

Jim Murphy
'The Insurance Industry and Natural Disasters: Policy Implications'
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Good morning.

Thank you for inviting me to provide some remarks from a Treasury perspective on issues facing the insurance industry.

I can see from the agenda that several important issues will be discussed today, including the implications of the floods in Queensland. The Queensland floods highlighted areas where the insurance industry and Government policy can be better.

This morning, I'd like to talk to you about how the insurance industry and Government work together to make improvements, and also the broad background to those changes.

Firstly, I will outline the important role the insurance industry plays in financial markets and the broader economy; how the Australian Government supports your industry; some of the policy implications of insurance and natural disasters in the wake of the extreme flooding in northern Australia early last year; and more recent events.

Overview of the insurance industry in Australia

This industry makes a substantial contribution to the Australian economy.

According to APRA, in June 2011, industry assets totalled nearly \$115 billion, with direct insurers accounting for 89 per cent of that figure.

The 25th annual *General Insurance Industry Survey*, released by KPMG in September 2011, illustrates the strength and resilience of Australia's insurance industry.

Notwithstanding the catastrophic events of 2010 and 2011 — the Queensland floods and storms, Cyclone Yasi and, for some insurers, the New Zealand earthquakes — total insurance profit increased marginally in the 12 months to June 2011 to \$3.1 billion, up from \$2.9 billion in 2010.

While profitability may fall this financial year as the financial impact of the disasters flows through, the industry remains in a financially strong position, even while it is undergoing a period of adjustment with rising insurance premiums in certain segments of the market reflecting a reassessment of risk and rising reinsurance costs.

A financially sound and competitive insurance industry is an essential component of any well-functioning modern economy. It provides financial security for individuals and business, and a source of funding for communities to rebuild in the event of a disaster. It allows individuals and businesses to manage risk, thereby facilitating commerce, trade and community life.

Government support of insurance industry

The Australian Government provides strong support to the insurance industry.

This involvement largely takes the form of maintaining a sound regulatory framework. Australia has adopted the ‘twin peaks’ approach to financial regulation.

Under this approach, APRA supervises the safety and soundness of financial institutions, while ASIC focuses on the conduct of business regulation.

The Australian Government also plays a key role in reviewing and improving existing insurance legislation, such as insurance arrangements for flood.

It also supports the insurance industry by providing reinsurance for terrorism losses and financial safeguards for those in need of medical indemnity insurance.

We all recognise that the private sector is the most efficient provider of general insurance, and that any Government intervention should focus on increasing the efficiency of the market and on providing appropriate safeguards for consumers. I think it's also well recognised that Government intervention and financial support of the insurance market is only warranted in cases where there is a clearly identified market failure.

An example of this is Australia's terrorism insurance scheme, which is administered by the Australian Reinsurance Pool Corporation; I have sat on the Board of the ARPC since 2003. The scheme provides replacement terrorism insurance coverage for commercial property, and was established in response to the widespread withdrawal of terrorism insurance following the events of September 11.

Another example is the failure of Australia's largest medical indemnity provider in Australia, United Medical Protection, in 2002. It sparked a crisis in the availability and affordability of medical indemnity insurance, and also required market intervention.

The Government responded with a suite of schemes that support the provision of medical indemnity insurance. The exceptional claims scheme, run-off cover scheme, UMP support payment, high costs claim scheme and premium support scheme all provide financial support. Together they ensure a viable and ongoing medical indemnity insurance market, and indirectly, support the viability of the public health system.

More recently, there have been calls for governments to subsidise flood insurance premiums and strata title insurance. Any measures to subsidise these segments of the insurance market can only be justified, in economic terms, when a market failure can be clearly identified. More work needs to be done to determine whether there is, in fact, a market failure in these segments of the insurance market which would justify government intervention in the form of a subsidy. As well, the complexity of any scheme and its budgetary implications need to be considered.

Natural disasters

I will now turn to the theme of my talk today — the insurance industry and natural disasters. I'm sure that none of us will forget the devastating events which occurred during the summer of 2010-11.

And sadly, we are seeing some of those scenes playing out again with more flood events in Queensland, Western New South Wales and Victoria.

The Government acknowledges the insurance industry's quick response in the aftermath of the disasters of 2010-11. The vast majority of claims were accepted and settled promptly.

Nevertheless, the disasters of 2010-11 and significant public criticism of the insurance industry have highlighted areas where the regulatory framework can be improved and the insurance industry can improve its handling of claims and its resolution of disputes.

Minister Shorten highlighted the response to the floods in a speech late last year:

'People with insurance policies with one definition of "flood" received compensation while people living next door, with a different policy and different definition, received nothing at all.'

The Minister went on to say:

'Many families and individuals affected by the 2010 and 2011 floods were not even aware their insurance did not cover flood.'

We — Government and insurers — need to do our utmost to make insurance as transparent as possible so that people understand the risk/premium trade-off.

The Natural Disaster Insurance Review

The Government responded to the floods and these difficulties by establishing the Natural Disaster Insurance Review in March 2011, and releasing a consultation paper titled *Reforming Flood Insurance: Clearing the Waters*, in April 2011.

The Natural Disaster Insurance Review was chaired by John Trowbridge.

The other panel members were John Berrill from Maurice Blackburn and the head of a large national plaintiff superannuation and insurance claims practice in Australia, and Jim Minto, Group Managing Director of the trans-Tasman Tower Limited Group.

The Review report, together with the Government's response, was released in November.

Standard definition of flood and Key Facts Sheet

As part of the response, the Government announced measures to introduce a standard definition of 'flood' and to require insurers to provide a Key Facts Sheet. The standard definition of 'flood' will provide policyholders with a single definition of 'flood' across all home building, home contents, small business, and strata title insurance policies. This will reduce confusion about what is, and is not, included in insurance contracts. Further, it improves consumers' ability to evaluate potential insurance policies and compare 'like' products between different insurance providers.

The Key Facts Sheet allows consumers to access the key information in relation to home building and home contents insurance policies in a concise and easy to understand format, so they know exactly what their insurance does, and doesn't, cover.

The Insurance Contracts Amendment Bill 2011, which will implement the legislative framework for regulation to establish the standard definition of flood and Key Facts Sheet measures, was introduced into Parliament in November. The details of the measures will be included in regulations.

The draft regulations of the standard definition of flood were released for consultation late last year and Treasury will undertake further consultation in order to ensure the wording and application of the standard definition is appropriate.

In February, Minister Shorten released a discussion paper seeking public comment on the content, format, structure and provision of the Key Facts Sheet. The discussion paper is available on the Treasury website, and the deadline for submissions is the end of this week.

The standard definition of flood and Key Facts Sheet will respond to industry and consumer group submissions and seek to strike the right balance between the need to provide better disclosure for consumers and the impact additional compliance costs will have on the insurance industry.

There will be a two-year transition period to ensure insurers can meet the new requirements. However, I am aware that some insurance companies are already adopting the Government's preferred definition of flood, and I would like to commend them on their initiative.

Unfair contract terms

As another response to the Natural Disaster Insurance Review, the Government, in consultation with industry and consumer stakeholders, is considering options for extending unfair contract terms laws to insurance.

The Government is considering whether there should be alignment between protections offered under the existing regulation of insurance contracts and that which currently applies to other financial products and services.

The Government is considering submissions in response to its draft consultation Regulation Impact Statement and is assessing options for progressing this issue further over the coming months.

Flood risk information portal

At the time of releasing the Natural Disaster Insurance Review, the Government announced that it would provide funding of \$12 million over four years to enable Geoscience Australia to collate existing flood risk data, including data held at all three levels of government.

The data collation initiative will be complemented by national guidelines to cover the collection, comparability and reporting of flood risk information.

Improving the availability and consistency of flood risk information may help insurers to more accurately price insurance policies, underpinning an expansion of flood coverage in the insurance market.

It will also improve decision-making by local government and land developers, and will ultimately help Australians to make informed decisions about where to live.

Proposal for mandatory offer of flood cover with opt-out

In addition, the Government is consulting on a proposal requiring all insurers to offer flood cover in home building and home contents insurance policies, while giving insurers the option of allowing consumers to 'opt out' of flood cover.

The proposal is designed to improve the availability of flood insurance and the transparency of flood risk, ultimately, increasing consumer take-up of flood cover.

Insurance Code of Practice

The Natural Disaster Insurance Review made several recommendations designed to improve the General Insurance Code of Practice in relation to insurers' handling of claims and disputes, particularly those relating to natural disasters.

The Government requested that the industry consider the recommendations made in the Review's final report. In February, the Insurance Council of Australia responded with an announcement that set out changes to the Code of Practice directed at improving claims handling and dispute resolution.

This is an example of the industry responding to the events of summer 2010-11 to make significant improvements in the way it deals with its customers. The Insurance Council has also foreshadowed an independent review of the changes to the Code of Practice this year.

Looking forward

When releasing the National Strategy for Disaster Resilience, the Attorney-General emphasised that disaster resilience is a shared responsibility for individuals, households, businesses and communities, as well as for governments. And that insurance has an important role to play when individuals and communities consider the financial implications of possible natural disasters.

Looking forward, there are many issues where governments, Treasury and the insurance industry will need to continue to work together.

One area currently attracting a lot of public attention is the large increases in strata title insurance premiums in northern Australia, particularly north Queensland.

The House of Representatives Standing Committee on Social Policy and Legal Affairs is currently inquiring into this issue, as part of its inquiry into the operation of the insurance industry during disaster events. The Standing Committee is expected to report its findings for the Government's consideration in the near future.

In addition, the same Committee has recently released a report examining the performance of the insurance industry in handling insurance claims arising from major disasters. The report makes a number of recommendations which will need to be considered by the Government.

The Queensland Commission of Inquiry into the 2010 and 2011 floods delivered its final report on 16 March.

The recent floods in Queensland, NSW and Victoria will undoubtedly raise additional issues for the Government to consider.

The Natural Disaster Insurance Review raised the question of whether there is a role for Government to assist the community in insuring against flood, particularly those households facing significant increases in insurance premiums because their insurer has assessed that their property faces a significant flood risk.

The merits of such a proposal need to be more fully explored through public debate and consultation. However, any proposal to subsidise insurance premiums needs to be weighed against the alternatives such as mitigation and land buy-backs, as well as issues around complexity, market distortions and cost.

Conclusion

In conclusion, the recent natural disasters have been a catalyst bringing together government, industry and consumer groups to develop responses to a complex set of issues.

My expectation is that the Government and the insurance industry will continue to work together, to assist the community in dealing with natural disasters.

Once again, thank you for inviting me to speak with you today.