	Tenure Type			
	Total (1,212) %	Owner with or without a mortgage (855) %	Renter (244) %	Rent-free (108) %
Home has Contents Insurance	81	93	45	69
Home does **not** have Home Contents Insurance	16	7	52	11
Can't say	3	1	3	20

SELF-REPORTED INCIDENCE OF HOME CONTENTS INSURANCE

Q. *Home Contents Insurance usually covers loss or damage to your furniture, furnishings, domestic appliances and so . Are the contents of your home covered by insurance? In other words, do you have Contents Insurance?*

Base: Total households (N=1,212).

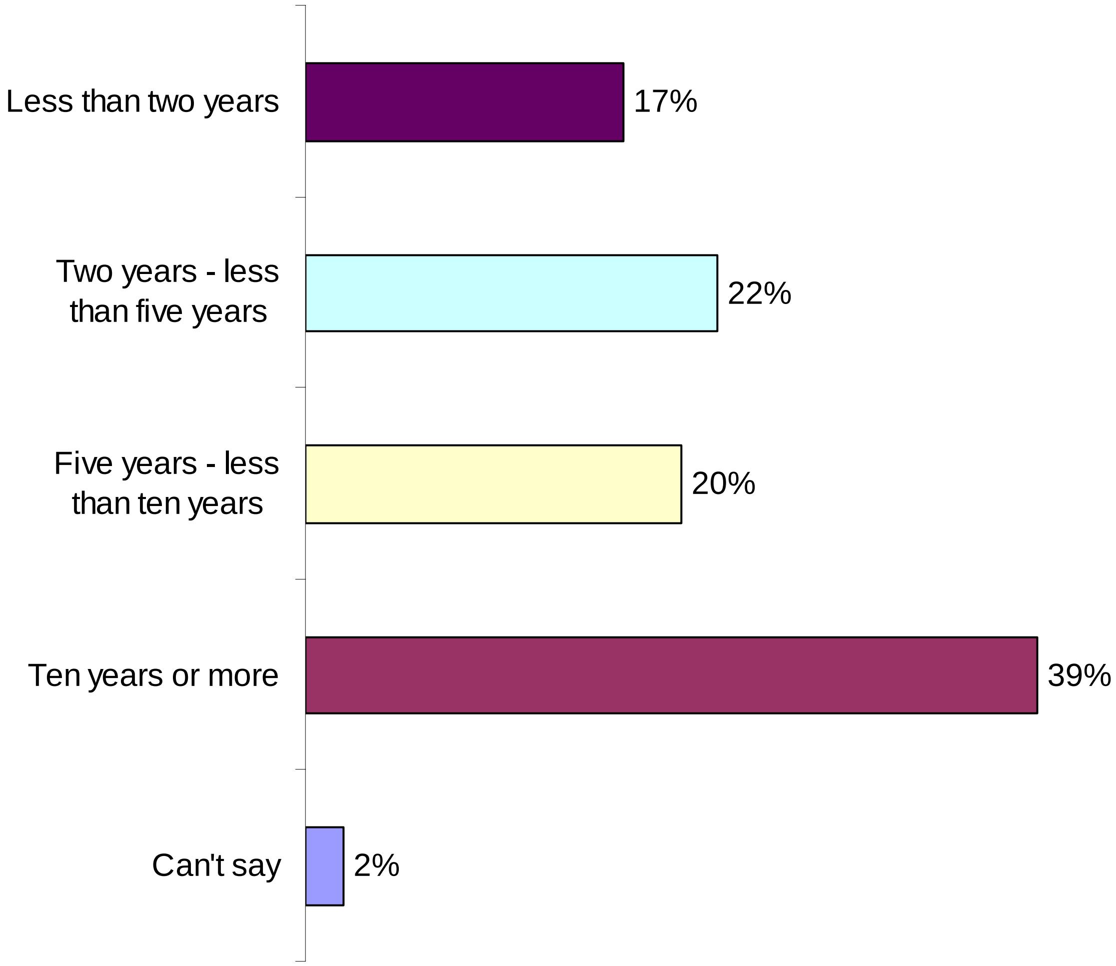
			LOCATION				
	Total (1212) %	**NSW/ACT (429) %**	**VIC (302) %**	**QLD (220) %**	**SA (97) %**	**WA (117) %**	**OTHER (47) %**
Home has Contents Insurance	81	75	81	83	90	85	96
Home does not have Contents Insurance	16	20	16	15	8	15	4
Can't say	3	5	3	2	2	-	-

			HOUSEHOLD INCOME			
	Total (1212) %	**To $25,000 (241) %**	**$25,001 to $50,000 (347) %**	**$50,001 to $90,000 (286) %**	**$90,001 to $150,000 (136) %**	**Over $150,000 (46) %**
Home has Contents Insurance	81	71	80	88	89	80
Home does not have Contents Insurance	16	26	18	10	10	15
Can't say	3	3	2	2	1	5

LENGTH OF TIME COVERED BY CONTENTS INSURANCE

Q. For how long have you had your Home Contents Insurance Policy at your current address?

Base: Homes with Contents Insurance (N=980)



Policy held for 10+ years more often by:

- Householders aged 55+ (65%)
- Living in a separate house (43%)
- Own their home outright (60%)
- Household income $25,000 or less (48%)

REASONS FOR <u>NOT</u> HAVING BUILDING AND CONTENTS INSURANCE

Q. Why is it that your home does not have (type of insurance)?

Base: Homes without Buildings or Contents Insurance.

	Total (227) %
Have rented, not owned	23
Insurance is too expensive (e.g. costs too much, can't afford premiums)	22
Contents are not worth insuring	19
Haven't got round to it, not thought about it	19
Small risk (e.g. I live in a safe area, I'm often at home, I've taken security measures)	8
Choose to carry risk myself	4
Living in Housing Commission	3
Don't believe in insurance	3
Other/Can't say	11

REPORTED IMPACT OF REDUCING HOME INSURANCE COSTS

Q. By reducing government taxes, the cost of Home Buildings and Contents Insurance could be reduced by between 20% and 45%. If the cost of Home Buildings and Contents Insurance did fall by 45%, would you say your home would be much more likely, a little more likely or no more likely to have (type of insurance)?

Base: Homes without Buildings or Contents Insurance.

	Total (227) %	Have Buildings but not Contents Insurance (63) %
Insurance much more likely	30	30
Insurance a little more likely	30	38
Insurance no more likely	40	32

DEGREE OF CONFIDENCE IN ADEQUACY OF HOME INSURANCE

Q. *I'd like you to imagine you're lodging a claim on your (type of insurance). How confident are you that you are adequately covered by your existing policy? Would you say your are….(read out)… that you're adequately covered?*

Base: Households with Home Insurance

	Total (1047) %
Very confident	47
Fairly confident	44
Not very confident	4
Not at all confident	1
Can't say	4

REASONS FOR LACK OF CONFIDENCE IN ADEQUACY OF HOME INSURANCE

Q. What makes you say that (you are not very or not at all confident)?

Base: Not very or not at all confident with adequacy of home insurance cover.

	Total (53) %
Policy would not cover total loss	21
Made a claim before and (payment) (replacement) (repair) was inadequate	15
Don't trust insurance companies (argue claims, loopholes in contract, hidden agenda)	15
Don't understand insurance, not enough information, policy ambiguous	9
Want to avoid paying higher premiums for adequate cover	8
Policy out of date, have not reviewed it recently	6
Other	28
Don't know	2

SELF-REPORTED INCIDENCE OF
NON-COMPULSORY MOTOR VEHICLE INSURANCE

Q. Do you, yourself, drive a car or some other passenger vehicle?

Q. Is the vehicle owned or being paid off by yourself or someone else in the household?

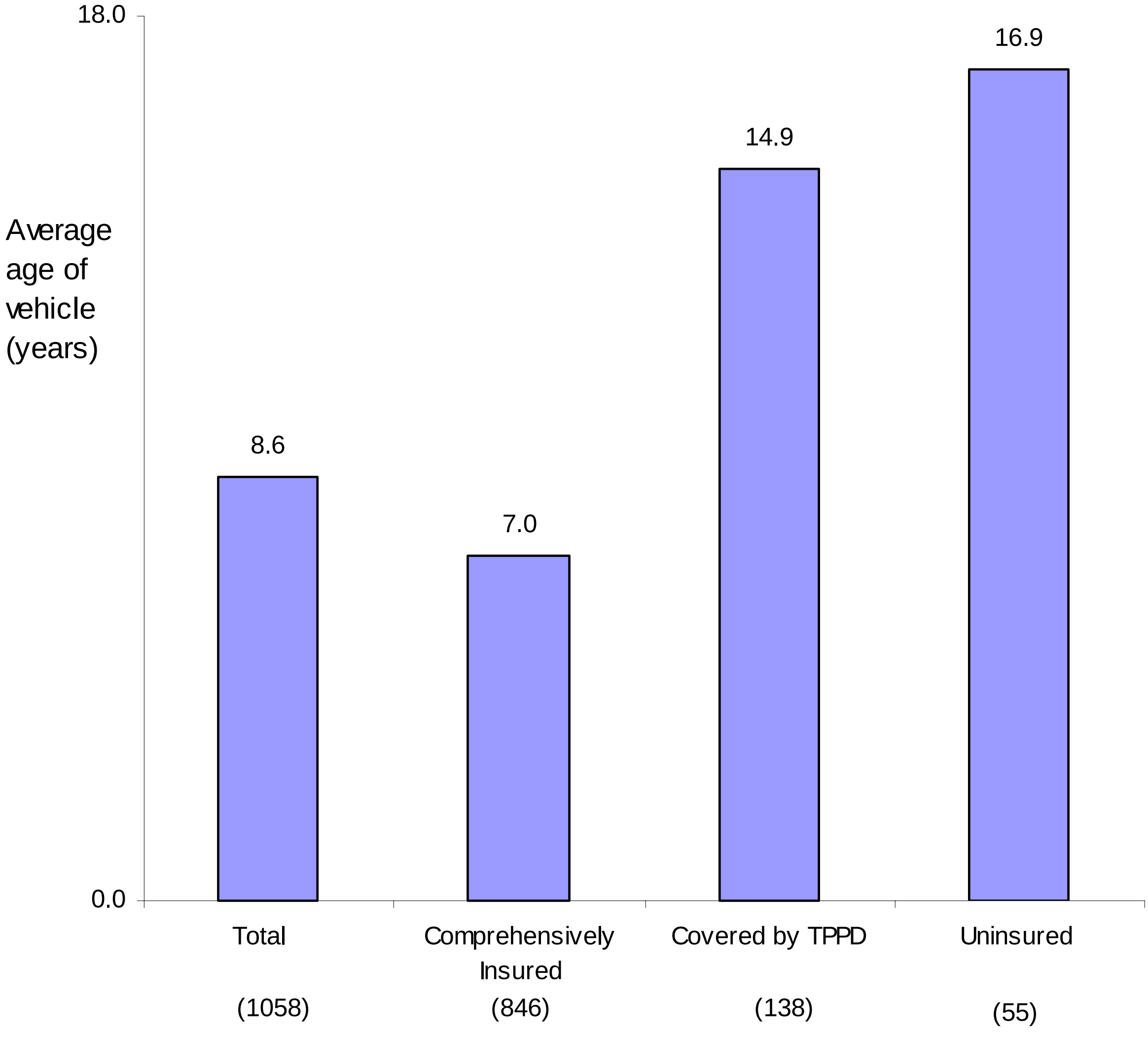
Q. Apart from CTP or Compulsory Third Party Insurance ("Green Slip" in NSW), does the vehicle you (mainly) drive have Comprehensive Insurance or is it only insured for Third Party Property Damage?

Base: Total Respondents.

	(N= 1,212) **%**
Householder owned vehicle:	
Has neither TPPD nor Comprehensive Insurance	4
Comprehensively insured	63
Has TPPD	11
Vehicle (mainly) driven not householder owned	8
Don't drive	13
Can't say	1

NON-COMPULSORY MOTOR VEHICLE INSURANCE
BY AGE OF MOTOR VEHICLE

Base: Drivers of passenger vehicles



SELF-REPORTED INCIDENCE OF NON-COMPULSORY MOTOR VEHICLE INSURANCE

Base: Drivers of passenger vehicles belonging to household

		Income				
	Total (963) %	**≤$25,000 (170) %**	**$25,0001 to $50,000 (286) %**	**$50,001 to $90,000 (238) %**	**$90,001 to $150,000 (117) %**	**Over $150,000 (38) %**
Comprehensive Insurance	80	68	78	87	86	84
TPPD	14	21	14	10	9	11
Neither	5	11	7	2	4	3
Can't Say	1	-	1	1	1	2

		Location				
	Total (963) %	**NSW/ACT (300) %**	**VIC (243) %**	**QLD (200) %**	**SA/NT (78) %**	**WA (99) %**
Comprehensive	80	85	78	75	79	73
TPPD	14	12	12	20	14	12
Neither	5	2	7	5	6	11
Can't Say	1	1	3	-	1	4

REASONS FOR NOT HAVING MOTOR VEHICLE INSURANCE

Q. Why is it that the vehicle you (mainly) drive does not have (type of insurance)?

Base: Drivers who don't have particular vehicle insurance.

	Why Don't Have Any Non-Compulsory Vehicle Insurance (55) %	**Why Don't Have Comprehensive Insurance (138) %**
Insurance is too expensive, (e.g. costs too much, can't afford premiums)	47	38
Vehicle is not worth Comprehensive Insurance	20	41
Haven't got around to it yet, not thought about it	9	4
Small Risk (e.g. I'm a careful driver, I live in a safe area, I don't drive much)	7	6
Choose to carry the risk myself	2	3
Don't believe in insurance	7	1
They won't insure me, won't insure my vehicle	1	1
Other	5	7
Don't know	2	4

REPORTED IMPACT OF REDUCING MOTOR VEHICLE INSURANCE COST

Q. *By reducing government taxes, the cost of car insurance could be reduced by as much as 20%. If the cost of car insurance did fall by 20%, would you say the vehicle you drive would be much more likely, a little more likely, or no more likely to be insured (type of insurance)?*

Base: *Drivers of passenger vehicles without Comprehensive Insurance.*

	Total without Comprehensive Insurance (193) %	**Don't have Any Non-Compulsory Insurance (55) %**	**Don't have Comprehensive Insurance (138) %**
Insurance much more likely	26	38	21
Insurance a little more likely	31	29	32
Insurance no more likely	43	33	47

DEGREE OF CONFIDENCE IN ADEQUACY OF MOTOR VEHICLE INSURANCE

Q. I'd like you to imagine you are lodging an insurance claim on your (vehicle) policy. How confident are you that you're adequately covered by your existing policy? Would you say you're [read out….] that you're adequately covered?

Base: Drivers with Non-Compulsory Vehicle Insurance.

	Total (984) %	**Have Comprehensive Insurance (846) %**	**Have TPPD (138) %**
Very Confident	55	59	33
Fairly Confident	38	36	46
Not Very Confident	6	4	17
Not at all Confident	1	1	4

REASONS FOR LACK OF CONFIDENCE IN ADEQUACY OF MOTOR VEHICLE INSURANCE

Q. What makes you say that (you are not very, or not at all confident)?

Base: Drivers with Non-Compulsory Vehicle Insurance who are not confident of their cover.

	Total (65) %	Have Comprehensive Insurance (35) %	Have TPPD (30) %
Policy would not cover total loss	28	20	37
Made a claim before and (payment) (replacement) (repair) was inadequate	25	34	13
Don't trust insurance companies (argue claims, loopholes in contract, hidden agenda)	8	11	3
Want to avoid paying higher premium for adequate cover	6	-	13
Don't understand insurance, not enough information, policy ambiguous	5	6	3
Policy out of date, have not reviewed it recently	5	3	7
Other	17	23	10
Don't know	8	3	13

RESEARCH REPORT

BUSINESS INSURANCE:
A NATIONAL SURVEY OF SMALL AND MEDIUM SIZE BUSINESSES

JULY 2001

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CONTENTS

BACKGROUND AND OBJECTIVES

There is anecdotal evidence that many small businesses in Australia are inadequately insured. In some cases they may not be covered by appropriate *kinds* of insurance, or else the *value* of their cover may be inadequate.

Owners and managers are often so tied up in the day-to-day running of their businesses (not to mention financial matters such as taxation), that the need to review insurance can be unrecognised or postponed indefinitely. Yet, without adequate insurance, businesses may be left unprotected from adverse events which have the potential to cause serious losses and disruption.

NIGL offers a range of commercial products, including "EasyBiz", an off-the-shelf package for small business owners and tradespersons. A suggested strategy for NIGL to raise its profile among small businesses is for it to highlight the extent and risks of underinsurance and to forge links with professionals who advise businesses on insurance. Part of this strategy involves collecting up-to-date, reliable data on underinsurance and related issues. Accordingly, NIGL commissioned research to determine:

- Type of insurance cover currently held by businesses in the target market
- Incidence and profile of businesses considered to be adequately covered, partially covered, and not covered at all by insurance

- Reasons for underinsurance or non-insurance
- When businesses consider or review their insurance
- Sources of information and advice about insurance businesses use

It is intended that results from the research provide a better understanding of the business insurance market and that they be reported to a wider audience through a professional association such as Certified Practising Accountants (CPA) and the Insurance Council of Australia (ICA).

RESEARCH METHOD

A total of 1,253 telephone interviews conducted across five mainland States and the ACT between 1 and 19 June, 2001.

- Computer aided telephone interviews (CATI) averaged 10 minutes in length.
- Sampling frame provided by Dun and Bradstreet of businesses employing up to 50 people
- Respondent nominated as the person responsible for making decisions about insurance
- Quotas set by location and industry type
- Results post-weighted to population of businesses by location, industry type and size (number of employees)
- Interviews conducted and validated according to IQCA standards.

Number of Interviews	**Location**						
Industry	NSW	ACT	VIC	QLD	SA	WA	TOTAL
Manufacturing	27	5	30	14	16	8	100
Construction	49	12	37	53	19	39	209
Wholesale	30	2	19	12	5	8	76
Retail	55	10	56	26	32	21	200
Property & Business Services	69	24	59	33	36	31	252
Other services	100	47	68	51	31	28	325
Other	21	1	31	11	11	16	91
Total	351	101	300	200	150	151	1,253

EXECUTIVE SUMMARY AND COMMENTARY

A survey of businesses employing up to 50 people was conducted in the five Australian mainland States and the ACT. Its objective was to estimate the extent to which these businesses may be underinsured and to provide information about the market for business insurance.

Survey results indicate that, while the large majority of businesses have some form of insurance, close to half either do not have a relevant cover or have a cover which is judged inadequate. Micro-businesses are most likely to report being underinsured in this manner.

The question an insurer should ask prospective business customers is not "Are you insured?" but "Are you *properly* insured?" The typical business may be covered for numerous adverse events, but the chances are that the operator will still feel vulnerable because an important cover is missing or an existing cover looks as if it might be inadequate. Operators are prepared to tolerate a degree of uncertainty or vulnerability often because they consider insurance premiums to be expensive and are loathe to spend more on insurance.

Among the majority of businesses, it is the broker who is the most important source of information about insurance and whose recommendation is crucial in determining which insurer's policy is used. This is true across all States. In this market, it is therefore crucial that NRMA Insurance understands the important role played by brokers and forges a good relationship with them.

Incidence of Business Insurance

The survey provides two measures of the incidence of business insurance. One measure simply asks operators whether, excluding Workers Compensation or WorkCover, their business has some form of insurance. The large majority of small and medium size businesses are reported to have *some form* of insurance cover.

Nine in ten operators of microbusinesses claim they have some insurance; the proportion of larger businesses with some form of cover is closer to 98%.

A second measure was derived from asking operators, for each of seven adverse events, whether the business is covered or not. If they are covered against *at least one* of the seven events, then they are classified as holding business insurance. By this measure, an estimated 98% of businesses hold some form of insurance.

There are differences in the incidence of insurance by industry. Businesses in the construction industry are most likely to have insurance while those offering property and business services are least likely to have any (98% vs 82% on the first measure, 100% vs 95% on the second measure).

Interstate differences on these measures are not significant.

Extent and Nature of Cover

On average, businesses reported having 5.2 out of 7 basic forms of cover. Businesses in construction held, on average, more forms of cover than those offering business or property services (5.7 vs 4.8 out of the 7 basic covers). Micro-businesses held significantly fewer forms of cover than other small and medium size businesses (5.1 vs 5.8 out of 7 basic covers).

Almost one quarter of all businesses (23%) had all 7 forms of cover; another quarter (26%) had fewer than 5 forms of cover. Microbusinesses and those offering property and business services were most likely to belong to this latter group.

Overall, cover for damage to buildings, contents and stock due to various defined events was the most common – held by 85% of businesses. Cover for loss of profit due to these same events was the least common – held by 56% of businesses.

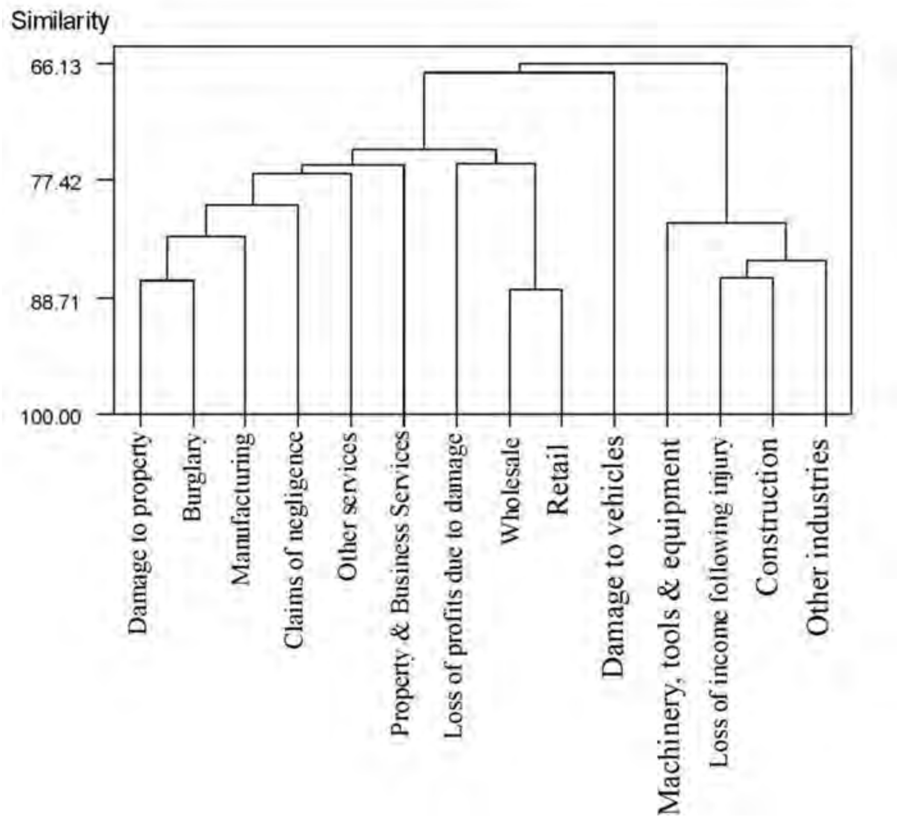
Businesses differ in the kinds of cover they hold. Manufacturing tended to be linked to cover for damage to property or from burglary. Wholesalers and Retailers were distinctively associated with cover for loss of profit or costs due to damage to property from defined adverse events (72% and 73%, respectively).

Construction businesses were distinctively linked to:

- damage to machinery, tools or equipment (82%)

- loss of income following injury or illness not covered by Workers Compensation (77%).

Some of these relationships between insurance cover and industry are shown in the following dendogram.



The Issue of Business Underinsurance

A business may be underinsured because its existing cover is inadequate or if it is not covered for a significant risk for which insurance is available. The survey examined each of these types of underinsurance.

For each form of cover held, operators were asked whether they believed the business was adequately insured or not. Results indicate that for each kind of cover, a small proportion of operators felt their policy was inadequate. For example, 6% of the 60% (i.e. one in ten) of businesses covered for loss of income following injury or illness (excluding Workers Compensation) believed they were not adequately covered.

In total, almost one in five (18%) businesses were reported to have some form of inadequate cover. Of course, this is the operator’s perception and it may be at variance, for example, with the opinion of brokers or insurers. Some may believe they are adequately insured when they are not.

By far the most common reason for being inadequately insured was the perception that premiums are expensive and that the business wanted to avoid paying any more for them (31%). Some respondents bluntly said they could not afford to pay any more for insurance (5%). Others felt they could not be sure of the adequacy of their cover until they actually made a claim (7%).

Where businesses did not hold a basic form of cover, operators were asked whether they believed it would be applicable to their business or not. For example, commercial vehicle insurance would not be applicable if no vehicles were used in the business.

Results show that a proportion of businesses do not have various forms of cover even where these are judged to be applicable. For example, 18% of businesses were not covered for loss of income following injury or illness (not covered by Workers Compensation), even though the cover was judged to be applicable. In other words, for 45% of businesses without the cover, insuring against this risk was still seen as relevant.

In total, more than one in three (37%) businesses missed a basic form of applicable cover. Again, the most common reason for not being more comprehensively insured related to the cost of premiums (39%). Some said they had not had the time to arrange it (11%); others simply had not thought about it (9%).

Business Operators' First Thoughts about Insurance

When business operators start to think about insurance, their thoughts usually fall into one or more of three categories:

1. *The salience of particular kinds of cover.* Public liability (28%) is most commonly mentioned, especially by businesses in the construction industry (42%).

   Businesses do vary by industry on their likelihood of spontaneously mentioning specific covers. Retailers are more likely than others to be concerned about protection from theft. Wholesalers think about product liability and insuring goods in transit. Manufacturers are more likely concerned about insuring property and stock as well as their workers. Those offering property and business services are more likely to think about professional indemnity.

2. *The need to have business insurance.* Many operators recognise that insurance is necessary to protect business and help manage risks which could deal it a crippling or fatal blow. It also offers

"peace of mind"-- less worry about events or situations which are beyond the operator's control:

> *"I wouldn't like to take any risks"*
>
> *"You can't go into business without it"*
>
> *"Thank goodness we have it in case the worst happens"*

3. *Important issues connected with business insurance.* Businesses often feel premiums are expensive and therefore want to control the cost of insurance. They also want to ensure they are comprehensively covered. To strike the right balance, they often deal with insurance brokers. Perhaps prompted by the HIH collapse, some are concerned about whether or not their insurers would pay when they come to make a claim; they mention the importance of dealing with a reliable, financially secure company.

Buying and Reviewing Business Insurance

For many businesses, insurance is not a matter of choice but of necessity. Asked why the business decided to take out insurance for the first time, the most common response was that this was just "good practice", "sensible", a matter of "commonsense".

Insurance was often also seen to be a *requirement*. It was required by:

- the industry in which the business operated

- the stakeholders in the business
- the customers or clients themselves

A small percentage of operators (3%) took out insurance because they had previously been “burnt” by an adverse event for which they had not been covered.

The large majority of businesses with insurance had reviewed their cover in the 12 months prior to the survey (87%). One third reviewed it as part of their standard annual business review (this practice was more common among medium size businesses – 46%); another third reviewed it when their insurance needed to be renewed. Other important triggers for review included bringing the insurance in-line with significant changes in the business, itself, or wanting to check on how competitive currently held policies were (in other words, they were triggered by a desire to shop around).

Almost half (44%) of the small minority of operators who, at first, reported their business had no insurance, considered it in the 12 months prior to the interview. Those who had *never* considered insurance were either one-person operations who considered themselves or the risks too small to warrant insurance, or they were businesses close to start-up who had given priority to other matters and perhaps had been willing, in the initial period, to take some risks.

Sources of Information and Purchase Channels

The majority of businesses when they need information or advice turn to a broker (66%) rather than to an insurance company (19%) or accountant (6%). Among medium size businesses, the broker is even more likely to be consulted (86%). In this respect, the market is obviously very different to that of home or car insurance.

The importance of the insurance broker is further underscored by the fact that three in four businesses had bought their insurance through a broker rather than direct from an insurance company (23%). Again, medium size businesses were even more likely to have dealt with a broker (91%). In the large majority of these cases, the businesses reportedly accepted the recommendation of the broker to use a particular insurer.

In buying cover directly from an insurer, businesses show a preference for dealing with a mobile consultant (62%). This is understandable given that many operators work long hours and often find it difficult to get away to conduct business elsewhere. It may also be the case that business insurance, because it can be complex, is better explained face-to-face than through a less personal medium. At any rate, a much smaller proportion (25%) stated a preference for making a phone purchase. Visiting the insurer's branches or Internet site were relatively unpopular options preferred by 6% and 8% of businesses, respectively.

SAMPLE VERBATIMS: FIRST THOUGHTS ABOUT BUSINESS INSURANCE

“Where can I get it cheaper? It is expensive. Complicated booklets of information to fill in …for insurance. Some are irrelevant.”

“I’m not sure. My broker handles that. I trust him.”

“Workers comp. Motor vehicle for reps. Theft re warehouse.”

“It’s a hassle to organise it….keeping up-to-date.”

“A safeguard - if there is a problem, the insurance covers it.”

“I need to know that I can cover my expenses if anything goes wrong. I’ll also go with a company I can trust. I’ll only change if I’m not happy”.

“Probably the most important is the company we are insuring with is not going to go bankrupt as well as a reliable policy”.

“Peace of mind. Public liability is a big one and you need that. It is a necessary evil. The companies question everything when you claim. [You] never want to claim.”

“It gives us a safety net. We have to have professional indemnity and liability and everything. We have vehicles as well. If something happened….we do a lot of travelling.”

RESULTS IN DETAIL

SELF-REPORTED INCIDENCE OF BUSINESS INSURANCE

Q. Apart from Workers Compensation does (name of business) have some form of business insurance?

Base: Total sample

- Incidence significantly higher among businesses employing 5 or more people. (98%)
- Relatively low incidence amount businesses offering property and business services (82%)

INCIDENCE, ON PROMPTING, OF SPECIFIC TYPES OF COVER

Q. Are you covered for…………?	(n=1,253)
Damage to buildings, contents, or stock due to fire or other events such as storm, explosion, vehicle impact or vandalism	85%
Claims of negligence against you involving injury or property damage	84%
Damage or losses from burglary	82%
Damage to vehicles used in the business	81%
Damage to machinery, tools or equipment used in the business	63%
Loss of profit due to damage from fire or other defined events	56%
Loss of income following injury or illness not covered by Workers Compensation	60%
Hold none of the above covers	2%
Mean number of seven covers held	5.2

ADEQUACY OF COVER

Q. Do you believe in the event…you would be adequately covered or not?

Base: Total sample	**Total with cover %**	**Adequately covered %**	**Inadequately covered %**
Damage to buildings, contents, or stock due to fire or other events such as storm, explosion, vehicle impact or vandalism	85	82	3
Claims of negligence against you involving injury or property damage	84	82	2
Damage or losses from burglary	82	77	5
Damage to vehicles used in the business	81	80	1
Damage to machinery, tools or equipment used in the business	63	59	4
Loss of income following injury or illness not covered by Workers Compensation	60	54	6
Loss of profit due to damage from fire or other defined events	56	53	3

MAIN REASONS WHY INADEQUATELY INSURED

Base: Businesses inadequately insured on one or more of seven covers	
Want to avoid paying higher premiums; premiums are high	31%
Insurance company can’t totally cover the loss; replacement cost would be too high	10%
Received poor advice	7%
I believe you can never be adequately insured; can’t know if you’re covered till something happens	7%
Have not reviewed insurance situation recently	6%
I can’t afford to pay more for insurance; you can only pay what you can afford	5%
I’m not sure of our position	5%
I have made a claim in the past and it was disputed; I felt ripped off	4%
Plan to look into it soon; we’re addressing the situation	3%
I pay what I feel is necessary relative to what I can afford; insurance must be cost-effective	3%

APPLICABILITY OF COVER

Q. Apart from whether you think insurance might be worthwhile, is being covered for ……applicable to the business?

Base: Total sample	Total not covered %	Cover judged to be…… Applicable %	Not applicable %
Damage to buildings, contents, or stock due to fire or other events such as storm, explosion, vehicle impact or vandalism	15	3	12
Claims of negligence against you involving injury or property damage	16	5	11
Damage or losses from burglary	18	8	10
Damage to vehicles used in the business	19	1	18
Damage to machinery, tools or equipment used in the business	37	6	31
Loss of income following injury or illness not covered by Workers Compensation	40	18	22
Loss of profit due to damage from fire or other defined events	44	16	28

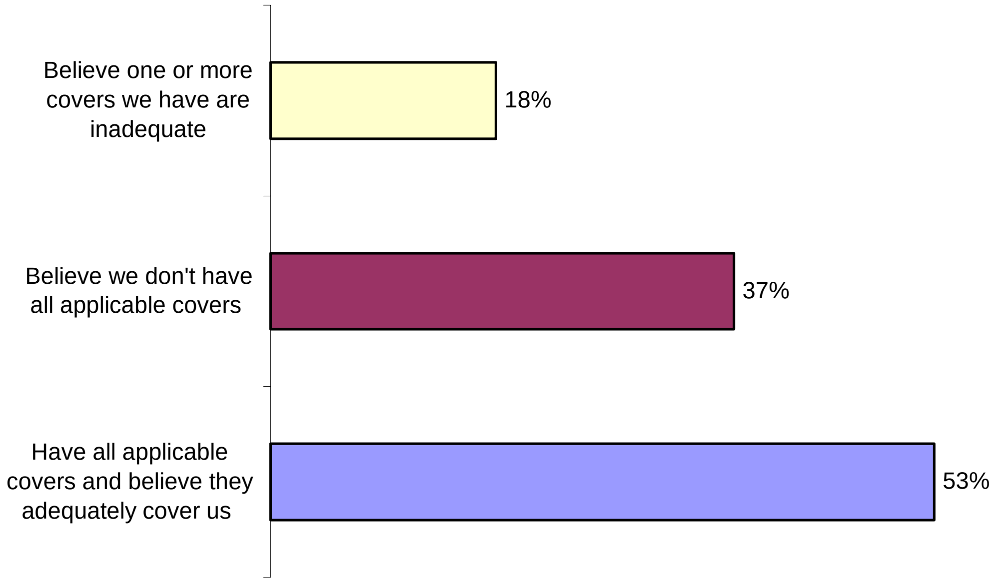
MAIN REASONS WHY NOT COVERED BY AN APPLICABLE INSURANCE

Base: Businesses not covered by an applicable insurance

Too expensive, premiums cost too much	39%
Not enough time to arrange it	11%
I'm not sure if we're covered for that or not; we may be covered, I'd have to check the policy	8%
I didn't think of it; hadn't thought about it before	9%
The risk of it happening is low; too low to justify the cost	8%
Could not find appropriate cover	8%
We are looking into it now; in near future	2%
Don't trust insurance companies	2%

PERCEIVED POSITION ACROSS SEVEN BASIC COVERS

Base: Total Sample



DO NOT HAVE ALL APPLICABLE COVERS OR BELIEVE ONE OR MORE COVERS WE HAVE ARE INADEQUATE	
Total Sample	47%
<u>Number of employees</u>	
1-4	50%
5-19	36%
20-50	27%
<u>Company structure</u>	
Company	46%
Partnership	46%
Sole trader	58%

MAIN ASSOCIATIONS WITH BUSINESS INSURANCE

Q. When you start to think about insurance for your business, what comes to mind? What issues does business insurance raise for you?

Base: Total sample

RESPONDENTS ………		
EXPLAINED THE NEED FOR BUSINESS INSURANCE	**IDENTIFIED PARTICULAR TYPES OF COVER**	**HIGHLIGHTED IMPORTANT ISSUES**
Safety, security of business, protection of business (11%)	Public liability, being covered against public liability is important to our business (28%) overall, Construction Industry - (42%)	The cost of insurance, high cost of premiums; business insurance is too expensive (13%)
It's a necessity; our business has to be insured (5%)	Insurance of business equipment, vehicles, machinery, contents (15%)	Coverage; adequate or comprehensive cover of business; covering all eventualities (11%)
Financial security of business; interruption to business (2%)	Theft, protection against theft, burglary (11%)	My broker deals with my insurance; I talk to my broker (3%)
Peace of mind (2%)	Fire; protection of business against fire (8%)	It's important that insurance companies pay your claim; frequently they won't pay (2%)
Risk reduction generally, all areas of risk; risk management (2%)	Indemnity insurance; being covered for professional indemnity is important to our business (9%)	Must deal with a reputable insurance company; a strong financially secure company (2%)
Insurance is important in business due to an increase in claims; a claim could put you out of business (3%)	Property, building insurance (8%)	
	Insurance against loss of stock, damage to stock, we have a lot of valuable stock (6%)	
	Income protection (6%)	

PROMPTS TO *FIRST* TAKING OUT BUSINESS INSURANCE

Q. *Can you recall what brought about the decision to take out business insurance for the first time?*

Base: Total businesses with insurance.

Good business practice, commonsense, sensible, good idea (46%)

"You'd be stupid not to have it because the building industry is very dangerous and you have to protect yourself".

It's mandatory, compulsory, necessary (33%)

Needed in our industry (13%)

" Public liability… make toys for children, need insurance in case anything goes wrong".

Required by law (12%)

To protect ourselves, our business, to ensure we are covered; security (12%)

Required by financial backers, shareholders, clients or by company policy (11%)

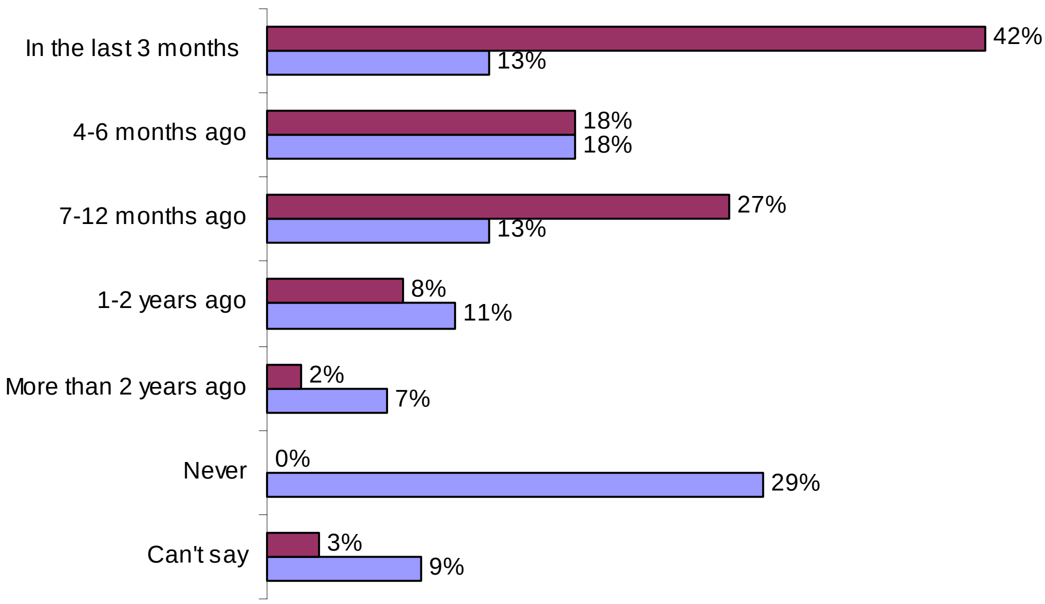
"Couple of nasty scares. [We were] broken into, theft at premises in the past…."

Needed for dealing with the public (7%)

WHEN BUSINESS INSURANCE WAS LAST REVIEWED OR CONSIDERED

Q. *How long ago was it that the business insurance cover was reviewed?*
Q. *How long ago was it that the issue of obtaining some form of insurance for the business was considered?*

Reviewed (N=1,190 businesses with insurance)
Considered (N = 63 businesses reporting "no" insurance)



MAIN REASONS FOR NEVER CONSIDERING OR REVIEWING BUSINESS INSURANCE

Base: N = 26

• Don't see a significant risk to the business	23%
• We are a very small business, one-man operation	22%
• No need	14%
• We have only just started our business or taken out insurance	12%
• Willing to take the risk	11%
• No time for insurance	7%
• Too complex	7%

MAIN TRIGGERS TO REVIEWING BUSINESS INSURANCE

Q. What triggered the review of business insurance?

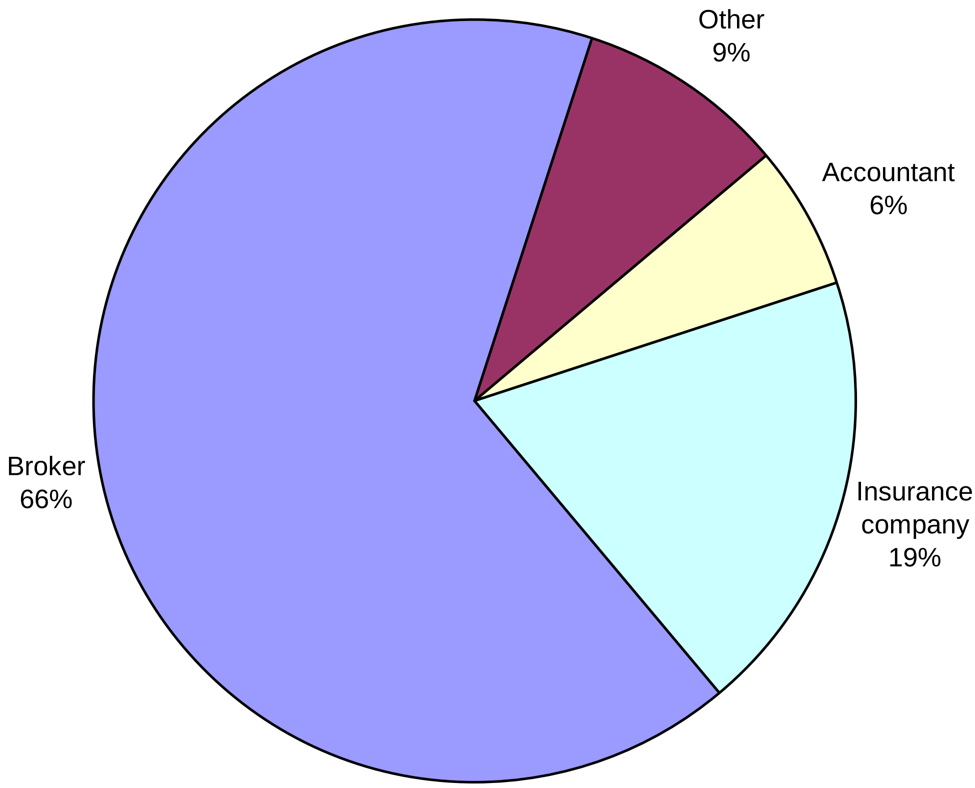
Base: Businesses who reviewed their insurance (n=955)

• Part of our standard annual review	33%
• At renewal - it was due for renewal	31%
• Wanted to make sure we were up-to-date or adequately covered	7%
• We had changes in our business direction, structure, circumstances	5%
• We wanted to shop around to see what other companies charged or offered	5%
Others (<5%) included: when business established; when initiated by broker; when bought new equipment or increased stock; when it became too expensive or when premiums increased.	

PURCHASE BEHAVIOUR

Q. *If you needed information or advice on business insurance, where would you look or who would you ask?*

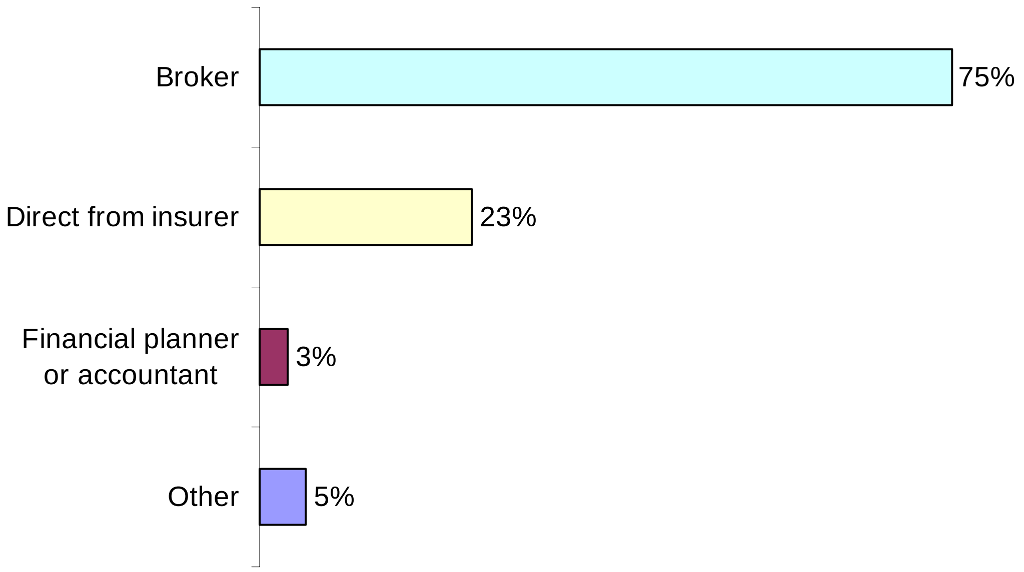
Base: Total sample



Brokers most likely to be used by: • Businesses in Western Australia 78% • Larger businesses (20-50 employees) 86%
"Other" includes professional or business associations, financial planners, colleagues or contacts in the industry

PURCHASE BEHAVIOUR

Q. Was the insurance that the business has, bought directly from an insurance company, through a broker, financial planner, accountant, or some other intermediary ?
Base: Businesses with insurance

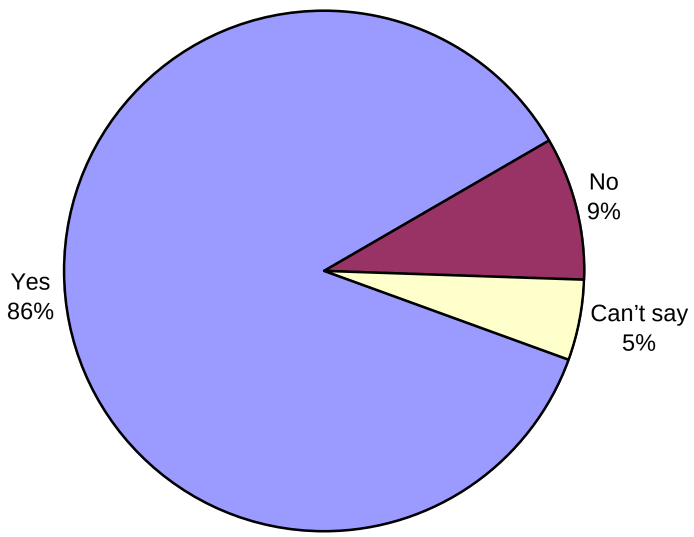


- Purchases most likely to be made through a broker by larger businesses (91%, 20-50 employees)

Note: Multiple responses accepted due to multiple covers.

Q. Did you accept a recommendation from the broker (or other intermediary) to go with a particular insurance company?

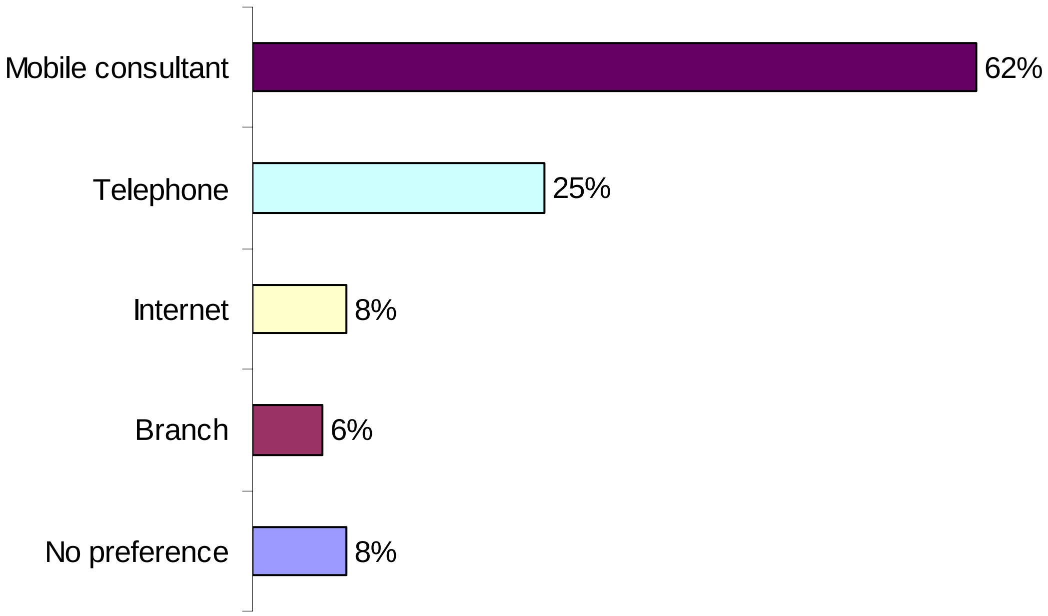
Base: Used an intermediary.



PURCHASE BEHAVIOUR

Q. If you were buying business insurance directly from an insurance company would you prefer to buy it over the telephone, through the Internet, by visiting a branch, or having a mobile consultant visit you?

Base: Total sample

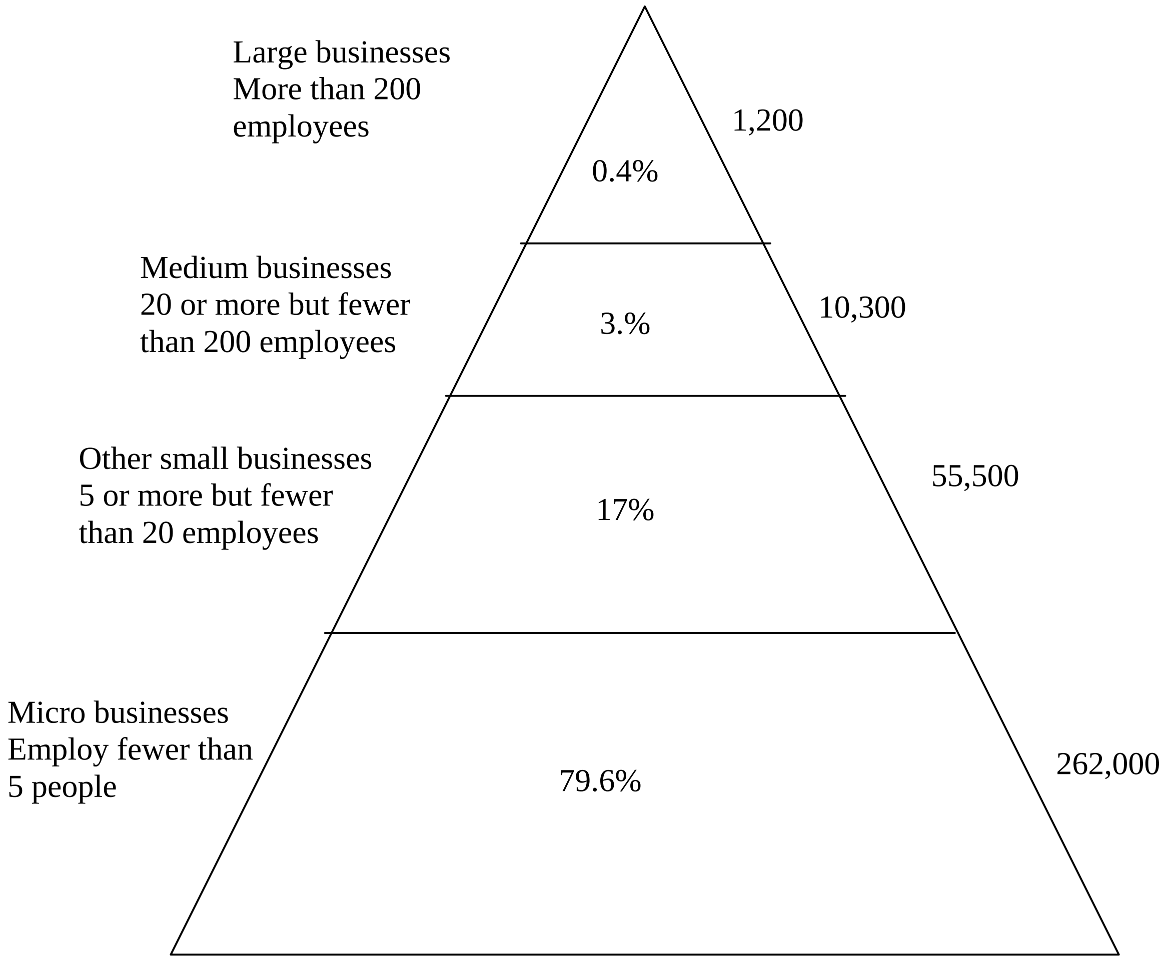


DESCRIPTION OF THE SAMPLE

	(N = 1,253)
Business Structure	Weighted %
Company	72
Partnership	16
Sole trader	8
Other	4
Number of employees	
1-4	80
5-19	17
20-50	2
Refused	1
Location	
NSW	34
ACT	2
Victoria	24
Queensland	20
South Australia	8
Western Australia	12
Industry	
Manufacturing	8
Construction	17
Wholesale	6
Retail	16
Property and business services	20
Other services	20
Remaining	13

EMPLOYER SIZE

TOTAL NSW BUSINESSES 329,000*



* *ABS, Small Business, 1321.0, 1999*

Appendix 3

Natural Peril Education Strategies

The OECD has developed a comprehensive guidance paper for the development of a national education framework in respect of natural perils. Below are some key points which IAG wishes to bring to the attention of the Commission (reference: *Draft Policy Handbook on Natural Hazard Awareness and Disaster Risk Reduction Education 2009, OECD*).

Government initiatives

Leadership and Coordination
The public sector should take a leading role in establishing a national framework and strategy for action and in coordinating the development of coherent national hazard awareness and risk reduction education programs and policies.

Assessment of Needs and Identification of Priorities
In order to identify priorities for action, an assessment should be performed of national circumstances and specific needs in respect of disaster risk awareness and risk reduction education. The initial assessment should also cover:

- The natural hazards to which Australia is exposed;
- The exposures, vulnerabilities and risks of Australia;
- The existing awareness and education initiatives and their efficiency in providing reliable and relevant information and knowledge on risk and risk reduction strategies and in changing public perceptions and behaviours regarding risk and risk reduction measures;
- The current risk perception of the population and concerned audiences, the extent to which appropriate risk reduction measures have been undertaken in society, and factors possibly contributing to any passive behaviours; and
- The priority attached to risk awareness as part of national policies and economic strategies, and the appropriateness of the level of this status in light of current risk exposures, global developments such as climate change, and available resources.

Public Awareness Campaigns and Events
The most systematic public education efforts are often built around widespread campaigns. The chief features of these campaigns are a series of messages and materials that are distributed through a wide variety of print, radio, television and internet outlets. Preparedness events must be repeated annually, so as to create public recognition, anticipation and to reinforce what was learned during previous events.

National-Level Guidelines on Public Service Message Content
While multiple organisations and sectors can be encouraged to develop and disseminate risk awareness and reduction education materials, guidelines on important content will help limit confusion, conflicting messages and disinformation. Organisations and sectors with relevant technical expertise and experience (e.g. local authorities, insurance companies, and emergency rescue associations) should collaborate, with the support or possible direct involvement of national governments, in developing standardised material that organisations can take and modify for their particular target audiences.

Distribution of Public Education Material
The mass distribution of printed material outlining major hazards, appropriate emergency responses, and strategies for reducing risks can be used as a risk awareness and risk reduction education strategy. Mass mailings can raise awareness about hazards and be valuable references for the public. Mass distributed education materials are effective when they aim to increase understanding of specific, local risks and list explicit risk reduction strategies. The costs and continued relevance of printed material may be a concern. These concerns may be addressed by targeted measures. For instance, attempts could be made to directly contact those at greatest risk in time for risk reduction or prevention actions to be taken.

Informational Websites
Risk awareness, preparedness, and risk reduction information should be made available on governmental websites. These websites should focus on natural hazard information (including, where relevant, simplified hazard maps), the benefits of collective and individual disaster risk reduction actions, the availability and scope of disaster risk financing, risk-sharing, and risk-transfer tools, such as insurance, as well as on event response and emergency planning for post-event preparedness. Information on suggested risk reduction activities aimed at preventing or lessening the impact of natural hazards should be fully integrated with appropriate and specific risk awareness material or descriptions of risk reduction effectiveness, both necessary components of effective risk reduction education. Special sections of such websites should be devoted to dedicated education and awareness material that targets a range of audiences including children, minority language speakers, policy makers and knowledge disseminators.

Disaster Parks
Locations of past disasters and sites of visible geophysical hazards can be effectively used as risk awareness tools. While interpretive sites are often limited in geographical impact, appropriate sites are plentiful in most communities and can be an immediate and local reminder of hazards and risk reduction. Educational sites can be incorporated into areas where land-use regulations restrict development due to natural hazard risk. They can help reinforce the necessity and importance of zoning laws, a risk reduction strategy often not well understood by the general public. To be effective, they should include not only easy-to-understand descriptions of the hazard, but specific strategies for reducing risk at the individual, household and community level.

Cross-sectoral partnerships for school education

Incorporating risk awareness and risk reduction strategies into school curricula is the strongest method for institutionalising the reach of these messages to the largest percentage of the population in perpetuity. What is learned in childhood becomes incorporated into collective knowledge and carried into future decision-making. Educating children about natural hazards and risk reduction, moreover, is of significant importance since in most countries they are very effective knowledge disseminators at the family level. The task of infusing risk awareness and risk reduction education into curricula is, however, a multi-decade effort.

Private-sector initiatives and sponsorships

The Insurance Sector
The insurance sector should work with the community groups, private, and education sectors to educate current and potential policyholders about risks, insurance, and risk reduction measures. Insurance companies and industry associations can play an important role in designing and providing appropriate, effective, accessible and affordable tools to protect households and the economy against the financial consequences of large-scale disasters. These products can also provide incentives for individuals and businesses to adopt cost-effective risk reduction measures.

The Corporate Sector
Leadership by example can be provided by corporations through the adoption of employee education programs, risk reduction measures and business continuity plans. Hazard and preparedness seminars for workers, school children and local community members can become part of corporate good neighbour policies. The engineering industry and some segments of the construction industries, moreover, can effectively support many risk reduction initiatives, including strict and mandatory building codes, hazard-conscious land-use planning and environmental stewardship as a means of encouraging risk-wise behaviour.

Community sector initiatives and sponsorships

Grassroots Initiatives
Broad community engagement is vital not only in the community sector where it is currently most prevalent, but also in private, public, and educational sector efforts. Communities should be invited to participate throughout the process of program development and message dissemination.

Many excellent risk awareness, risk reduction and advocacy programs have begun with grassroots efforts rather through national initiatives. These programs are often more grounded in the local physical, cultural, economic and political context of a community than nationally developed programs, and they are able to target vulnerable or marginalised members of a community. These are important not only for the content of the materials they have created, but also for the social networks on which they rely for dissemination.