

Natural Disaster Insurance Review

Natural Disaster Insurance Review Submission

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The Rural and Regional Insurance Market

Introduction

This document contains the Wesfarmers Insurance submission to the Natural Disaster Insurance Review's Issues paper released in June 2011. This submission deals specifically with the provision of Flood cover to Australia's rural and regional customers. In particular, this submission seeks to highlight the challenges of offering flood cover to rural and regional household risks as compared to metropolitan risks.

Executive Summary

Wesfarmers Insurance:

- supports the Insurance Council of Australia submission and argues for a policy that preserves private market competition for the provision of flood insurance;
- maintains that the availability of quality federalised flood mapping is the vital enabler to address the issue of lack of accessibility of flood insurance in Australia; and
- recommends that the design of any proposed solution needs to consider specific challenges of rural and regional market, not just metropolitan areas.

A number of insurers have exited the rural and regional market in recent years given underwriting challenges associated with extreme weather, lack of data and underwriting losses.

It is imperative that any solution does not have any unintended consequences of reducing capacity or changing the risk appetite of insurers and reinsurers in this market.

To do so may increase the underinsurance or non-insurance problems that are already inherent in the Australian market.

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Both the NDIR Issues paper and the ICA submission fail to acknowledge that the flood issues are exacerbated in the rural and regional market. This paper will provide an overview of the challenges and complexities specific to the rural and regional market that should be considered under any proposed flood cover solution.

About Wesfarmers Insurance

Wesfarmers Insurance is a division of Wesfarmers Limited, one of Australia's largest listed companies and employers. Its diverse business operations cover: supermarkets, department stores, home improvement and office supplies; coal mining; energy; insurance; chemicals and fertilisers; and industrial and safety products. Wesfarmers first commenced insurance operations in 1919 as a rural insurer and now has general insurance underwriting and broking operations in Australia and New Zealand and insurance broking in the United Kingdom.

Within the Australian general insurance business Wesfarmers Insurance operates three brands:

- WFI: A leading rural insurance business offering clients high levels of personal service via a network of Area Managers located within rural and regional locations across Australia. WFI is a market leader in the rural insurance market servicing approximately one-third of all Australian rural insurance business.¹
- Lumley Insurance Australia: Distributes high quality general insurance products through independent licensed brokers and underwriting agencies.
- Affinity and Direct: Wesfarmers Insurance partner facility to deliver insurance to consumers via well known Australian brands, most notably Coles and Kmart Tyre & Auto.

¹ Based on the ABS Agricultural Business Counts 2008/2009 Report # 71210.

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Wesfarmers Insurance supports the flood discussions that are occurring as a result of the Natural Disaster Insurance Review (NDIR). The release of this paper is highlighting key issues and enablers that are required to improve the resilience of communities to recover from major natural events. In particular:

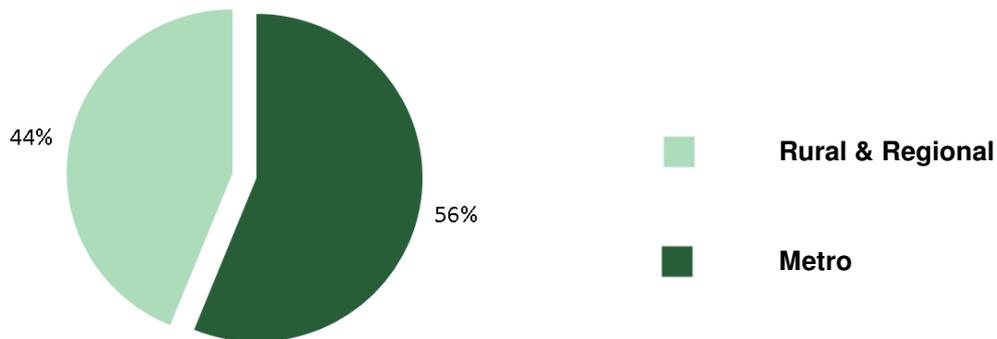
- improved access to comprehensive flood mapping for insurers as well as the wider community;
- improving customer awareness of their policy coverage;
- acknowledging the necessity for effective risk mitigation; and
- addressing availability and affordability of flood cover to households.

Wesfarmers Insurance also acknowledges the submission put forward by the Insurance Council of Australia (ICA) that recommends:

- improving customer awareness of their household flood risk;
- supporting a private market solution via improved flood mapping and risk mitigation;
- ensuring that those who are required to improve the resilience of communities are incentivised for doing so; and
- Government subsidies of flood cover premiums for those households with high and extreme risk.

However both the NDIR Issues paper and the ICA submission do not adequately consider the inherent difficulty in establishing flood cover for rural and regional households. Lack of flood mapping data and unique issues associated with the built environment on rural properties are key challenges. Given that rural and regional households represent 44% of all households in Australia, it is an important demographic that requires due consideration.

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*Source: Australian Bureau of Statistics (Cat. No. 2064.0 - CDATA Online 2006)
Separate house, semi detached and town-house dwellings are included in the above.
Excludes apartments above one story.*

The purpose of this submission is to ensure that the final solution proposed by the NDIR effectively addresses the additional complexity and challenges of the rural and regional market; both with respect to the design and implementation of the target solution.

Key Challenges for Flood Cover in the Rural and Regional Market

Flood Mapping

Access to quality flood mapping is essential for insurers to be able to price flood coverage. The insurance industry requires a national approach to collection, collation, analysis and presentation of flood related data.

- At present there is no consistent or national approach to flood mapping and there are major data gaps in some regional areas.
- The current systemic issues with respect to flood mapping make it difficult or expensive to undertake.
- Federalised flood mapping is not expected to be available for at least three to four years.

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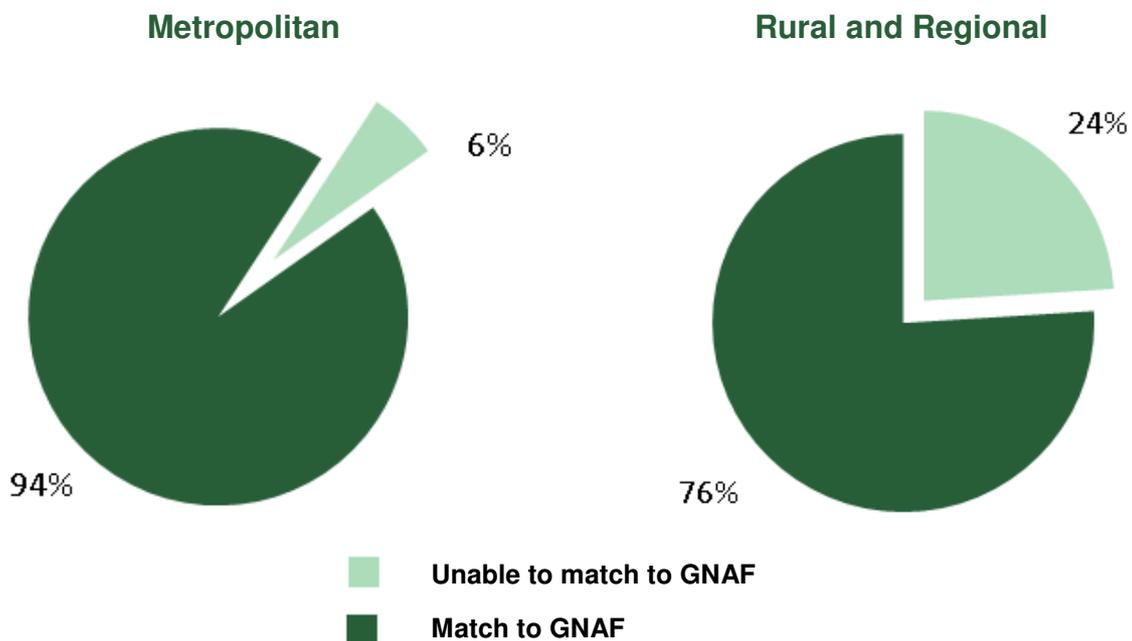
If the release of national publicly available flood mapping is not aligned with changes introduced as a result of the NDIR review, then this lack of data could possibly result in the withdrawal of insurers from the property insurance market.

If rural and regional mapping is delivered at a lower priority, then the ability for insurers to service this segment of the market will be compromised.

This could potentially translate into reduced competition under the new scheme, which may result in higher prices for property insurance irrespective of whether the property carries a flood risk or not.

Geocoded National Address File (GNAF):

Assigning a GNAF coordinate for a household is critical for pricing its flood risk. However, attempting to assign a GNAF coordinate for a household in rural and regional locations is more complex than for metropolitan areas.



Wesfarmers Insurance experienced a 24% failure for rural and regional households to find a successful GNAF match. By comparison, 94% of all metropolitan household risks were successful in finding a match.

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Issues in attempting to derive a GNAF are:

- having a property address that covers multiple acreage with varied terrain. GNAF returns the centre of property; which is not necessarily the location of the household and hence the flood risk remains inaccurate or unknown;
- only having a Roadside Delivery address (RSD), Royal Mailbag location (RMB) or rural property name to assess from, and hence not an exact risk address; and
- the accuracy of the GNAF cannot be guaranteed for rural properties where the property is located some distance from the roadside address.

Flood Pricing:

Limited flood mapping in rural and regional areas, combined with inherent difficulties in matching rural and regional properties to an exact GNAF location, adds to the complexity of pricing flood risk effectively in this market. This is further compounded by the greater heterogeneity of rural and regional household risks, compared to metropolitan locations.

Under the proposed operation of the NDIR's flood insurance pool, 25% of the non-flood premium along with the full flood premium would be ceded to the pool for all eligible household flood risks – primarily those risks that insurers are unable to price below the pool's threshold.

If insurers are unable to price flood effectively in rural and regional areas, this will impact the competitiveness of the premium. In turn this may result in a disproportionate number of risks being ceded to the pool; and potentially forcing insurers and reinsurers to allocate less risk capital or exit this segment of the market.

Risk Mitigation:

For household risks which are located in rural or remote areas it may prove difficult to introduce government mitigation efforts to reduce the risk of flood. Whilst structural measures provide a highly visible warning of the risk of flood, they can be expensive or impractical to introduce in rural or remote areas and could encourage further development in an area that should be protected.

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For these areas, even large scale government mitigation may not be possible or feasible.

Planning and development controls are the most important measure that can be introduced in areas such as these to adequately control the flood risk to properties.

Wesfarmers Insurance would support the introduction of standard controls for floodplains across Australian local and state governments. This would ensure land use planning supports the efforts to reduce the impact of flood.

Operational Costs:

If Wesfarmers Insurance was required to provide mandatory flood cover to every household, it is estimated to take three years to complete the individual property survey process to:

- establish reliable GNAFs for each household location; and
- assess engineered risk mitigation activities by landowners that cannot be quantified from risk mapping alone.

The implementation costs would be considerable and would ultimately increase premiums for all insured's including the non-flood premium - adding to the cost of living for those in rural and regional areas and potentially leading to lower take-up of insurance.

The operational cost impacts noted above are predicated on full flood mapping being available for rural and regional areas. It is likely however that additional cost would be incurred by the private market to strengthen and develop the existing flood mapping and pricing capability for rural and remote areas, further increasing the operating costs of insurers that service these locations.

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Choice for rural and regional customers:

A disadvantage of mandatory flood coverage is the loss of choice to rural and regional customers. Some policyholders on rural properties understand their risks, have undertaken mitigation activities and elect not to insure for flood risk.

In Australia rural properties can be passed through the generations, therefore the historical weather and flood exposure of these properties is a known factor to the home owner.

During the recent flood events, there were examples of self management of risk mitigation by property owners, who are aware of the risk of flood to their properties and have invested in self built flood levies, located their households on the highest point within their land or applied other engineering methods to protect their property.

Home owners that have self managed their flood risk may be especially sensitive to being forced to pay a flood premium of any amount. If forced to take out expensive flood cover, these customers lose the ability to access competitively priced insurance for risks other than flood.

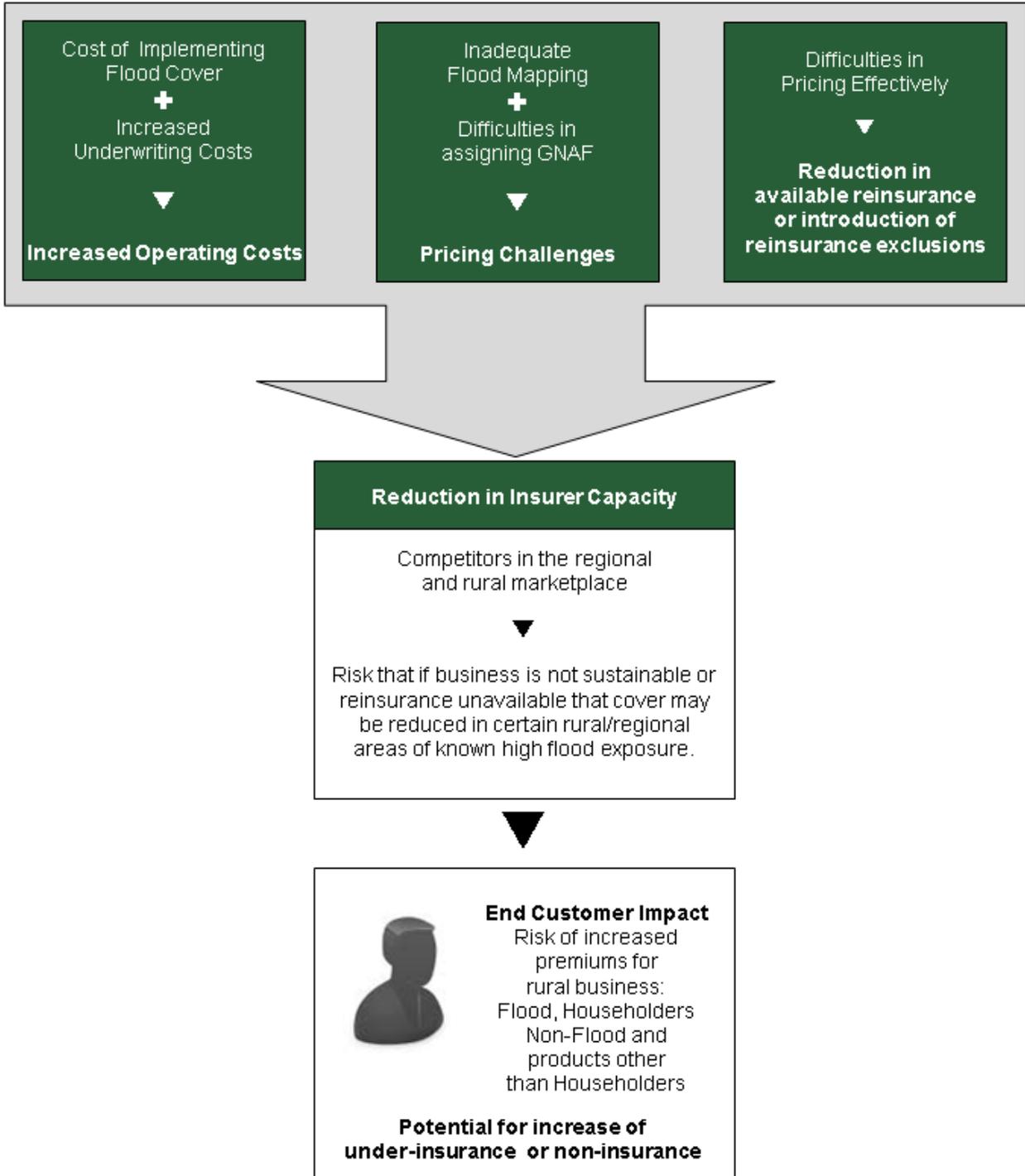
Impact on the Rural and Regional Market

If insurers were obliged to provide flood cover in rural and regional markets without adequate flood data and timeframes for implementation, the consequences may be as follows.

The combination of increased operating costs, ineffective mapping and consequential pricing issues, may reduce the viability for insurers to apply capital to certain geographical areas with known high flood risk or large unknown exposure.

These same challenges may also lessen the appetite for reinsurers to commit capital. If reinsurers were to withdraw capacity or introduce exclusions, the risk of competitors withdrawing from certain rural or regional geographical areas would increase.

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The end impact on rural and regional customers could be increased premiums across a greater product range: Flood, non-flood householders as well as other products.

Response to NDIR Issues Paper Options

The NDIR Issues paper proposes three options with respect to flood insurance:

1. Status Quo
2. Mandatory Inclusion of Flood Cover, with Active Opt-Out by Consumer
3. Mandatory Inclusion of Flood Cover, with No Opt-Out

Wesfarmers Insurance provides the following response to these options with respect to the rural and regional market challenges.

NDIR Proposed Option	Response
Status Quo	<p>The market reforms presented by the ICA submission are fully supported by Wesfarmers Insurance. It is important to note that the ICA has committed to and proposed a number of new reforms, so the term “Status Quo” is not representative of the proposed way forward.</p> <p>However the continuation of the private market trend in delivering flood solutions more widely is critically dependant on federal support for the collection, collation, analysis and presentation of quality flood related data.</p>

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NDIR Proposed Option	Response
<p>Mandatory Inclusion of Flood Cover, with Active Opt-Out by Consumer</p>	<p>There is additional complexity required to develop detailed flood mapping and pricing for rural and regional areas. Hence timeframes for implementing this proposed option will need to allow for this complexity.</p> <p>The proposed pool may find it difficult to establish eligibility and pricing for rural and regional properties, particularly those in remote locations.</p> <p>The complexity to develop flood pricing for rural and regional areas may result in a disproportionate number of risks ceded to the pool; negatively impacting the capital of insurers that service these markets.</p> <p>The combination of increased operating costs, ineffective mapping and consequential pricing issues, may reduce the viability for insurers to apply capital to certain geographical areas with known high flood risk or large unknown exposure.</p> <p>The end impact on rural and regional customers from reduced competition could be increases to premiums and lower take-up of insurance.</p>
<p>Mandatory Inclusion of Flood Cover, with No Opt-Out</p>	<p>The same responses noted above with respect to pricing, pool operation, insurer capital, and customer impacts, apply equally to this option.</p> <p>In addition, this solution does not preserve customer choice and adequately allow for self mitigation activities of land owners.</p> <p>This option, in the absence of adequate flood mapping, will result in a significant increase in insurance premiums to many rural and regional policyholders. This will increase the risk of non-insurance.</p>

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Recommendations

Wesfarmers Insurance supports the Insurance Council of Australia submission and argues for a policy that preserves private market competition for the provision of flood insurance and encourages affordable insurance protection.

Both the NDIR Issues paper and the ICA submission fail to acknowledge that the flood issues are exacerbated in the rural and regional market.

The prospect of mandatory flood cover in the current environment will result in higher premiums, especially in rural and regional areas, and these costs will ultimately be borne by taxpayers. This is akin to a new tax which will further discourage the take-up of insurance.

Wesfarmers Insurance:

- is resolute that federalised flood mapping must be in place prior to any implementation of flood coverage on policies; with the condition that the rural and regional areas are given due consideration;
- recommends that the design of any proposed solution needs to consider specific challenges of rural and regional market, not just metropolitan areas;
- requests that the implementation timeframes are sufficient to ensure key rural and regional issues are addressed adequately before imposing any design; and
- recommends that the protection of competition and choice to rural and regional home owners must be a priority criterion in assessing the design of any potential solution.

