INSURANCE COUNCIL OF AUSTRALIA

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RESPONSE TO

2011 NATURAL DISASTER INSURANCE REVIEW

JULY 2011

Image: Dirrinbani, Queensland, Flood levee protecting town against 2009 flooding

EXECUTIVE SUMMARY

The True Problem. 7% of residential property in Australia is exposed to predictable and repetitive flooding, causing an average of $400 - $450 million in damages per year. This is the true community problem that requires reform by government to achieve lasting solutions, without which any government or private market flood insurance solution is not sustainable over the long term.

The private market works, but it can be improved. Insurers have accepted 85% - 92% of claims lodged as a result of the Queensland and Victorian floods during the summer of 2010/11. The private insurance market is working, but there is room for improvement through market reforms and government action on risk mitigation and community support.

There is No Market Failure. Flood insurance has been widely available for every property in Australia since 2006. Market provision of cover is accelerating with 54% of policies selected by consumers currently providing cover, this is expected to exceed 84% in the next 18 months. There is no issue with availability.

Improving not Removing Choice. Australians decide to purchase, or not purchase, flood insurance for a variety of reasons – removing their choice in the matter is not the solution. The solution is to improve their options and the information available in order to allow an informed decision. Mandating automatic cover where every insurer must offer flood under the same model will increase the cost of living for all Australians, or force them to not insure at all. Choice of model between insurers is as important as the need for unambiguous disclosure. Mandated automatic cover with or without an Opt-Out is not supported.

A Government Flood Pool will raise the Cost of Living. No government flood insurance pool is necessary. A new pool will require further government bureaucracy and complexity and will increase the cost of living for ordinary Australians. The majority of insurers do not support the creation of a system that will pool flood premiums in government hands, preferring instead a model targeting those in need of premium support, with direct subsidies. A government flood insurance pool is not supported.

Affordability - Provide Direct Subsidies to Extreme Risk. Those most at need, property owners who face large flood risks as a result of a lack of government flood mitigation and land-use planning decisions, should receive direct premium subsidies from governments, using a model proposed by industry modeled on a first homebuyers grant scheme.

Map, Mitigate & Manage the Risk to Reduce the Community Exposure. Government spending on the mitigation of flood risks is a small fraction of the ultimate cost of events and must be improved. There is a community expectation of government action on the mitigation of flood risks, including a modernisation of the way in which the flood risk is mapped and communicated to the public. A repeat of 2011 flooding, damaging the same homes, will be a failure of mitigation, not a failure of private market insurance. This is the core issue that needs to be addressed urgently.

Industry submits that the following actions be taken:

PROPOSED INDUSTRY ACTIONS	PROPOSED GOVERNMENT ACTIONS
Industry to improve community understanding of flood insurance options through adoption of the Standard Definition for Flood in home & contents policies.	**Government** to provide public access to all publicly funded flood mapping conducted in Australia in a central location, followed by a program to harmonise Australian flood mapping practices to be aligned with worlds best practice.
Industry to clearly identify on a ***Key Facts Statement*** with every home & contents policy that the policy either: 1. Automatically covers flood with no opt-out 2. Automatically covers flood, but the customer can choose to opt-out 3. Excludes flood cover, but the customer can purchase additional cover 4. Excludes flood cover	**Government** through COAG to implement legislation ensuring flood risk disclosure, to provide all property owners and tenants with flood risk information: 1. During title transfer or development application. 2. When a lease is entered into for occupation or use of a property. 3. Annually to the resident and to the ratepayer for the property.
Industry to provide a public portal for property owners to visit and view a representation of the flood risk to their property, to encourage them to consider the benefits of mitigation of the risk, of obtaining adequate insurance and undertaking emergency preparedness.	**Government** through COAG to reach agreement on national policy for land-use planning whereby no residential property is constructed on at risk land, without enforcement of development controls that reduce the risk to less than a 1:100yr return period.
Industry to provide governments with a geo-coded database of known flood prone properties across Australia, according to collected government flood mapping, to facilitate mitigation prioritisation and consideration of direct support to those at risk.	**Government** commit to flood mitigation reform whereby a measurable reduction in the number of flood exposed residential properties in each LGA is achieved each year for 20yrs.
Industry to provide support to governments regarding the calculation of and qualification for government premium subsidies to policyholders in high risk flood areas, and to act as agents of the scheme in applying subsidies at the point of sale.	**Government** through COAG to provide a temporary, targeted, direct premium subsidy scheme to policyholders in each State who face High and Extreme flood risks as a result of a lack of mitigation of land-use planning **OR** to refer any alternative flood pool options to the Productivity Commission for appropriate review and assessment for government.
Industry to provide a public tool for members of the community to measure the resilience of their property to hazards such as flood, providing recommendations and guidance for practical measures to reduce the risk through building modification, maintenance, planning and practice.	**Government** to implement legislative changes to allow: 1. Insurers to provide greater guidance to consumers on products at the point of sale. 2. Insurers to simplify disclosure to consumers through electronic delivery of documentation where it is appropriate to do so.
Industry to produce and provide the public with a guide to *Smarter Insurance*, explaining how insurance products function and the importance of obtaining cover that is right for individual circumstances.	**Government** to access general insurance expertise in managing built environment risks through appointment of insurance risk expertise to the National Emergency Management Committee and to the Board of the Australian Building Code.
	Government to implement measures to remove disincentives to the uptake of insurance, by removing all taxes on insurance in accordance with the Henry Review 2009.

Introduction

The Insurance Council of Australia (ICA) is pleased to be able to provide this submission to the Natural Disaster Insurance Review. This response sets out a preferred approach to improving the accessibility and affordability of private market insurance to those faced with Natural Disaster hazards and in particular the risk of riverine flood.

Importantly, this submission also seeks to demonstrate why improving accessibility and affordability of insurance is not a solution to the true community issue of flooding and why such measures can not be sustainably achieved before reform and action to address the root cause of the problem.

The Insurance Council of Australia – Who we are

The ICA is the representative body of the general insurance industry in Australia with members of the ICA representing more than 96 percent of total premium income written by private sector general insurers.

ICA members provide insurance products ranging from those usually purchased by individuals, such as home and contents insurance, travel insurance, motor vehicle insurance, to those purchased by small businesses and larger organisations, such as product and public liability insurance, professional indemnity insurance, strata, commercial and industrial property, as well as directors and officers insurance.

In developing this response the ICA commissioned a committee of insurers and global re-insurers to determine the best path forward regarding flood damage and the community.

The role of general insurance in Australia

Private sector general insurance provides a vital service to protect the financial well being of individuals, households and communities. Although often unrecognised, it is general insurance that assists in the speedy and expeditious recovery of communities after a significant catastrophic event - such as those witnessed in Queensland during the summer of 2010/11[1].

In simple terms general insurance, through its primary offer of *peace of mind*, facilitates transactions, enabling households and businesses to undertake activities safe in the understanding that financial recovery will be available in the event of loss or misadventure.

For governments, private sector general insurance provides financial security and stability in the community. Western governments, with a free market, operate secure in the knowledge that in the event of a major catastrophic event, the cost of assistance and recovery will not need to be met by governments alone, with the resultant straining of government capacities, resources and funding calls on taxpayers.

The ongoing acquisition of private insurance by Australians should be viewed as a core measure of success for COAG's National Resilience Strategy[2] announced in February 2011. A strategy acknowledged by the general insurance industry as worlds best practice.

Australians becoming more resilient to adversity through a combination of accurate hazard information, personal preparation, the adoption of mechanisms such as insurance and the provision of adequate mitigation by responsible governments, is a national reform worthy of support by all stakeholders.

The other role of general insurance is that of a measure of community risk. Insurance can act as the proverbial *canary in the coalmine*, giving a strong signal (through price and availability) of the level of risk involved in an activity or choice. For example, if private insurance premiums are high and increasing it will generally be driven by an increasing risk or failure to control risk - leading to an increasing probability of the event and a loss being realized.

[1] As at 24 June 2011, Queensland residents have provided for their own recovery through private insurance to the sum of $3.5 billion, alleviating taxpayers from the burden of this recovery.
[2] http://www.ag.gov.au/www/agd/agd.nsf/Page/CouncilofAustralianGovernmentsMeeting_CouncilofAustralianGovernmentsMeeting

In this manner, private market insurance can provide an invaluable early warning signal to governments regarding community risk behavior and the value of risk mitigation. A signal that provides an opportunity for government to address the core issues driving the community hazard.

Obstacles to private market insurance uptake in Australia

Despite the widespread benefit that accrues to the community from having efficient private insurance markets, the Australian general insurance market has been criticised by governments and remains burdened by inefficient taxation imposts[3].

These issues, combined with a failure by governments across Australia to adequately reduce disaster risks through mitigation, building codes and land-use planning, reduces the market capacity to provide affordable and accessible private insurance to ordinary Australians and the businesses that drive the Australian economy, as well as the appetite for those highly price sensitive stakeholders to protect themselves with private cover.

The average Australian who owns an insurable asset, currently faces an environment where he/she will be taxed, heavily in some instances, for seeking to become more resilient through the purchase of an private insurance product. This disincentive is compounded by an environment where the risks are increasing and government spending on mitigation to reduce the hazards are orders of magnitude lower than post-event recovery funding[4]. Private insurance, as a result, is priced to account for an environment of concentrated vulnerabilities.

Property owners face a dilemma – Should they purchase a product to give them peace of mind and secure their assets, when:

- that product is generally becoming more expensive[5]
- is a large source of taxation revenue for government, and
- is frequently condemned by the same government decision makers who are responsible for not mitigating many of the hazards that their property faces[6].

The Natural Disaster Insurance Review

The ICA has welcomed the establishment of the Natural Disaster Insurance Review (NDIR), as an opportunity to raise issues that currently prevent the efficient provision of private insurance to those in the market who seek to protect themselves.

The *Issues Paper* released by the NDIR provides a relatively narrow approach to 'solving the problem' and significantly dismisses:

- the work already done in Australia to provide flood insurance, and
- the capacity to develop the private market further.

This is one of the fundamental failings of the NDIR *Issues Paper*, as it does not encourage a full discussion of the issues and potential solutions, including those already operating in the market today.

Additionally, the *Issues Paper* pays little regard to the drivers of the flood hazard in Australia and fails to draw the fundamental link between hazard mitigation to reduce the risks and the provision of affordable private insurance to protect against those risks, that can not be reduced to an acceptable level.

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[3] State Governments raise revenue by charging Stamp Duty on the sale of insurance products. Federal governments charge GST. All taxes are layered on top of the premium and are a disincentive to purchasing adequate insurance. In 2009/10 $4.6 Billion was paid by Australian families and businesses to government as taxation on insurance.

[4] http://www.attorneygeneral.gov.au/www/ministers/mcclelland.nsf/page/Speeches_2011_SecondQuarter_16May2011-InstituteofActuariesofAustraliaFloodResilienceRisks,MitigationFundingSolutions

[5] There are examples where flood premiums have been reduced directly as a result of completed government flood mitigation, for example in and around St George QLD.

[6] There is a notable moral hazard here for governments. As risk premiums rise due to increasing risk driven by low mitigation spending from governments, government revenue increases due to taxes on larger risk premiums.

Any government solution that does not contribute to driving down the number of properties at risk is not sustainable. True reform is needed, rather than the creation of Band-Aid solutions to fund post event recovery, that do not contribute to driving down current and future hazards.

In responding to the NDIR *Issues Paper* the ICA has elected to:

- Define the **problem of the flood hazard** in Australia in more meaningful and community oriented terms,
- Define the **challenges of flood insurance** in Australia in more precise terms
- Define **options** that address these issues for those at high risk in the community, that seek to:
  - Drive mitigation and the reduction of the flood hazard and its impacts on Australians,
  - Ensure individual property owners with a flood risk are informed of the risk,
  - Ensure that sustainable options to purchase flood insurance from a range of general insurance providers will remain available, and
  - Provide options for high flood risk individuals to be supported in a purchase of flood cover whilst simultaneous mitigation efforts to reduce the risk are underway.

The true community problem defined

There are some challenges with private market flood insurance that can be addressed by industry in partnership with government.

However, the focus on solving flood insurance as *the problem* disregards the fact that flood insurance, whether provided by the private market or by government, is a risk management tool that appears at the end of the risk chain, dealing with residual risks to the community. By itself, flood insurance is not a sustainable solution to what is a significant community problem.

Insurance - not the start point for a solution, critical foundation issues need to be resolved first

The position of insurance at the end of the risk management chain can be demonstrated usefully through another example - comprehensive vehicle and third party car insurance.

The community and government **do not expect** that cheaper or subsidised car insurance for *at risk* drivers will stop accidents on the road occurring. Indeed, reducing the price signal for hazardous driving activity in this instance may have the opposite outcome by removing one of the *hip-pocket* consequences of risky driving behavior. Affordable car insurance can not substitute for risk mitigation activities that lower the occurrence of accidents – For example; law enforcement, campaigns for road safety, drink driving, speeding and fatigue. Car insurance comes at the end of these risk mitigation activities and sends a price signal regarding the residual risk.

Flood insurance is the same. Insurance does not cause flooding, it sends a price signal regarding the risks and as with vehicle insurance that signal can only be attenuated through appropriate risk mitigation activity. The key is to prevent losses due to flood. Insurance is a method to recover from the residual risk and to spread the costs of damage. Importantly, flood doesn't only cause economic loss – it often results in loss of life, emotional distress and irreplaceable loss;

Flood damage is a persistent risk to almost **7%** of residential addresses in Australia causing an average of **$400 - $450 million** in damages annually.

The first problem, to be solved by the government and the community, is to reduce the extent of exposed property from the current **7%** to **0%**, or as low as possible. Regular and repeated flooding of residential property should not be tolerable to government or the community and is the primary driver for flood insurance costs.

While the risk remains unmitigated and exposure uncontrolled, any insurance scheme will reflect the high costs of the risk repeating time and time again. **A one-dimensional response, focusing on flood insurance, will only shift costs and defer action on solutions to solve the true problem.**

Community Expectations - The required community endstate for flooding in Australia

Access to affordable flood insurance should only be part of the desired community endstate for this government review process.

The primary objective of government efforts to respond to the flood events of 2010/11, should be to stop the flood impacts reoccurring through appropriate mitigation; to provide advice to those who face the ongoing risks; and to assist all stakeholders with appropriate strategies to adapt.

The current approach of government to flooding – The key risks

The government focus on insurance as *the problem* and the various consequential measures being contemplated including[7]:

- A flood insurance pool requiring funding and administration,
- Removing consumer choice through mandatory automatic cover for flood (with or without an opt-out),
- Expansion of these concepts to classes beyond home and contents,
- Changes to claims handling processes including legislation to mandate timeframes,
- Increases to capital holding requirements

When combined with:

- A hazard rich environment,
- A systemic failure to mitigate,
- Building codes that do not protect buildings,
- Land-use planning regimes that allow inappropriate development,
- A taxation system that penalises those who insure, and
- An ongoing upwards adjustment of global reinsurance charges in light of Australia's increasing risk.

A preventable risk? - Landuse planning regimes do not always prevent inappropriate development or stipulate building methods that are resilient.

…… will deliver almost certain premium increases and increased cost of living for Australians who insure.

There are already examples of household premiums increasing for ordinary Australians in real and very significant terms – Premium increases of 20- 40% have been reported in each state[8] for home and contents from some providers, driven primarily by reinsurance costs.

These 'cost of living' increases are a natural result of an adjusting view of Australia as a risk prone location by global reinsurers, with little or no government action taking place to address the ongoing concentration of vulnerability, or to protect ordinary Australians.

Flood Damage in Australia – A result of poor decisions and little mitigation effort

Australia is a flood prone country.

Driven by the La Nina cycle, parts of Australia face frequent, but relatively predictable flooding events. These flood risks are naturally defined by extensive river catchment systems, which are particularly, but not exclusively, active in the Eastern part of Australia.

Settlement has traditionally taken place close to convenient water sources and transport routes (rivers). As a result, some property in Australia has been developed in areas that flood frequently. Over the last decade some State Governments have reformed

[7] Both as part of the NDIR and other concurrent review and inquiry processes from government all focused on insurance.

[8] An increase in insurance risk premiums in not always a bad thing for government - apart from being an opportunity to recognize the risk signal and take action on mitigation, an increase of 20-40% in risk premium delivers more stamp duty revenue from households to government.

the approach that planning authorities adopt with regard to authorising development in flood prone areas to help control the risks.

However, there is still a significant legacy issue, in the form of older building stock in known flood risk areas, and there are examples of poor development decisions continuing to be made.

Consumer advocates involved in the insurance debate have publicly stated that mitigation of flood risks is not possible. However, mitigation of risk in flood prone areas that have been built upon is not only possible, in many cases it is relatively easy to achieve, through adaptation of existing infrastructure or changes to current water management regimes. In some areas of Australia this has been undertaken, whilst in others it remains deficient and repetitive flood damage continues.

Permanent Flood Barriers in Maclean, NSW prevent frequent catastrophic flooding of the town centre

Flood is estimated to cost on average $400 - $450 million annually[9] in damage to the community. However, over the period 2007 – 2011 less than $110 million was allocated to disaster mitigation in Australia by the Federal Government, with only a portion of that amount being used to address flood risks.

Flood mitigation can be achieved in a variety of ways, including flood control barriers, dams, drainage controls and at the property level by ensuring buildings are elevated and that appropriate construction methods and materials are used.

At its easiest, flood mitigation may involve simple changes to water management processes, for example the levels that dams are maintained at in order to not sacrifice planned flood mitigation capacities. In extreme cases flood mitigation may also involve the rezoning and resumption of residential property by government.

Governments have proven in isolated cases that a competent and thorough approach to layered flood mitigation will reduce the impacts of flooding on the community to a level that is manageable. Examples of the correct approach can be found in many country towns that are in close proximity to large rivers, for example Lismore and Grafton in NSW, where flood defences have reduced an extreme flood risk to a low flood risk[10] with an accompanying reduction in insurance premiums.

True national reform focussing on reducing the flood risk to Australians is not only possible to achieve, it makes good financial sense for the future.

The level of flood exposure in Australia

There is presently no complete measure of the number of properties exposed to flooding in Australia, beyond the NFID created by the general insurance industry[11].

The NFID is vulnerable to three risks – refusal by local governments to release mapping publicly, inaccurate and out-dated mapping, and in some flood prone areas an absence of government flood mapping having been undertaken at all.

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.

Flood mapping has been made available to the ICA from NSW, VIC, SA, TAS, NT and WA.

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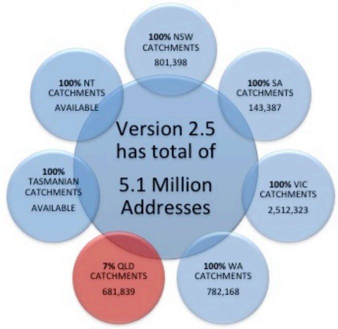
[9] Finity Consulting, 2011

[10] Once flood mitigation works are completed it becomes equally important that they are maintained and operated correctly. There are growing concerns in the insurance sector over the state of existing flood mitigation works where they exist, with some insurers making the assumption, in some locations, that the existing flood mitigation will fail or not be sufficient to protect communities.

[11] In 2007 the ICA has created the **N**ational **F**lood **I**nformation **D**atabase to identify individual properties with a flood risk, according to government flood mapping that has been made available publicly.

Some flood mapping has also been made available from QLD, but not enough to suggest that a comprehensive view can be established regarding the number of properties under threat in that State.



The NFID currently has flood risk data for 5.1 million[12] addresses in Australia and is continuing to grow. Much of the property information in the database **confirms no flood risk** for individual properties, which is often equally important in an underwriting sense (confirming there is no known risk).

Of note, a consumer survey[13] conducted by the ICA indicated that 93% of households support the need for accurate flood mapping to be carried out in order to improve the delivery of improved flood insurance in Australia.

Currently available data modelling the number of ‘at risk’ residential addresses is as follows:

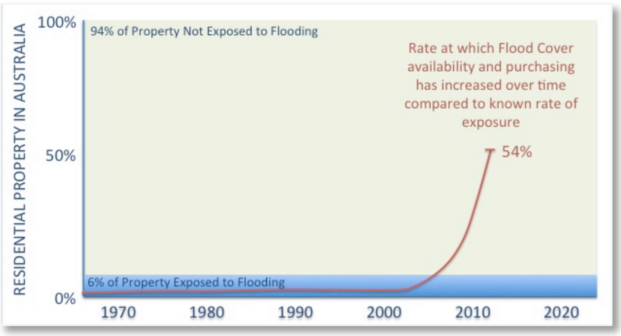
Table 1

	Exposure*			
	Extreme	**High**	**Medium**	**Low**
	Residential Addresses >1:20 Return Period	Residential Addresses 1:20 – 1:50 Return Period	Residential Addresses 1:50 – 1:100 Return Period	Residential Addresses 1:100 - PMF
NSW	68,913	24,929	16,874	3,860**
QLD***	8,794	18.610	17,912	51,506**
VIC	3,860	5,757	4,297	10,239**
SA	1,927	787	7,848	49,576**
WA	206	124	171	10,000**
TAS	110	89	15	4,100**

* This represents the number of exposed residential addresses according to NFID and G-NAF 02/11. An estimation of the number of households exposed can be gained by using a ratio of 67%.
** Low confidence numbers as some jurisdictions do not map the PMF risk
*** Only data for Brisbane, Gold Coast and several smaller catchments have been provided to ICA, QLD data is therefore under-quoted – Modeling suggests that this is 60% - 75% of exposed addresses.

The Insurance ‘Status Quo’ – It changed in 2006 without intervention

The private insurance market works. Since 2006, the private market has successfully developed and delivered flood insurance to the residential market in Australia.



- In 2006 **3%** of policies purchased in Australia covered flood.
- In 2010 **54%** of policies purchased in Australia covered flood, through private market action on the issue.
- By 2013 it is estimated that a further **30%** of the market will potentially offer flood insurance, if market conditions and regulation permits, bringing the total to **84%**[14].

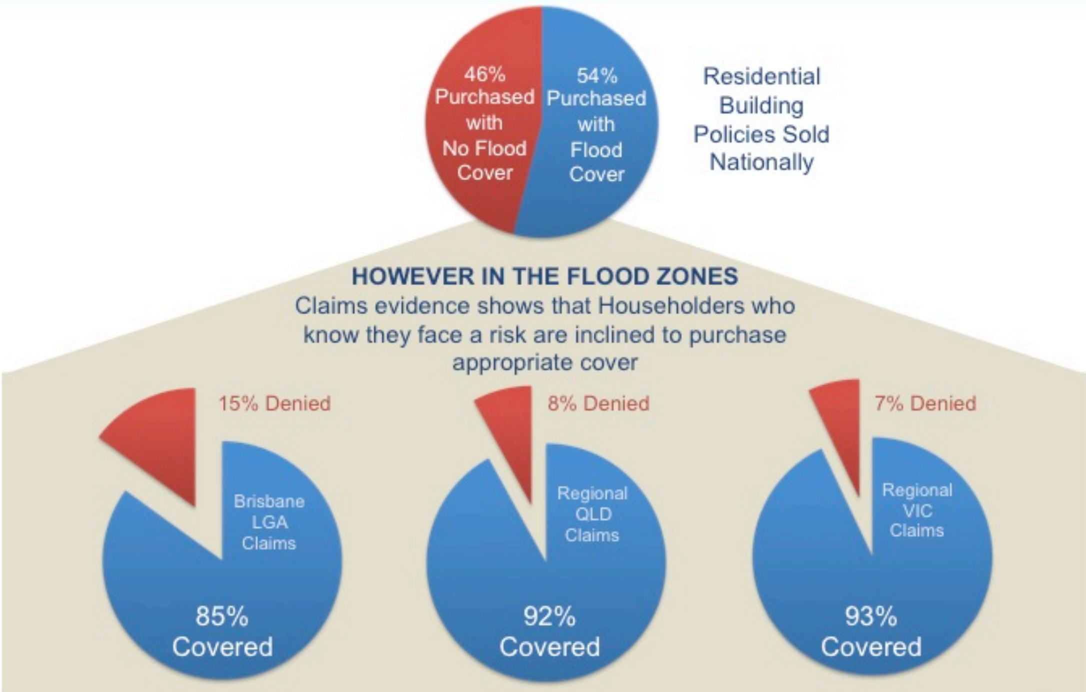
The market already provides accessible and affordable flood solutions to the vast majority of the Australian population. Insurers should be encouraged to compete further and to offer their flood products to more customers.

The challenge is to ensure, at least in a perfect sense, that the 7% of property with a flood risk are contained within the 54% of policies purchased by property owners.

Flood insurance has already been purchased by many who own property in high risk flood zones, however there is a natural relationship between increasing price for cover and decreasing uptake.

[12] It is important to note that not all properties in Australia have a flood risk, are in river catchments, or have a need to be mapped for risk.
[13] The survey was and internet based survey, conducted by Roy Morgan over the first week of April 2011 on behalf of the insurance council. There were 397 respondent households in the flood affected area of Brisbane, 407 respondents in the non-flood affected area of Brisbane, 415 respondents in the rest of Queensland and 415 respondents in the rest of Australia. The total number of respondents was 1634
[14] or 73% by 2012, based on the extent of current market preparation reported by individual ICA member companies.

Despite media reports to the contrary, much of the residential property damage that occurred in Queensland in 2010/2011 has been covered by private insurance. Approximately 85% of policies in the Queensland floods of February 2010 and again in the summer of 2010/2011 responded to the event. This strongly suggests that whilst not a universal rule, property owners are more inclined, if informed properly, to purchase cover that suits their risks where the premium is within their financial capacity.



Reported Claims Acceptance and Denial Data from Insurers dated 24 June 2011

Why do some consumers with a flood risk not purchase flood cover?

There are several potential reasons why a consumer with a flood risk may not purchase a flood insurance product.

These reasons are important to understand as they are fundamental to achieving an endstate where property owners at risk have made an informed choice regarding cover.

The reasons that a property owner with a flood risk may not purchase flood insurance are:

1. **Unaffordability**. The unmitigated flood risks in the location may be large and the risk premium combined with all statutory government charges may be beyond the financial appetite of the policyholder. The post flood ICA consumer survey found that 1 in 3 households who knew they were in a flood zone, who had not purchased flood insurance, cited cost as an important factor in the decision to not insure.

2. **Failed Risk Disclosure by governments**. A failure to understand that a flood risk exists at the property or misunderstanding the risk information that is presented.

   Over 60% of respondents to the ICA consumer survey, living in a flood zone, cited a belief that they did not live in a flood zone – without this critical awareness it is unlikely that any community can be adequately prepared for flooding.

3. **Unclear Disclosure of Coverage**. A failure to understand which products offer flood cover and which do not. The post-flood ICA consumer survey found that 40% of flood-exposed households who did not have flood insurance cited that they did not know their policy would not cover flood. The ICA survey also found that less than 50% of insured households had read the PDS before purchasing the product.

4. **Non-Insurance**. A reliance on government support for personal recovery rather than a purchase of private insurance. Over 20% of households in known flood zones responded to the

ICA survey that an important reason behind their decision to not purchase flood insurance, was a belief that government would ultimately provide assistance.

With the exception of unaffordability, the primary policy choice advocated by the NDIR seeks to remove the need to address these core issues by forcing a solution on every individual that insures.

Processing of flood claims – Is it evidence for change?

The NDIR paper places significant weight on the time taken to process a storm claim vs the processing time for a flood claim – Using this position as further evidence for the need to make flood insurance mandatory in all policies, therefore reducing the time or removing the necessity taken to make a decision on liability.

The NDIR makes no reference to the unique nature of flooding, its impacts on the community and infrastructure. Flood claims take longer to process for several reasons, all of which will remain regardless of the level of government intervention in the private insurance market:

- Flooding causes significant disruption to local roads and often prevents assessors from accessing properties for a considerable time.
- Flooding often causes additional hazards in properties, such as damaged utilities that until rendered safe by local authorities prevents access to a property.
- Flooding causes unique damage to a property that often disguises pre-existing conditions and risks that are not covered by home and contents policies. Determining the extent of these issues can require expert support.
- In many cases flooding causes hidden structural damage to buildings that can take expert support to determine if liability exists under the insurance policy.

All of these issues are largely not present in fires, storms and hail.

However, these issues and consequential delays, also occur to some degree in earthquake events, even though earthquake damage is a covered event in nearly every home and contents policy.

Unfortunately, the NDIR has not compared data for assessment times for earthquakes to other events. The average assessment time for these events is 32 days, compared to an average of 28 days for flood damage.

Whilst there were delays that can be attributed to definitional issues, these have now been addressed through agreement to a standard definition for flood. Nevertheless, government should resist the urge to rely upon a relatively uninformed view of the realities of managing flood claims, to justify a shift in insurance cover that will have unintended consequences.

Why remove insurance choice from consumers?

Increasing the number of consumers who make the right choice is achievable through reform of the market and a new emphasis on mitigation and risk disclosure by government agencies.

Some consumers choose not to insure at all, or are not provided with adequate information regarding their risks by government in order to make a risk appropriate decision. If properly informed in a free market, consumers should be **not be restricted** in the choice of cover that suits their circumstances. In a competitive market, consumers can **opt-in** or **opt-out** of any cover by purchasing the product that suits them best.

Governments role in insurance should be to ensure that the right risk information is available to help consumers and insurers manage their risks, whilst government maintains a focus on mitigating the legacy flooding exposures and preventing the flood prone population from expanding.

The private insurance market role is to ensure that easy to understand insurance products are widely and competitively available to the community.

Competition and choice for consumers should be maintained and would be assisted by both clear disclosure and no deviation by the insurance industry from the common definition for flood.

The industry will clearly disclose and identify on a ***Key Facts*** sheet, with reference to the *common definition for flood*, for every home and contents policy, the treatment of flood cover – identifying that the policy either:

- Automatically covers flood with no opt-out (*standard flood cover*)
- Automatically covers, but the customer can choose to opt-out (*standard flood cover, opt-out*)
- Excludes flood cover, but the customer can choose to purchase additional cover (*optional extra*)
- Excludes flood cover (*flood cover not provide at all*)

This approach would enable customer choice, whilst ensuring that the extent of cover purchased is unambiguous and provides a simple mechanism for consumers to purchase the cover appropriate to their needs.

Mandated automatic cover – Increasing the cost of living for everyone

At a superficial level making the provision of flood cover **mandatory in all insurance policies** would seem to solve the apparent government problem of individuals in a flood zone having to exercise personal choice.

However, the mandatory inclusion of flood cover in all home and contents policies, from all insurance providers, will have unintended consequences that outweigh the approach proposed by the NDIR.

Mandated automatic flood cover with or without an opt-out, **for all insurers**, will require all insurers to secure adequate capital and reinsurance to contend with potential uptake in advance of selling product in the market, as these two issues have a large influence on the price at which a policy is sold. It will also require insurers to amend current policy regimes and to configure claims systems to manage inevitable flood claims. **This is within the appetite of a large portion of the market, but not all.**

If mandated that all insurers are required to provide automatic flood cover, it will immediately increase the capital and operating costs of the entire industry. It will be necessary to pass on these costs to policyholders. Under a mandated automatic or default regime, consumers will not be able to avoid these costs by choice, as all policies will be forced to offer cover for the risk.

As already identified, the industry will clearly disclose and identify on a ***Key Facts*** sheet, with reference to the *common definition for flood*, for every home and contents policy, the treatment of flood cover – identifying that the policy either:

- Automatically covers flood with no opt-out (*standard flood cover*)
- Automatically covers, but the customer can choose to opt-out (*standard flood cover, opt-out*)
- Excludes flood cover, but the customer can choose to purchase additional cover (*optional extra*)
- Excludes flood cover (*flood cover not provide at all*)

This approach would enable customer choice, whilst ensuring that the extent of cover purchased is unambiguous and provides a simple mechanism for consumers to purchase the cover appropriate to their needs.

If this approach is not adopted, insurers with no appetite or capacity to accommodate flood risks within the products they currently capitalise, price and sell - will find themselves in the position of having to not offer any insurance product at all, to those communities who have a flood risk.

This 'redlining' of geographic areas by some insurers will decrease the choice those consumers have, will reduce competition in the market and will, perhaps most significantly, increase the risk through anti-selection of the insurers who remain in the market. Ultimately driving those remaining to premium increases and/or exit from the market.

The simplistic response to these potential consequences will be to dismiss them.

If government remains committed to such a path the ICA strongly recommends an appropriate review by the Productivity Commission to determine the implications before proceeding.

Consumer views of automatic cover and the appetite for cross-subsidisation were also tested during the post-flood ICA consumer survey. While a small majority of households surveyed (55%) supported the concept of mandatory flood cover they were not prepared to pay for it. Only 34.3% of those that supported mandatory flood cover were prepared to pay an additional amount to ensure all Australian's had cover for natural disasters and of this cohort only 12.0% were prepared to pay an additional $1.0 per month, 26.0% were prepared to pay an additional $1.0-$2.0 per month and 30.0% were prepared to pay between $2.0-$4.0 per month extra.

Unintended Consequences of Mandatory Automatic Flood Cover:

- Householders who do not wish to purchase flood cover at all, will be forced to not have any cover for any risk, increasing the non-insurance problem in Australia.
- The provision of mandatory flood cover in polices, will force insurers to introduce premium cross-subsidies from those with low or no flood risk to those with a flood risk. This will increase individual household premiums, even where no risk exists, increasing the cost of living for the vast majority of Australian households.
- If it is also mandated in contents cover, low cost contents (basic cover) that have been designed by the industry for low income earners will increase in price and may become unaffordable to that highly price sensitive segment.
- Insurers who do not wish to offer flood cover or accumulate flood exposures in excess of their risk appetite may 'redline' flood prone areas and not offer any form of insurance in those areas.
- Smaller insurers with less sophisticated pricing mechanisms (and capacity to raise capital or reinsurance for flood risk) may well choose to pull out of the home insurance market reducing competition.
- Overtime, only insurers with large portfolios will provide cover in these areas, potentially reducing competition. Premium impacts would be exacerbated as capital and reinsurance requirements increase for those insurers with most of the flood exposure, driven by anti-selection.
- Acting as a disincentive or barrier to new market participants who do not have appetite to mandatorily provide flood cover.

Removing choice and reducing competition through the mandatory inclusion of flood cover in home and contents policies is not supported by industry.

Provided that disclosure arrangements are adequate to ensure the policyholder is making an informed choice and that insurers provide or exclude the cover to a standard definition for the risk, there is no need for government intervention.

Industry is prepared to work with government to ensure that those who currently do not purchase cover (and who potentially have a risk to protect against) are able to make an informed and in some cases supported choice.

However it needs to be understood that the current advice regime under the Corporations Act acts as a disincentive for insurers to offer advice to consumers (due to cost and compliance uncertainty). The concept of scaled advice is not providing much comfort as this concept is already in the Corporations Act (and it is difficult to apply in real life).

Additionally the FOFA reforms in regards to the additional requirements on advisors (Best Interests Test) will act as a further deterrent. The industry has previously submitted to FOFA that general insurers issuing/dealing in prescribed cover should be exempted from the advice provisions of the *Corporations Act*, specifically to encourage more direct general insurers to provide advice to consumers. Insurance staff are not financial advisors (planners) in the traditional sense, however as insurance is a financial product under the *Corporations Act,* it falls under the advice requirements.

Removing the focus on solving the real problem

Mandated automatic flood cover with or without an opt-out, will remove motivation for governments to undertake the hard reforms required to reduce the true problem.

If governments are able to guarantee that communities at risk of flooding, receive post-event recovery funding through insurance (or other measures) there will remain little appetite to carry out the work required to actually reduce the level of flooding that occurs. International examples such as the current situation with flood insurance in the UK give ample evidence of this predictable phenomenon[15].

Reducing the level of risk to the community through mitigation is achievable in the vast majority of cases. It will however require mitigation reforms from governments that seek to reduce the probability of future flood events and the impacts to the community, rather than shifting the costs elsewhere.


Stopping flood damage occurring through adequate mitigation is the outcome the community expects.

A dedicated pool will be expensive for the community and doesn't address the problem

The majority of insurers are strongly opposed to the establishment of a dedicated natural disaster pool as outlined by the NDIR. Capacity exists in the private market to underwrite the risk affordably, if those in the highest risk areas are given targeted and tested support by those governments responsible for mitigation.

A dedicated pool for natural disasters or flood risks would serve to distort the provision of private market insurance and would ultimately increase the cost of living for those with no or low risks as they are forced to subsidise those with high risks.

A pool would also involve the establishment of a new bureaucracy or the expansion of an existing one, which would also need to be funded. This should not come from policyholders.

Government intervention into private insurance markets should be kept to a minimum. Government involvement, for example through the creation of insurance programmes or pools, can increase the potential burden on the taxpayer after a loss and create hidden subsidies. It can also limit the effectiveness of the insurance industry by distorting competition and reducing rates to uneconomic levels. This in turn can result in government-run schemes expanding beyond their original remit, creating large liabilities for taxpayers both by expanding the number of policyholders and by increasing the implicit subsidy to each.

Notably, the NDIR Issues Paper refers to the FAIR plans in the United States. It should be noted that these plans, and the Beach and Windstorm plans, which cover mainly wind only risks in selected coastal areas of the US, have over the last forty years experienced considerable growth.

Between 1990 and 2005, the total FAIR and Beach Plan policies in force rose from 780,000 to over 2 million. Their exposure to loss rose from US$40.2 billion in 1990 to US$380 billion in 2005. This shift has left some plans with huge concentrations of risk and the potential for severe financial difficulties.[16]

Another example of a government flood pool is the US National Flood Insurance Program (NFIP). Government policy has driven the NFIP's premium rates well below those the private market would offer to cover flood. It provides overall flood insurance at one-third true risk cost in higher risk areas owing to its rating methodology and is restricted by law in its ability to adjust existing rates and to offer

[15] Much weight is given by some stakeholders to international flood insurance schemes as potential examples for Australia to follow. The UK flood insurance arrangement is now at risk of failure due to a government failure to commit to mitigation and the US flood insurance program is running at a deficit of $18.3 billion – a cost to be borne by US taxpayers. Other international examples are discussed at www.oecd.org/dataoecd/51/9/18074763.pdf

[16] Further information can be found in the Insurance Information Institute 2007 report "From Markets of Last Resort to Markets of First Choice".

risk-based pricing. According to a March 2011 report by the US Government Accountability Office, the NFIP owed the Treasury US$17.8 billion and was in serious need of financial reform.

There are more cost effective and targeted measures that could be used to address individual affordability and capacity to pay issues, that would benefit the community.

Unaffordability: Temporary targeted government subsidies whilst mitigating

Where flood risks are high as a result of inappropriate land-use planning and/or a lack of mitigation, private market flood insurance solutions can result in high premiums that may be unaffordable for some in the community.

Each insurer presently underwriting flood has invested in actuarial processes to determine a competitive premium relative to their own underwriting criteria. ICA has developed a raw technical flood premium that is an relatively unsophisticated representation of the relationship between damage | cost | probability | number of properties, but that nonetheless is a conservative estimation of the cost of flood premiums.

This raw data does not represent actual costs, as many other factors must be taken into account.

Table 3

Risk Band	Frequency of flooding (ARI)	Number of properties	Probability of flooding p.a.	Average Claim Size ($)	Flood Risk Premium ($)	Annual cost of flood ($mil)
No Flood risk	Nil	6,174,912	0%	$ -	$ -	$ -
Low	Greater than 111	276,277	0.19%	$ 40,242	$ 77	$ 21
	Total low	***276,277***	***0.19%***	***$ 40,242***	***$ 77***	***$ 21***
Medium	111 to 105	3,509	0.93%	$ 40,849	$ 378	$ 1
	105 to 100	3,081	0.98%	$ 40,895	$ 399	$ 1
	100 to 67	25,292	1.25%	$ 40,544	$ 507	$ 13
	67 to 50	18,483	1.75%	$ 41,475	$ 726	$ 13
	Total medium	***50,366***	***1.39%***	***$ 40,928***	***$ 572***	***$ 29***
High	50 to 40	14,092	2.25%	$ 42,333	$ 952	$ 13
	40 to 33	12,149	2.75%	$ 43,269	$ 1,190	$ 14
	33 to 29	8,160	3.25%	$ 43,557	$ 1,416	$ 12
	29 to 25	9,373	3.75%	$ 43,979	$ 1,649	$ 15
	25 to 22	8,073	4.25%	$ 45,220	$ 1,922	$ 16
	22 to 20	6,019	4.75%	$ 45,832	$ 2,177	$ 13
	Total high	***57,867***	***3.28%***	***$ 43,736***	***$ 1,443***	***$ 84***
Extreme	20 to 18	6,654	5.25%	$ 46,456	$ 2,439	$ 16
	18 to 17	3,610	5.75%	$ 46,514	$ 2,675	$ 10
	17 to 15	7,905	6.25%	$ 47,554	$ 2,972	$ 23
	Less than 15	39,410	> 6.50%	$ 58,880	$ 6,777	$ 267
	Total extreme	***57,578***	***9.70%***	***$ 55,114***	***$ 5,496***	***$ 316***
	All Flood prone	**442,088**			**$ 1,018**	**$ 450**

Technical Flood Premium Calculations produced for ICA July2011 – Finity Consulting

* Property numbers quoted in this table are conservative and are based on 2006 estimates – This would need to be adjusted upwards to account for the number of properties now mapped in each risk band, with effect the latest data of June 2011 – See Table 1, Page 6.

The flood risk premiums depicted in *Table 3* are only one layer of the total premium that would be payable by an individual seeking to purchase cover. With the addition of the premium payable for the other risks covered under the policy, plus taxes and FSL, a NSW resident in a flood zone may be facing premiums as per *Table 4*.

Table 4

Risk band	Non-flood risk premium	Average Flood Risk Premium	Total premium	FSL @ 23%	GST 10%	State stamp duty @ 9.0%	Base cost to Household*
Low	617	77	694	160	85	85	**$1,023 ***
Medium	617	572	1,189	273	146	145	**$1,754 ***
High	617	1,443	2,060	474	253	251	**$3,038 ***
Extreme	617	5,496	6,113	1,406	752	744	**$9,015 ***

* This does not include insurer and reinsurance costs

There is presently a great deal of competition and innovation in the market regarding how individual insurers are pricing the risk. Importantly, under a mandated scheme with a flood insurance pool concept, this competition and innovation will largely be redundant. Current competitive activity forcing premiums down, will no longer exist with a government pool in operation.

Where high premiums occur as a result of unmitigated high flood risks, government should consider measures to provide direct support to those who do not have the capacity to protect themselves . Such measures may include a means/capacity tested rebate or premium subsidy, paid directly to eligible high risk property owners or a premium subsidy paid directly to insurers to offset a flood premium at point of sale for those who are eligible.

The post-flood ICA consumer survey found that there was majority support for Government assistance to encourage the purchase of private insurance, with 61.5% of households surveyed in favour of the Government providing some sort of concession or premium rebate to households that have purchased flood cover.

Government solutions to other affordability issues provide useful models and should not be immediately discarded in favour of a pool. For example, the First Home Buyers Grant – Eligibility can be established, a process for payment of a subsidy or rebate defined and the outcome of supporting those in need can be met.

However, affordability is not just about capacity to pay – its about willingness to pay.

Insurance as a relative priority for householders is also an issue. Insurance products are often prioritised below other discretionary household expenditure. The table below was produced by the ICA drawing from data from the Australian Bureau of Statistics Household Expenditure Survey, for the various income groups in Queensland:

ABS2003/04 Household Expenditure in Queensland on Insurance Vs Other Discretionary Items as proportion of household income							
Income Quintile	Pay TV	Take-Away	Fresh Food	Alcohol & Tobacco	Gambling	Contents Insurance	Building Insurance
1st	6.6%	4.1%	6.2%	4.9%	3.1%	1.7%	2.1%
2nd	2.3%	2.9%	4.0%	4.5%	2.5%	1.0%	1.6%
3rd	1.6%	2.8%	2.5%	3.7%	0.0%	0.7%	0.6%
4th	1.1%	2.6%	1.9%	3.2%	0.6%	0.5%	0.5%
5th	0.7%	1.9%	1.4%	2.1%	1.3%	0.3%	0.3%

From this table, it can be seen that for all income groups in Queensland, **expenditure on insurance is prioritized below spending on other household goods and services such as subscription television, spending on alcohol and tobacco** and spending on food purchased outside the home.

Claims that household insurance premiums are unaffordable should only be made in the context of what discretionary funds are used for in lieu of purchasing adequate insurance.

Whilst some commentators might take this as a sign that home and contents insurance should be made mandatory, a more reasonable free market view is that greater financial literacy is needed on the importance of having adequate insurance.

Government subsidisation for those living with a high risk

With regard to subsidising those at high and extreme risk (estimated at less than 2%), the ICA is of the view that it should only be conducted in a manner that

- does not impact financially on those who have a low level or no flood risk
- does not encourage those at high risk to do nothing to avoid the risk,
- does not encourage further expansion of the number of properties at high risk, and
- motivates those responsible to carry out mitigation to reduce the risks.

The creation of a dedicated 'flood pool' to pay for claims or to subsidise premiums for those at high risk would be complicated and potentially costly. Pools for natural disasters that involve inequitable cross subsidies ultimately distort the operation of the private market and lead to those with low risks enduring a higher cost of living to pay for the costs of those with higher risks. Asset values and income levels of property owners are also important considerations (and complications) if affordable flood insurance subsidy mechanisms are to meet the community outcome of assisting with 'affordability' issues and not simply supplement the lifestyle of those who can afford to insure and who wish to remain in a waterside location. Who will be eligible for a subsidy or support?

Parallels drawn between the necessary creation of the terrorism pool in Australia to meet a market failure and the need for the creation of a flood pool are not in all cases relevant to the extent that the private market is capable of providing affordable cover to the majority of households. Government intervention on this issue should be limited to providing support to eligible purchasers of flood insurance at the upper end of the flood risk spectrum.

Should the government view that there is a portion of the high risk community that should be entitled to support in order to obtain flood insurance, it should be:

1. targeted at residential property owners where high or extreme flood risk makes premiums potentially unaffordable;
2. applicable only to home insurance (ie building and/or contents) for domestic residences;
3. based upon an agreed national database of flood risks categorising properties according to government flood maps;
4. payable directly to the policyholder as a rebate or subsidy from government upon application, **or**
5. payable as a premium subsidy at the point of sale, either directly to the insurer or to the policyholder, where the subsidy is:
    a. based upon an actuarially negotiated formula for at risk properties where the property owner pays the major portion of the risk premium and the government funds the minor portion;
    b. transparently declared to the policyholder as a subsidy payable by government to the insurer on behalf of the policyholder;
    c. remitted by government to the insurer accepting the risk, within 7 days of the policy being accepted for a property listed in the national database of flood risks;
    d. renegotiated on a 3 - 5 yearly basis between government and the ICA as a representative of the general insurance industry;
6. accompanied by an agreement to fund mitigation and draw down the number of flood exposed property over a suggested period of 20 years at which time the need for ongoing premium support should be reviewed.
7. recovered or offset by contributions from local governments who have residential flood risks and who do not undertake mitigation.

8. be exempt from insurance taxation, unless government wishes to have their own contributions taxed.

Importantly, insurers must remain free to apply self determined flood premiums (net of agreed subsidy) to ensure continued competition in the market and retain the insures right to manage risk selection according to own risk appetite for flood risk.

The advantages of a direct premium subsidy or rebate model are that it will not necessitate the establishment and management of a large standing pool. Once design of the process is complete and a contribution/rebate formula established, transactions can be automated and drawn down state government funds established in the same manner as the homebuyers subsidy scheme. The quantum of the annual funds required by State Governments varies according to which scenario and risk threshold the government prefers.

Assisting with unaffordability: A scheme to provide subsidies

A model similar to the First Home Buyers Scheme provides a template for how subsidies or rebates could be provided to eligible homeowners using previously successful mechanisms – whilst maintaining the critical link and motivation for mitigation to be carried out to reduce the number of risks over time.

The majority of insurers prefer a direct subsidy model to assist those in need of government support for flood insurance, based on the following schematic:

Eligibility for Subsidy
- Primary place of residence
- Applicant is a natural person or trust
- Applicant is an Australian citizen resident at the property
- Sum insured not exceeding state average (capped rebate)
- Existing property registered as a known high or extreme flood risk.
- Constructed prior to 2011
- Annual premiums only

Information Required
- Property database of agreed High and Extreme flood risks for matching against application at time of sale, for properties as at 2011.

Administration of Scheme
- Commonwealth treasury to manage scheme with Federal AG, to ensure linkage between payment of subsidy's with planned mitigation projects to reduce the flood risk in that location.
- Office of State Revenue to Administer Scheme at State Level
- Insurers who provide flood cover in the State, register to apply the agreed rebate at the point of sale once eligibility of the property owner is established against the register of agreed flood prone properties.
- Alternatively, a where an insurer does not offer point of sale assistance, the policyholder may seek a rebate directly from government.
- Property owner pays part of the flood risk premium to insurer, the insurer collects the government co-contribution from the Office of State Revenue within 7 days.
- Property owner becomes a policyholder with a covernote for the property. If government rebate is not paid within 14days cover is withdrawn.

Scheme Costs
- Administration and systems costs to be borne by the State.
- State to relinquish percentage of revenue from Insurance Stamp Duties (or other income) for the purpose of paying targeted subsidies.
- Insurers to bear administration and systems costs of being registered agent for the scheme.
- Policyholder to bear transaction costs as applicant for subsidy.
- Potential aggregate scheme costs vary according to shares of flood premium to be paid by policyholder and government respectively.
- Agreed flat rebate for each risk band to be established on 3yr basis by joint actuarial committee established between government and ICA.

There are a variety of ways in which the premium subsidy could be approached regarding the component to be paid by government (the subsidy) and the component to be paid by the consumer.

It is critical that the risk price signal for the property owner be maintained, there should be no free riders in the system where a subsidy has the effect of removing any motivation for the property owner to take action at a property level to reduce their risks or to consider relocation. As an extension of this it is important that all stakeholders are discouraged, through a risk price signal, from establishing new property in high risk locations.

The balancing act to be achieved is to maintain this price signal for the property owner, whilst providing reasonable support from government to address the governments contribution to the risky position the property owner finds themselves in as a result of a lack of mitigation or bad land-use authorisation.

Regardless of the mechanism to strike this balance, the constant factor under each different combination is that the combined premium (subsidy + consumer) would be paid to the insurer[17] who would underwrite and retain 100% of the risk.

Several options and examples for splitting the subsidy and consumer premiums are (referencing the technical flood premiums from Table 3):

Option 1a: Capping Government subsidy to $500 a year

Risk Band	Average Premium paid ($)		Average annual flood cost ($mil)			Split of cost	
	Consumer	Subsidy	Consumer	Subsidy	Total	Consumer	Subsidy
Low	$ -	$ 77	$ -	$ 21.2	$ 21.2	0%	100%
Medium	$ 86	$ 485	$ 4.3	$ 24.4	$ 28.8	15%	85%
High	$ 943	$ 500	$ 54.6	$ 28.9	$ 83.5	65%	35%
Extreme	$ 4,996	$ 500	$ 287.7	$ 28.8	$ 316.5	91%	9%
Total flood prone risks	$ 784	$ 234	$ 346.6	$ 103.4	$ 450.0	77%	23%

Option 1b: Capping consumer premium to $500 a year

Risk Band	Average Premium paid ($)		Average annual flood cost ($mil)			Split of cost	
	Consumer	Subsidy	Consumer	Subsidy	Total	Consumer	Subsidy
Low	$ 77	$ -	$ 21.2	$ -	$ 21.2	100%	0%
Medium	$ 485	$ 86	$ 24.4	$ 4.3	$ 28.8	85%	15%
High	$ 500	$ 943	$ 28.9	$ 54.6	$ 83.5	35%	65%
Extreme	$ 500	$ 4,996	$ 28.8	$ 287.7	$ 316.5	9%	91%
Total flood prone risks	$ 234	$ 784	$ 103.4	$ 346.6	$ 450.0	23%	77%

Option 2a: Capping Government subsidy to $1000 a year

Risk Band	Average Premium paid ($)		Average annual flood cost ($mil)			Split of cost	
	Consumer	Subsidy	Consumer	Subsidy	Total	Consumer	Subsidy
Low	$ -	$ 77	$ -	$ 21.24	$ 21.24	0%	100%
Medium	$ -	$ 572	$ -	$ 28.79	$ 28.79	0%	100%
High	$ 455	$ 988	$ 26.31	$ 57.20	$ 83.51	32%	68%
Extreme	$ 4,496	$ 1,000	$ 258.88	$ 57.58	$ 316.46	82%	18%
Total flood prone risks	$ 645	$ 373	$ 285.19	$ 164.81	$ 450.00	63%	37%

Option 2b: Capping consumer premium to $1000 a year

Risk Band	Average Premium paid ($)		Average annual flood cost ($mil)			Split of cost	
	Consumer	Subsidy	Consumer	Subsidy	Total	Consumer	Subsidy
Low	$ 77	$ -	$ 21.24	$ -	$ 21.24	100%	0%
Medium	$ 572	$ -	$ 28.79	$ -	$ 28.79	100%	0%
High	$ 988	$ 455	$ 57.20	$ 26.31	$ 83.51	68%	32%
Extreme	$ 1,000	$ 4,496	$ 57.58	$ 258.88	$ 316.46	18%	82%
Total flood prone risks	$ 373	$ 645	$ 164.81	$ 285.19	$ 450.00	37%	63%

Option 3a: a sliding scale

Risk Band	Split of cost		Average Premium paid ($)		Average annual flood cost ($mil)		
	Consumer	Subsidy	Consumer	Subsidy	Consumer	Subsidy	Total
Low	100%	0%	$ 77	$ -	$ 21.24	$ -	$ 21.24
Medium	100%	0%	$ 572	$ -	$ 28.79	$ -	$ 28.79
High	65%	35%	$ 938	$ 505	$ 54.28	$ 29.23	$ 83.51
Extreme	28%	72%	$ 1,546	$ 3,950	$ 89.01	$ 227.45	$ 316.46
Total flood prone risks	43%	57%	$ 437	$ 581	$ 193.32	$ 256.68	$ 450.00

Option 3b: a flat scale

Risk Band	Split of cost		Average Premium paid ($)		Average annual flood cost ($mil)		
	Consumer	Subsidy	Consumer	Subsidy	Consumer	Subsidy	Total
Low	40%	60%	$ 31	$ 46	$ 8.50	$ 12.75	$ 21.24
Medium	40%	60%	$ 229	$ 343	$ 11.52	$ 17.27	$ 28.79
High	40%	60%	$ 577	$ 866	$ 33.40	$ 50.11	$ 83.51
Extreme	40%	60%	$ 2,198	$ 3,298	$ 126.58	$ 189.88	$ 316.46
Total flood prone risks	40%	60%	$ 407	$ 611	$ 180.00	$ 270.00	$ 450.00

[17] .. or be recovered by the policyholder from government as a rebate if the policyholder has paid the premium up front.

Funding for targeted rebates and subsidies should come from those responsible for mitigation

Premium subsidies or rebates should be funded by those who are responsible for the management of environmental hazards and planning of the built environment, who have created the flood risks to property over time. This would present a targeted incentive for those governments to mitigate and reduce the exposure over time.

Community members who currently insure, provide State Governments with significant revenue through duties, taxes and levies. Whilst these taxes act as a direct disincentive to take out insurance it is clear that those in the community who 'do the right thing' by insuring are contributing significantly to state treasuries.

In 09/10 State Governments collected $4.6 Billion in revenue from insured members of the community:

Taxes	NSW	VIC	QLD	SA	WA	TAS	ACT	NT	Total
FSL	$554,000,000	$538,000,000	0	0	0	$17,000,000	0	0	$1,109,000,000
Stamp Duty	$1,073,000,000	$725,000,000	$449,000,000	$295,000,000	$428,000,000	$43,000,000	$57,000,000	$29,000,000	$3,099,000,000
Other	$135,000000	$140,000,000	$59,000,000	$52,000,000	0	$4,000,000	0	0	$390,000,000
Total	$1,762,000,000	$1,403,000,000	$508,000,000	$347,000,000	$428,000,000	$64,000,000	$57,000,000	$29,000,000	$4,598,000,000

Source ABS Catalogue Number 55060Do001_200910 Taxation Revenue Australia, 2009-10

Notably, this table only represents the revenue generated for State Governments, a further approximate $1,500,000,000 is collected for the Federal government through GST on insurance products.

With this revenue already being raised through policyholders, it is clear that State's have current capacity to relinquish a proportion of revenue to carry out targeted mitigation works to reduce the risks to those in the community who insure and to subsidise those who have a high risk burden due to poor planning and mitigation.

Whilst the use of Stamp Duty Revenue for this type of activity is a form of cross subsidization by government, the relinquishment of revenue would serve as a powerful motivation to carry out mitigation, to reduce the risks and to gradually reduce the extent of subsidization required. Alternatively, State Government could apportion recoveries of the subsidies to local governments who have flood risks and who are not actively mitigating.

Should insurers contribute to premium subsidies?

The NDIR issues paper suggests that one source of funding subsidies should be from insurers themselves. Insurers are strongly opposed to the concept that policyholders would be required to contribute. A cross subsidisation of the premium, to other policyholders with no flood risk, would have the undesirable effect of increasing their premiums and reducing the price signal to the property owner with the risk.

The funding of a premium subsidy (or other subsidy) must be delivered by the party who owns the asset and the party who has caused the risk, thereby creating motivation to act on mitigation.

Measuring the flood risks – Flood mapping and information access

The unavailability of transparent flood mapping in Australia is a significant contributor to the current challenges facing flood insurance and flood risk mitigation.

The ICA submits that this should not be undertaken by a new Flood Insurance Pool, but by a Federal Agency with current responsibilities for flood warning, alerts and broader water management information. A single body, with appropriate powers and responsibilities should assume a national responsibility for the collection, maintenance and publication of flood information.

The Bureau of Meteorology (**BoM**) should be delegated with responsibility for, and appropriate powers in connection with, the collection, maintenance and publication of national, open source, flood information.

This should be achieved by an amendment to the *Meteorology Act 1955 (Cth)* (**Meteorology Act**) to:

- allow or confirm that the BoM has the power to collect existing flood data and other flood information. This will include the power to collect this information from state and local governments.
- require the BoM to:
    - maintain and update this flood information to ensure it remains accurate and up to date; and
    - publish this flood information to the public at no cost.

Parallel to this legislative change, a flood information taskforce should be established to assist the BoM, in an initial implementation period, to examine what improvements can be made in Australia regarding flood information.

A critical part of being prepared for the next flood is the capacity to:

understand clearly the land zones (in particular, population zones) that are most likely to be impacted by flood events;

predict the occurrence and magnitude of flood events; and

deliver appropriate warnings to communities that will be impacted.

Similarly, critical factors for the insurance industry in offering affordable flood insurance are:

the ability to predict the likely impact (occurrence and severity) of flood events on particular properties and infrastructure; and

the minimisation of the impact of flood events on properties and infrastructure.

From the above, it can be seen that government, the community and the insurance industry have a shared interest in ensuring that everything that can be known about flooding, is known by all of those involved in its risk management.

Publically available flood mapping and other flood impact information is crucial to community understanding and risk management of flood risks and the contribution of the insurance industry to the risk management of flood events.

Its already government policy – The National Resilience Strategy

On 13 February 2011, the Council of Australian Governments (**COAG**) adopted the National Strategy for Disaster Resilience[i].

Better risk management for the community is central within this strategy. The strategy recognises that the collection and access to relevant information and data is a crucial plank in successful community risk management of disaster events.

On page 7, the strategy paper states that:

> 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.

One of the priority outcomes of the strategy is identified[ii] as:

> Organisations, individuals and governments routinely share information and maps on risks, for the benefit of the community.

In order to achieve the requisite understanding of disaster risks, in particular the risks posed by flood, a single national body should coordinate the collection and publication of information and maps on risk. This will:

- avoid overlapping roles and responsibilities at local, state and national level, while not detracting from the ability of a local or state government to collect this information;
- enhance accountability of the collection agency; and
- streamline access to information for the community.

Role of the Bureau of Meteorology (BoM)

The BoM is Australia's national weather, climate and water agency.

Its expertise and services include the provisions of regular weather, climate and water forecasts, warnings and monitoring for the Australian region and Antarctic territory. As many know, much of this information is publically available on the BoM website[iii].

The BoM operates under the *Meteorology Act 1955 (Cth*) (**Meteorology Act**) and the *Water Act 2007 (Cth)* (**Water Act**).

The BoM is responsible for, among other things:

- under the *Meteorology Act*, issue of warnings of gales, storms and other weather conditions likely to endanger life or property, including weather conditions likely to give rise to floods or bush fires, the supply of meteorological information, the publication of meteorological reports and bulletins and the promotion of the use of meteorological information[iv]; and
- under the *Water Act*, collecting, holding, managing, interpreting and disseminating Australia's water information and providing regular reports on the status of Australia's water[v].

In accordance with these responsibilities, the BoM currently provides the following services:

- forecasting and issuing weather warnings, including flood warnings; and
- monitoring, assessing and forecasting the availability, condition and use of water. This includes seasonal stream flow, water storage and flood forecasting[vi].

Given the scope of the current roles and responsibilities of the BoM, and its status as a Commonwealth executive agency, the BoM is the entity most appropriate to assume the overall responsibility for flood information.

To extend the BoM's current roles and responsibilities to include overall responsibility for flood information, *Meteorology Act 1955 (Cth*) (**Meteorology Act**) will need to be amended to:

- allow or confirm that the BoM has the power to collect existing flood data and other flood information. This will include the power to collect this information from state and local governments.
- require the BoM to:
  - maintain and update this flood information to ensure it remains accurate and up to date; and
  - publish this flood information to the public at no cost.

To assist in expanding the BoM's flood information responsibilities and capabilities further funding of the BoM by the Australian Government will be required.

This funding should be used, during the first year of operation, to establish enhanced flood information capability, gather all of the required flood information and, at the end of the first year of operation, make further recommendations on improvements to information relevant to flood.

Once the required legislative changes have been enacted, it is submitted that the BoM should be assisted by a flood information taskforce that will examine what improvements can be made in Australia regarding flood information.

Improving household understanding of individual flood risk

Property owners who live in flood zones should have an explicit understanding of the risks they face.

When asked about the source used to assess the insurable risks to their households ' own personal judgement ' was nominated by 88% of respondents, 'local councils' 32% of the time and 'members of the community or neighbours' 32% of the time. The BoM and Local emergency services were nominated as sources 32% and 11.0% of the time while the local media was surprisingly nominated by 22.0% of households surveyed. It is clear that households in flood zones have been forced to gain knowledge from a range of sources, in lieu of it being provided in a consistent manner by a competent authority.

Credible knowledge of the flood risk should be held prior to purchasing a property, or the leasing of a property, and should be reiterated to the owners and occupants of a risk property prior to each flood season. No property owner or tenant should be 'surprised' by the advent of a flood, or should be forced to compare competing information from variable sources.

A knowledge of the flood risk enables property owners to take action.

Such actions may include:

- Implementing property level mitigation measures and building improvements
- Developing a flood emergency response plan
- Purchasing flood insurance
- Engaging with local authorities regarding flood mitigation efforts in the area

Local consent and planning authorities have a moral and legal responsibility to ensure that adequate risk information is provided to householders regarding both the predicted level of flood risk, as well as temporal flood risk information in the face of an impending flood event.

It is the view of the ICA that this responsibility is carried out in an inconsistent manner nationwide, with some local councils providing residents with ample information at regular intervals, whilst others provide little or no information, often only when absolutely required under State law.

The ICA commissioned a consumer survey of Queensland residents following the 2010/2011 Flood Event to understand consumer issues and the potential drivers of decision making around the purchase of property insurance. Approximately 22% of flood impacted residents in the Queensland Floods (2010/1011) who had not purchased flood insurance, indicated that the primary reason for not purchasing flood cover was that they did not know that they had an exposure to the hazard.

To improve this situation the ICA proposes that a National Reform be undertaken through COAG to harmonise State legislation regarding disclosure of risk information to property owners and occupants. These changes should require:

1. The property owner to receive a certification of the flood risk at the time of purchase of a property.
2. Certification of the flood risk to be attached to property rental leases by a licensed property manager or by the owner of the property.
3. Property agents to draw attention to the certified flood risk to prospective purchasers and/or renters.
4. States to agree to the adoption of a harmonised property rating system for the flood risk and this flood rating system to be used in all declarations of the risk and communication with property owners, occupiers and tenants.

5. States to agree to a regime where owners, occupiers and tenants of properties with a high flood rating are reminded at least annually (prior to each flood season) of the rated flood risk at their location.

To support the effort to ensure those with risks are informed by relevant authorities, a national property register of flood risks, based upon government flood mapping should be developed. For example – property may be categorised as follows and that categorisation would be used by government, industry and property owners to reference risks:

Flood Category	Exposure	Description
Category F0	**None**	No known flood risk
Category F1	**Low**	Property may be exposed to flood risks greater than 1:250yr return periods
Category F2	**Low - Medium**	Property may be exposed to flood risks between 1:100yr and 1:250 yr return periods
Category F3	**Medium - High**	Property may be exposed to flood risk between 1:50yr return period and 1:100yr.
Category F4	**High - Extreme**	Property may be exposed to flood risk between 1:20yr return period and 1:50yr return period.
Category F5	**Extreme**	Property may be exposed to a flood risk of greater than 1:20yr return period.

ICA further proposes that as part of maintaining a private market solution to flood insurance, that the industry fund and maintain an interactive public portal, showing flood risk at property level, which is accessible via internet and smartphone applications. Such a community engagement solution would be contingent upon provision of local government flood mapping.

Improving property owner understanding of flood insurance cover inclusion or exclusion

Industry has agreed to the development and use of a *Key Facts Statement* to accompany policy documentation. This *Key Facts* document will enhance current disclosure arrangements and will further ensure that policyholders have every opportunity to comprehend the extent of the cover they are considering a purchase of.

To facilitate disclosure improvements, ICA considers it critical that government accelerate consideration of changes to the *Insurance Contracts Act* that would authorise insurers to send disclosure documentation electronically where it is appropriate to do so.

The present regime of disclosure has been driven by the enactment of FSR some 10 years ago. The FSR changes have caused policy documentation to be longer and more complex. The ICA would welcome an opportunity to participate in a review of the FSR regime to determine if it continues to meet desired community outcomes, or needs adjustment to accommodate modern approaches to communication and delivery.

Government mitigation to reduce the hazard

Poor planning regimes that allow inappropriate development, building codes that do not instil durability into the built environment and a failure to mitigate flood risks all combine to maintain a high, but preventable, level of flood risk for some in the community. Insurers do not contribute to these causal factors, but do offer financial risk products to at risk communities where the risks are within an appetite and capacity to do so. Insurers operate at the end of the chain of hazard events, but have a strong interest in encouraging those who control the hazards to do so thoroughly.

The following initiatives are required in order to reduce the risk of flood damage occurring to residential property in Australia:

1. A commitment from government, through COAG to undertake flood mitigation in flood prone regions, such that the number of individual properties exposed is reduced each year. Simple strategies are available from international experience and include:

   a. Minimum floor heights and structural requirements for at risk property,

   b. Investment in flood barriers, canals, dykes, pumps, levees and flood retention works in at risk locations,

   c. Deep setbacks buildings from hazard sources, or compulsory construction in a hazard appropriate manner such that the risk of damage is reduced,

   d. Relocation of buildings or infrastructure that are at risk,

   e. Land buyback or land-swap[18] schemes where possible and as a last resort to address extreme risks.

2. The Building Code of Australia should be reformed to include a minimum performance requirement for durability of property to hazards both present and predicted over the lifespan of the property, to the extent that following a natural hazard occurring the property remains useable for its registered purpose. The present government minimum standard for buildings only reflects sustainability, safety and cost.

   Whilst the government is prepared to intervene in private insurance to mandate the adoption of cover by private citizens, it has long neglected the need to ensure that the buildings that Australians invest in, construct and occupy are able to remain functional after extreme weather.

   The building code of Australia requires modernisation to world's best practice that incorporates minimum standards for cost effective property durability. The introduction of cyclone building codes in the 1980's to help preserve life in cyclone prone regions has had unintended successes in preventing damage to buildings, with a reduction in cyclone damage claims of an average of 63%[19].

   Deliberate action to assist Australians to become more resilient is possible and should be a priority.

   General insurance advice to the Australian Building Codes Board, accompanied by amendment of the BCA principles is recommended.

3. There is a need to review and upgrade the capability of the National Disaster Mitigation Program. The NDMP provides an application and funding mechanism for mitigation projects aimed at reducing community exposure to natural hazards. Mitigation projects approved under the NDMP have included:
   a. Natural disaster risk management studies;
   b. Disaster mitigation strategies;
   c. Investment in disaster resilient public infrastructure;
   d. Structural works to protect against damage (eg. Levees)
   e. Community awareness and readiness measures;
   f. Land and building purchase schemes in high-risk areas.

   The ICA submits that the broad objectives of the mitigation program remain appropriate, however the scale and importance placed on the program will increase as a result of the changed hazards predicted as a result of climate change. In this regard, the ICA submits that the NDMP program objectives would be properly improved with an expansion to include more

[18] The local government responsible for Grantham (QLD) has initiated a voluntary land-swap scheme for residents who currently have flood exposed property, offering to resume their land and in return granting them title to land nearby that has a lower risk profile – This is mitigation in action and has been commended by the general insurance industry as an example of a local council undertaking a hard reform to remove a community risk.

[19] McAneney, J., Crompton, R. and L. Coates, 2007. *Financial benefits arising from regulated wind loading construction standards in Tropical Cyclone areas in Australia*. Report prepared for the Australian Building Codes Board, Risk Frontiers.

flood mitigation as well as stormwater mitigation and drainage works. Bureau of Transport & Economics data shows that 55% of property damage in Australia arising from weather events comes from flooding and severe storms.

Accordingly, the ICA submits that a review of the funding adequacy of the NDMP program be undertaken. Federal funding for the NDMP is estimated to be around $35 million in 2008/09, as compared to some $90 million set aside for natural disaster relief recovery.

Flood pool proposals from NDIR and other options

The majority of the industry prefers a concept where no flood insurance pool is created and direct subsidies are paid to those who need support. It is apparent however, from the *Issues Paper*, that the NDIR Panel has a strong preference for creating a government flood insurance pool.

The ICA submits that the NDIR process is not capable of a proper examination of the economic consequences of flood pool options.

Should government insist on the establishment of a dedicated pool it is recommended that the Productivity Commission be used to conduct a full impact study and costing of the various options, as well as the key risks and benefits.

Some alternative examples of flood pool options not considered by the NDIR are:

Model: **100% Government Flood Insurance**
Concept: The private market ceases to provide options for the community to purchase riverine flood cover. Government creates scheme to pay for post event funding of individual recovery, asset repair and replacement. Pool to be funded by government.

Model: **Private Insurance Capped Claim Topup of Claim Value from Government**
Concept: Private market offers flood insurance priced on the basis that the insurer's contribution to a flood claim is capped (eg 5% of sum insured). Where a claim exceeds the cap, a government pool pays the additional claims cost. Pool to be funded by Local and State Governments based on flood risk.

Model: **Government Flood Insurance Pool for High Risk Properties**
Concept: Government accepts insurance responsibility for high and extreme risks properties, paying claims from a government pool, funded by state, federal and local governments.

Model: **Government Insurance Capped Claims Optional Private Insurance Topup**
Concept: Government offers flood insurance with claims to a capped amount. Government pool for paying claims funded by government. Consumers may purchase private flood cover to top-up government claim payment where consumer believes government pool may not cover total value of expected damages.

Extension of premium support to other classes – Commercial, Strata, Contents

The primary objective of offering support to high risk property should be to accommodate protection for primary places of residence. **ICA does not support the extension of premium support to commercial classes of insurance.**

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.

Insurers' 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.

Commercial businesses, particularly in the SME sector are also highly price sensitive and entrepreneurial with regards to risk management. In October 2008, the Insurance Council published a study titled “Non Insurance in the Small to Medium Size Enterprise Sector”. The key findings from that report were:

- 26% of all small to medium sized enterprises (SMEs) do not have any form of general insurance.
- Sole traders have the highest rate of non-insurance with 40.0% operating their business with no general insurance.
- Of the SMEs that purchase general insurance, 94.0% indicated they considered that they were adequately insured. Taken together with the rate of non-insurance, this means that under two thirds of all SMEs have adequate insurance.
- Over 80% of SMEs who indicated that they were inadequately insured sighted the cost of insurance as a barrier to purchasing. Reform of taxation on general insurance products would therefore reduce the cost burden to SMEs and contribute to a reduction in the incidence of non-insurance amongst SMEs.
- For the majority of small businesses, profit expectations do not appear to impact on planned insurance coverage, at least in the short term. 50.0% of respondents indicated they would leave their insurance coverage unchanged despite the expected change in profits over the coming year.

There can be little doubt that government intervention to mandate cover in commercial insurance, that results in any increase in price, will result in more non-insurance and under-insurance in the SME sector.

The preferred approach to addressing governments perceived concerns with insurance in the SME sector is to concentrate on providing unambiguous information regarding the risks the business faces and to encourage a sound approach to risk management.

Mandatory automatic cover for strata policies

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
- 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
- Strata developments are increasingly being constructed in risk prone areas, for example in riverside locations or flood plains where there is ample space for development and land that may have been rezoned specifically for the project, is cheap to acquire for the developer.
- Strata developments are often constructed to minimum standards in an effort to keep unit costs low for the developer. Minimum standard developments often have less durability to common and extreme weather events.

Given the diversity of risk and potential scale of losses in strata title buildings, it is suggested that an "opt-in" model through the private market is the best type of flood cover for strata title customers.

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.

Mandatory automatic cover for contents policies

Premium subsidies for contents insurance are not considered critical as contents are portable and other risk management actions can be undertaken in the face of a flood, for example moving the contents. However, if government is committed to providing the community with a government subsidy, the thresholds for providing government support would need to be carefully considered as both the criticality of contents items (to the individuals lifestyle) and the costs of contents, varies considerably. What support should taxpayers provide to assist in securing flood insurance for those who choose to purchase expensive items.

New insurance arrangements for risks beyond flood

Insufficient information has been presented by the NDIR to suggest that a market failure exists with regard to other risks. There is cover available for landslip and actions of the sea. However as a risk it has a very low rate of occurrence and is therefore not widely sought after by the community.

To consider a mandatory automatic cover system, without an adequate examination of the possible implications would be ill-advised.

If government has particular concerns regarding these issues it should be passed to the Productivity Commission for examination, as recommended by government in 2009 by the House of Representatives Standing Committee on Climate Change, Water, Environment and the Arts. The report of the inquiry *Managing our Coastal Zone in a Changing Climate: the time to act is now,* tabled in the Parliament on 26 October 2009, provided an as yet unacted upon recommendation that:

> ***Recommendation 19***
>
> *The Committee recommends that the Australian Government request the Productivity Commission to undertake an inquiry into the projected impacts of climate change and related insurance.*

Making home building insurance compulsory

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.

Any such consideration, of what would be a tectonic shift in regulation impacting the community, should be referred to the Productivity Commission for serious examination regarding the economic rationale before further any further consideration.

Government disincentives to insurance uptake by households - Taxation

State Governments currently charge Australian property owners and businesses more than $4,598,000,000 each year on insurance transactions. This does not include an approximated $1,500,000,000 raised through GST for the Federal Government.

This revenue raising from the daily budgets of households and operating budgets of small businesses, who are purchasing insurance to ensure their resilience to misfortune, acts as a disincentive. Government intervention in private insurance that leads to an increase in the price of cover will increase the revenue raised by governments through insurance taxes.

The ICA proposes that insurance taxes, including stamp duty on insurance contracts, should be abolished in order to encourage community members to access insurance cover at more affordable rates

The inefficiency of insurance taxes and their drag on insurance take-up by community members is well documented and reported. The Henry Tax Review, the Victorian Bushfires Royal Commission and independent reports from various State government bodices such as IPART in NSW, have variously recommended the removal of these taxes.

Recommendation Number 79 of the Review of Australia's Future Tax System states inter alia: All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption. (Reference: Australia's Future Tax System: Part One: Overview)

In 2007, the ICA commissioned Dr Richard Tooth from the ANU Centre for Law & Economics to undertake an elasticity study into the demand for house and contents insurance in Australia. (see Tooth, Richard (2007) "An Analysis of the Demand for House & Contents Insurance in Australia: A report for the Insurance Council of Australia" (Centre for Law & Economics)

Taking Queensland as an example, the key findings from that report were:

> The number of households without contents insurance in Queensland was 441,000.
>
> The number of households without buildings insurance in Queensland was 34,000
>
> The forecast reduction in the number of households without contents insurance in Queensland if State taxes were removed would be 24,300.
>
> The forecast reduction in the number of households without buildings insurance in Queensland if State taxes were removed would be 4,800.

Removal of taxes on insurance would make insurance more affordable and would therefore assist with achieving greater national resilience – as take up of personal mitigation is enhanced.

Government should act on this issue without further delay.

Underinsurance – Is total replacement cover the answer?

Total replacement cover seeks to guarantees the rebuilding or replacement of a property to an 'as was' condition. This cover is available in the market for any consumer who wants to make a purchase. This cover is typically more expensive to purchase as there is no defined sum-insured and the policy must respond to a large number of unknown factors in the nature of the construction, materials and conditions of the property. This additional expense is acceptable to some consumers, but not all.

Other consumers operate within budgets and prefer to purchase insurance with a known sum-insured. This sum-insured is the total value of the policy and the upper limit of what can be expected to be paid out if there is a total loss. Some products offer additional percentages of cover (+10%, +25% etc) to accommodate policyholder uncertainty.

To assist consumers in determining a reasonable sum-insured to adopt, most insurers offer web-calculators where the consumer can obtain estimates of rebuilding costs for their type of dwelling in that location.

Going further than this, some insurers require that this step be undertaken before a quote will be given and some insurers will now not provide insurance cover for a sum-insured that falls well outside of a recommended sum-insured band for the building described by the consumer.

The concept that the choice of policy type should be removed from the hands of consumers is not supported by the industry. Even the most rudimentary consumer and market analysis shows that consumers consider their insurance purchases in diverse ways to meet a range of different budgetary and personal circumstances.

A one-size-fits-all approach will not suit the Australian consumer and should not be entertained as a real option by any government committed to competition and choice in the market place.

The solution to under-insurance remains education, access to estimation tools and removal of the current $4.6 billion in price disincentives on insurance imposed by governments. (taxation).

What measures could improve consumer understanding of their insurance cover, particularly if purchased over the telephone?

There have been long standing concerns amongst ICA members that the regulatory regime established by the *Financial Services Reform Act 2001* (Cth) fails to adequately consider the specific characteristics of general insurance. (It is notable that the Wallis Report which was the basis for the new regime had very little discussion on insurance.) In responding to these concerns in relation to disclosure, the ICA has done considerable research and analysis over the last two years into options for improving consumer understanding of the insurance cover being offered to them. This work is in addition to the continuing improvements made by individual ICA members to their disclosure documents particularly through the use of plain english.

As part of the Ten Point Plan to Tackle Disasters (the Ten point Plan), the ICA members committed to simplify and improve the summary arrangements in insurance product disclosure statements. Subsequently, the ICA Board agreed with Assistant Treasurer Shorten that the ICA would work with the Federal Government on the development of a one page key facts statement. The Government endorsed the Insurance Council's suggestion that this work be undertaken by Treasury's Financial Services Disclosure Advisory Panel (FSDAP). The ICA has urged Treasury and ASIC to deal with the work on the key facts statement as part of a major project looking at the effectiveness of disclosure in general insurance. As a sign of its bona fides in wanting worthwhile outcomes from FSDAP's work, the ICA made its research findings on disclosure available to both Treasury and ASIC.

The government sought submissions on the possible form and content of a key facts statement as part of its Consultation Paper *Reforming Flood Insurance: Clearing the Waters* and we understand that Treasury will shortly release for consultation a draft Regulatory Impact Statement outlining the direction in which the Government wants to take the key facts statement.

It is unnecessary in this submission to repeat the points made in the ICA's response of 16 May 2011 to the Clearing the Waters paper. The Insurance Council made a number of suggestions as to how a useful one page summary of a policy's key features and exclusions could be devised. However, the ICA urged caution as to how much can be achieved in improving consumer understanding through a one page document. It is important that consumers understand the detail of the cover they are being offered and one page is insufficient for this to be done to the extent necessary for informed decision making.

The ICA acknowledges the view of some consumer advocates that any new disclosure document that a consumer may read is a good result given the low number of consumers who currently read their Product Disclosure Statement (PDS) before purchase. They see the key facts statement as being used to compare and decide between policies. However, due to its one page limit the key facts statement will have such little detail that the Insurance Council sees them more as a tool that consumers can use to identify policies that appear to meet their needs and should be investigated further. It is for this reason that the Insurance Council has recommended that, apart from being freely available in both hard and soft copy, the key facts statement should accompany the PDS when it is provided to a consumer.

The only basis on which meaningful comparisons can be made between policies is using the information in a PDS. The key therefore to improved consumer understanding of insurance will be through the improvements that are made in the usability of PDSs. The Insurance Council looks forward to the ongoing efforts of members in this area and is hopeful that the consumer testing that will be part of the FSDAP's work in developing the key facts statement will provide further insights into possible innovations in disclosure.

The ICA and its members have urged government for a number of years to implement the recommendation of the 2004 report into the *Insurance Contracts Act 1984 (IC Act)* to give insurers the unambiguous ability to provide electronically to consumers documents required by the IC Act without fear of breaching regulatory requirements. The clear ability to communicate electronically would enable insurers to explore innovative ways to explain the contents of a policy to a consumer. Insurance contracts are of necessity detailed documents but in electronic form there are a number of ways in which a consumer could be helped to navigate around a document and quickly find the parts of most relevance to them.

As part of a consultation commenced by ASIC in the second half of 2010, the Insurance Council and its members are already in discussion with ASIC about the disclosure that is required to be made when consumers are ringing around seeking quotes from different insurers for comparative purposes. In view of the wider issues raised by recent catastrophes, the Insurance Council has suggested to Treasury that FSDAP should include as part of its work on general insurance the potential for improving disclosure during telephone sales of insurance. It is possible that the key facts statement could be modified for use in this sales channel.

How would consumers benefit from being provided with personal advice that takes account of the insurer's assessment of the consumer's risk?

In considering the situation of people who suffered loss during the recent catastrophes through not having any or only partial flood cover for their home and contents, it is self evident that some of these cases could have been avoided if they had been prompted to consider whether they were in a flood prone area and if so whether the policy they were purchasing had appropriate flood cover.

However, apart from situations where only product information is provided, in discussing general insurance with a client, a general insurer or their representative will often meet the fundamental test of personal advice – the consideration of one or more of a client's objectives, financial situation or needs. This triggers a number of obligations under the Corporations Act. The Government has provided exemptions from for general insurers from a number of these obligations. (For example, the need to provide a Statement of Advice (SoA) in relation to most classes of general insurance[20].) This relief is appreciated but the onerous requirement remains to have a reasonable basis for personal advice[21].

While such an obligation, with its connotations of an extensive fact find on the personal circumstances of the consumer makes sense for investment products, is overly cumbersome for general insurance products that are typically simple in nature, run for a set period of time, can generally be cancelled at any time and changed at renewal, have a cooling off period and do not involve any risk in terms of lost income or investments.

As a result the majority of general insurance is sold on a 'no personal advice' model. If advice is used, it is most likely to be general advice. The Insurance Council considers that this lack of simple personal advice has hindered consumers in choosing policies with cover suited to the risks they faced. Consequently, the Insurance Council's Ten Point Response to issues raised by the current floods includes:

> "Commitment by government to ensure the advice provisions in the Corporations Act do not impede discussion between consumers and insurers on appropriate insurance cover needs."

The Insurance Council and its members have therefore seen the Government's Future of Financial Advice (FOFA) project as an opportunity to help general insurer's provide limited personal advice on the appropriateness of their policies to meet the consumer's needs. In the context of the FOFA

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[20] See s946B(5)(c) of the Act and reg. 7.7.10 (d)-(i).

[21] Corporations Act s945A:

(1) The providing entity must only provide the advice to the client if:

(a) the providing entity:

(i) determines the relevant personal circumstances in relation to giving the advice; and

(ii) makes reasonable inquiries in relation to those personal circumstances; and

(b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and

(c) the advice is appropriate to the client, having regard to that consideration and investigation.

discussions, the Insurance Council raised the possibility of limited personal advice on general insurance being treated as general advice. (Advice such as that offered by brokers comparing the advantages and disadvantages of competing policies would have continued to have been subject to full personal advice requirements.) However, such alternatives were put to one side by Treasury in favour of seeing whether creating greater certainty around the ability to give scalable advice would give general insurers sufficient confidence to consider offering limited personal advice.

What are the benefits for consumers being provided with scaled advice? What, if any, are the impediments for insurers and insurance brokers providing it?

As explained above, the clear ability to provide scaled advice would enable general insurers to consider a particular aspect of a consumer's insurance needs, such as discussing with them their vulnerability to flood. They could do this without opening up the possibility that they would later be seen by a court as failing their personal advice obligations by not asking about another aspect of a consumer's needs on which they had not sought advice.

Lack of confidence about the ability to scale advice has been widespread across the financial services industry. Treasury and ASIC have tried to reassure financial service providers for a number of years that the existing regulatory regime allows for scalable advice. It is only recently after ASIC provided specific examples in its regulatory guidance that superannuation funds have been confident enough to provide limited personal advice on intra superannuation fund issues.

The Insurance Council welcomed the announcement on 28 April 2011 that the government will legislate to give more clarity in the *Corporations Act* on the ability to give scaled advice and also that ASIC will expand its regulatory guidance on scalability to include more financial services sectors. The Insurance Council looks forward to working with Treasury and ASIC on these matters. In particular, the Insurance Council has urged Treasury in implementing the Government's decision to introduce a best interest duty for financial advisers not to do it is such a way as to counteract the work on scalability. The danger is in implying that an adviser providing limited personal advice has a best interest obligation to go beyond the specific matters that a consumer actually asked for advice about.

Is there a particular need for unfair contracts laws to protect policyholders in natural disaster insurance?

In its submissions to Government and relevant parliamentary committee hearings on the question of whether insurance contracts should be subject to review for unfair terms under the Australian Consumer Law (ACL), the Insurance Council has argued that the IC Act provides better protection to consumers of insurance than would the ACL which was not specifically drafted to address the particular issues raised by insurance contracts.

The effectiveness of the Act in promoting fairness will be strengthened by the amendments that were tabled in the Australian Parliament[22] on 17 March 2010; for example, the proposed ability of ASIC to intervene as a party in any proceeding relating to a matter arising under the Act.

The protections for consumers under the current Act are many and include:

- section 13 which places on both parties an obligation that they act towards each other with utmost good faith and section 14 that prevents a party relying on a contract provision if to do so would be contrary to this requirement.

  The High Court recently stated that "… *an insurer's statutory obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured.*"[23]

  The importance for consumers of sections 13 and 14 will be strengthened by the proposed amendment that gives ASIC the same powers in relation to an insurer's breach of the duty of utmost good faith as it has in relation to a breach by the insurer of a financial services law.

[22] Insurance Contracts Amendment Bill 2010
[23] *CGU v AMP* (2007) HCA 36

- Other restrictions on insurers' contractual rights and remedies to meet specific situations where it would be unfair for the insurer to rely on the right or remedy. For example section 54 restricts the ability of the insurer to rely on a specific act or omission of an insured which brings into play exclusion in the policy if that act or omission did not cause or contribute to the loss or where the insurer cannot show actual prejudice. Consequently, if the insured were unlicensed or under the influence of alcohol but this did not cause or contribute to the loss the insurer could not generally rely on such exclusions in a motor vehicle policy to refuse a claim.

The protections that consumers enjoy in relation to general insurance contracts are further bolstered by provisions of the *Corporations Act,* the free (to consumers) external dispute resolution avenue provided by the Financial Ombudsman Service (FOS) and the General Insurance Code of Practice (the Code). It is also relevant to note the recent changes to the Code which now emphasise the duty of utmost good faith.

When examining dispute data and individual cases, it is clear that insurance contracts are already subject to review on the basis of fairness both under the Act and the terms of reference for FOS. Importantly, due to its broad terms of reference FOS can look beyond the terms of the contract when making a decision. A decision will include not only consideration of legal principles, but applicable industry codes, good industry practice and what is fair in all the circumstances.

The Insurance Council is not aware of any cases of consumer detriment arising from the recent catastrophes that have raised issues of unfairness which are not already addressed by the existing regulatory regime.

The above position notwithstanding, the Insurance Council recognises that the government wants to apply the ACL across all products and service including insurance. The Insurance Council appreciates the current discussions under the direction of the Parliamentary Secretary to the Treasurer, the Hon David Bradbury, to identify options for compromise which would see insurance contracts subject to the ACL but minimise the uncertainty for insurers in relation to the terms on which the insurance was provided.

Industry can assist with achieving positive outcomes

Industry has expertise in the value of risk mitigation, the identification of property risks and measures to help increase the resilience of community members.

In lieu of the creation of a flood pool by government and the delivery of targeted rebates/subsidies and mitigation, industry can undertake actions to assist, if complimented by government actions to address the real problem with flooding.

Industry submits that the following actions be taken:

PROPOSED INDUSTRY ACTIONS	PROPOSED GOVERNMENT ACTIONS
Industry to improve community understanding of flood insurance options through adoption of the Standard Definition for Flood in home & contents policies.	**Government** to provide public access to all publicly funded flood mapping conducted in Australia in a central location, followed by a program to harmonise Australian flood mapping practices to be aligned with worlds best practice.
Industry to clearly identify on a ***Key Facts Statement*** with every home & contents policy that the policy either: 5. Automatically covers flood with no opt-out 6. Automatically covers flood, but the customer can choose to opt-out 7. Excludes flood cover, but the customer can purchase additional cover 8. Excludes flood cover	**Government** through COAG to implement legislation ensuring flood risk disclosure, to provide all property owners and tenants with flood risk information: 4. During title transfer or development application. 5. When a lease is entered into for occupation or use of a property. 6. Annually to the resident and to the ratepayer for the property.
Industry to provide a public portal for property owners to visit and view a representation of the flood risk to their property, to encourage them to consider the benefits of mitigation of the risk, of obtaining adequate insurance and undertaking emergency preparedness.	**Government** through COAG to reach agreement on national policy for land-use planning whereby no residential property is constructed on at risk land, without enforcement of development controls that reduce the risk to less than a 1:100yr return period.
Industry to provide governments with a geo-coded database of known flood prone properties across Australia, according to collected government flood mapping, to facilitate mitigation prioritisation and consideration of direct support to those at risk.	**Government** commit to flood mitigation reform whereby a measurable reduction in the number of flood exposed residential properties in each LGA is achieved each year for 20yrs.
Industry to provide support to governments regarding the calculation of and qualification for government premium subsidies to policyholders in high risk flood areas, and to act as agents of the scheme in applying subsidies at the point of sale.	**Government** through COAG to provide a temporary, targeted, direct premium subsidy scheme to policyholders in each State who face High and Extreme flood risks as a result of a lack of mitigation of land-use planning **OR** to refer any alternative flood pool options to the Productivity Commission for appropriate review and assessment for government.
Industry to provide a public tool for members of the community to measure the resilience of their property to hazards such as flood, providing recommendations and guidance for practical measures to reduce the risk through building modification, maintenance, planning and practice.	**Government** to implement legislative changes to allow: 3. Insurers to provide greater guidance to consumers on products at the point of sale. 4. Insurers to simplify disclosure to consumers through electronic delivery of documentation where it is appropriate to do so.
Industry to produce and provide the public with a guide to *Smarter Insurance*, explaining how insurance products function and the importance of obtaining cover that is right for individual circumstances.	**Government** to access general insurance expertise in managing built environment risks through appointment of insurance risk expertise to the National Emergency Management Committee and to the Board of the Australian Building Code.
	Government to implement measures to remove disincentives to the uptake of insurance, by removing all taxes on insurance in accordance with the Henry Review 2009.

Conclusion

Is it necessary for all Australians to purchase flood cover, regardless of exposure? Should Australians with no flood risk be forced to purchase cover, or should individuals be given adequate information by governments in order to make an informed choice regarding cover before accessing a competitive marketplace to make a purchase of what is right for their circumstances?

It is clear that private insurance can be and has been made available widely in Australia. Uptake of flood insurance in flood risk areas exceeds the national average for flood policies sold. However, there is more that can be done to encourage the uptake of flood insurance for those who are most in need of the cover.

Rather than removing the choice that consumers may elect to make in this environment, by making the purchase of flood insurance mandatory (by including it in all cover), governments should focus instead on informing those in hazard prone areas that they face risks and encourage them to adequately mitigate and plan for the event.

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[i] See http://www.coag.gov.au/coag_meeting_outcomes/2011-02-13/index.cfm?CFID=395347&CFTOKEN=20654049
[ii] On page 8 of the National Strategy for Disaster Resilience
[iii] See http://www.bom.gov.au
[iv] Section 6 of the *Meteorology Act 1955 (Cth)*
[v] Section 12 of the *Water Act 2007 (Cth)*
[vi] See http://www.bom.gov.au/water