



Royal Commission into Misconduct in the Banking,  
Superannuation and Financial Services Industry

# Natural Disaster Insurance

## Background Paper 20

This paper was prepared by Treasury in response to a request made by the  
Royal Commission.



**Australian Government**

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**The Treasury**

# **Financial Services Royal Commission**

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## **Request for information Natural disaster insurance**

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# INTRODUCTION

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Natural disasters, including bushfire, floods, storms, cyclones and earthquakes are an enduring fact of life in Australia. Responding to natural disasters, including the provision of relief and recovery assistance to disaster affected communities, is primarily the responsibility of State and Territory Governments. However, in recognition of the significant cost of natural disasters, the Australian Government established the Natural Disaster Relief and Recovery Arrangements (NDRRA) to alleviate the financial burden on the States and Territories to facilitate the early provision of assistance to disaster affected communities.

The NDRRA operates according to the principle that assistance is not intended to replace the need for appropriate self-help strategies, such as acquiring insurance or undertaking appropriate disaster mitigation. Hence the private insurance market plays a critical role in protecting individuals and communities against loss caused by natural disasters.

The Australian Government has, over the past decade, contributed over \$10.5 billion under the NDRRA to support recovery efforts nationally.<sup>1</sup> Following the widespread flooding of 2010-11, the then Australian Government introduced a temporary flood and cyclone reconstruction levy to help meet the extraordinary amount of funding paid to the States and Territories under the NDRRA and other arrangements in respect of recovery from floods and cyclones.

The insurance industry has also paid out significantly in claims following natural disasters. For example, insurance claims in the wake of cyclones Yasi (2011) and Debbie (2017) exceeded \$1.5 billion for each.<sup>2</sup> Claims following the widespread flooding of 2010-11 were around \$2.4 billion.<sup>3</sup>

Nevertheless, after cyclone Yasi, for example, the Australian Government paid \$310 million in respect of 273,944 claims for disaster recovery and \$8 million for 5,689 claims for disaster income recovery.<sup>4</sup> Since 2013, the Australian Government has also committed

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1 Of this, more than \$9 billion has been provided to Queensland.

2 Insurance Council of Australia, 6 November 2017, \$1 Billion in Cyclone Debbie Insurance Claims, available: [http://www.insurancecouncil.com.au/media\\_release/plain/436](http://www.insurancecouncil.com.au/media_release/plain/436)

3 Insurance Council of Australia, 29 March 2012, *General insurance claims response 2010-11: Queensland floods and cyclone*, page 2, available: <http://www.insurancecouncil.com.au/assets/files/ica%20march%202012%20qld%20claims%20update.pdf>

4 Figures from the Emergency Management Australia DisasterAssist, available: <https://www.disasterassist.gov.au/Pages/disasters/previous-disasters/Queensland/Tropical-Cyclone-Yasi-2-February-2011.aspx>

more than \$30 million to the Queensland Government under the National Partnership Agreement on Natural Disaster Resilience to support local projects that build the disaster resilience of Queensland communities.<sup>5</sup>

The issue of natural disaster insurance has been examined extensively in a series of inquiries in recent years. The matters that have been subject to scrutiny fall into two broad (and somewhat overlapping) categories:

- Availability and affordability of natural disaster insurance, and the reasons for non-insurance and underinsurance, and associated proposals for government subsidisation or other intervention in markets.
- Issues around conduct of insurers and performance of insurance markets. This includes matters going to the handling of disaster related claims and the effectiveness of the industry code of practice, disclosure of and reliance on policy exclusions, and the legitimacy of pricing of natural disaster insurance (including the level of competition) in some locations.

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5 Minister for Revenue and Financial Services, 18 December 2017, Government responds to Northern Australia Insurance Premiums Taskforce and General Insurance Senate Inquiry, available: <http://kmo.ministers.treasury.gov.au/media-release/120-2017/>

# AVAILABILITY AND AFFORDABILITY OF NATURAL DISASTER INSURANCE

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In relation to issues around affordability and availability of insurance cover for natural disasters and other risks, successive Australian governments have generally held to a view that major intervention in private insurance markets, such as by mandating that certain types of insurance cover be provided, or by government subsidisation of premiums, or government participation in markets, can only be justified where there is a clear market failure. Additionally, active mitigation should have a central role in reducing disaster risks and also contribute to better conditions in the insurance market.

In practical terms, a failure in the market for natural disaster insurance would arise where insurance is not being offered because insurers cannot price appropriately or where consumers are unable to access insurance for an affordable price; for example, where there is price-gouging due to monopolistic or oligopolistic market behaviour. Market failure would be a crucial pre-condition to the government directly intervening in the market for natural disaster insurance, for example by providing a subsidy to consumers affected by the failure or establishing a government reinsurer for disaster insurance.

Examples of instances where such intervention has been considered justified include medical indemnity insurance for doctors (and later for midwives) following a market failure that emerged as an adjunct to the HIH failure and ensuing crisis in the liability insurance market in the early 2000s, and for terrorism cover for commercial property following the withdrawal of private insurers from this market in the wake of the terrorist attacks of September 2001 in the United States.

In relation to natural disaster insurance, major intervention to address availability and affordability was recommended by the Natural Disaster Insurance Review (NDIR) in 2011 (including mandating the provision of flood cover and providing subsidised reinsurance. At the time of the NDIR in 2011, there was a particular issue with availability of flood insurance. This issue identified the problems with inconsistent definitions of events used by insurers. The exclusion of flood cover and consumers' lack of understanding about the fact or consequences of the exclusions, proved key problems with consumer experiences with insurance in the 2010-11 floods. These problems were powerful drivers behind the establishment of the NDIR, as well as the publication of other reports by the Treasury.

The NDIR recommended that there be a requirement that home building insurance policies have 'automatic flood cover' or mandatory flood cover, and that this be subject to a standard and inclusive definition of 'flood', which is discussed later in this paper. To offset the affordability problems associated with the high costs of providing flood cover to 'at risk' properties, the NDIR recommended the establishment of a Government funded "discount

and reinsurance” system. The (then) Government ultimately rejected these recommendations, apart from the adoption of a standard definition of flood,<sup>6</sup> instead accepting a Productivity Commission recommendation that “Governments should not subsidise household or business property insurance, whether directly or by underwriting risks.”<sup>7</sup>

The 2015 Northern Australia Insurance Premiums Taskforce (NAIPT) also examined Government intervention in the insurance market, this time in relation to the risk of cyclones in northern Australia, considering premiums for residential strata title insurance, as well as home and business insurance.

The options examined by the NAIPT included using the Commonwealth balance sheet (for example, through a reinsurance pool or mutual).<sup>8</sup> The NAIPT found that a reinsurance pool or a mutual insurer would involve substantial cost and risk to the Government (and the taxpayer) and would be unlikely to lead to an on-going reduction in premiums when the Government withdrew its support. It also came to the conclusion that mitigation should be the central focus as a sustainable long-term way of reducing premiums. In December 2017, the Government announced its response to the NAIPT, which stated that it accepted the findings of the NAIPT, and will not intervene directly in the insurance market at this time.

Governments have chosen not to make such interventions in the market to address issues with natural disaster cover, generally citing the potential cost, the absence of clear market failure, the difficulty in exiting such arrangements and a preference for more sustainable solutions based on mitigation of risk. Government interventions in the market would also suppress market signals that are important for encouraging mitigation works.

The NAIPT also identified a number of low-cost options to encourage mitigation which included strengthening building codes, better retrofits of existing structures, government public works, resilience rating tools, and mitigation awareness campaigns.

While successive governments have chosen not to make major interventions to address affordability, some government funding has been made available for the purpose of funding mitigation projects to put downward pressure on premiums through reducing risks. For example, in 2013, \$17 million was provided for the construction of a flood levee in Roma and improving the flood defences in Ipswich.

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6 *Insurance Contracts Amendment Regulation 2012 (No. 1) (Cth)*, available: <https://www.legislation.gov.au/Details/F2012L01232>

7 Australian Government, March 2013, *Australian Government response to the Productivity Commission report: Barriers to Effective Climate Change Adaptation* (see response to recommendations 16.2, 16.3), available: [http://content.webarchive.nla.gov.au/gov/wayback/20140801061140/http://www.climatechange.gov.au/sites/climatechange/files/documents/03\\_2013/ag-inquiry-response.pdf](http://content.webarchive.nla.gov.au/gov/wayback/20140801061140/http://www.climatechange.gov.au/sites/climatechange/files/documents/03_2013/ag-inquiry-response.pdf)

8 The Australian Government the Treasury, November 2015, *Northern Australia Insurance Premiums Taskforce Final Report*, available: <https://treasury.gov.au/publication/northern-australia-insurance-premiums-taskforce-final-report/>

# CONDUCT OF INSURERS AND PERFORMANCE OF INSURANCE MARKETS

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A second set of issues relating to natural disaster insurance that have been closely scrutinised in multiple inquiries and other contexts goes to the conduct of insurers and the performance of insurance markets. Key issues that arise in this category include:

- Consumer awareness and understanding of policy terms and conditions and what insurers do to promote this.
- Claims handling and the effectiveness of the General Insurance Code of Practice.
- The level of competition in insurance markets and whether insurers engage in anti-competitive practices or ‘price gouging’.

## CONSUMER AWARENESS AND UNDERSTANDING OF POLICY TERMS AND CONDITIONS

In insurance contracts there is generally an asymmetry of information between the parties to the contract. Understanding of policy terms and conditions can be affected by the complexity of policy terms and the limitations of disclosure, meaning that particular matters may not be brought to the attention of the consumer. Various measures have been, or are being, taken to address this issue.

### Standard cover

The need to improve consumer awareness of insurance policy terms and conditions has long been a goal of Australian governments. In 1982, the Australian Law Reform Commission (ALRC) recommended the introduction of a “standard cover” regime for certain classes of insurance contracts including for “homeowners’ and householders’ insurance”.<sup>9</sup> The idea of such a regime is that certain prescribed terms of cover must be included in a contract of insurance unless the insurer specifically draws to the insured’s attention any derogation from the standard cover terms.

A standard cover regime was subsequently included in Part V of the *Insurance Contract Acts 1984* (Insurance Contracts Act). Home building and home contents policies are

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9 Australian Law Reform Commission, December 1982, *Insurance Contracts*, (ALRC Report 20), paragraph [57], [60], available: <https://www.alrc.gov.au/report-20>

prescribed under the standard cover regime. Notably, prescribed cover includes a range of natural disaster events such as fire, earthquake, storm, tempest, flood, the action of the sea, high water, tsunami, erosion or land slide or subsidence.<sup>10</sup> The effect of section 35 of the Act is that this cover can only be derogated from if the insurer proves that it clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise) that the relevant cover was excluded, or the insured ought to have known this to be the case.

Whether the standard cover regime had its intended effect has been the subject of controversy. In a 2004 *Review of the Insurance Contracts Act*, the Treasury noted that:

*“Nevertheless, on introduction of the Insurance Contracts Bill, a substantial change was made to the original ALRC recommended regime. That change had the effect that unusual terms under section 37 could be notified by providing a copy of the policy document.”<sup>11</sup>*

Many submissions to the Treasury review argued that merely including the limitation on standard cover in a policy document or Product Disclosure Statement (PDS) did little to bring it to the attention of the insured, and that it should rather be presented in a separate document. While expressing some sympathy for this view, the Review Panel confined its recommendation to one that:

*“The clarity test of ‘clearly inform’ in sections 35 and 37 of the Insurance Contracts Act should be replaced by a requirement that the information be presented in a ‘clear, concise and effective manner’.”<sup>12</sup>*

That recommendation was not directly acted upon in that these words were not incorporated into the Insurance Contracts Act. However in 2005, in response to the Review Panel’s recommendation, section 1013C of the *Corporations Act 2001*’s requirement that a PDS be written in a ‘clear, concise and effective manner’ was amended to apply to the insurance policy document, and other disclosure documents required under sections 35 and 37 of the Insurance Contracts Act.

Nevertheless, the efficacy of the standard cover regime was again questioned in the NDIR Final Report, which noted:

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10 *Insurance Contracts Regulations 2017* (Cth), regulation 19, available: <https://www.legislation.gov.au/Details/F2017L01658>

11 The Australian Government the Treasury, June 2004, *Review of the Insurance Contracts Act 1984* (Cth), ‘Final report on the second stage: provisions other than section 54’, page 40, available: <http://icareview.treasury.gov.au/content/Reports/FinalReport/downloads/ICAFinalReport.pdf>

12 *Ibid.*, page 45.

*“The Review Panel is concerned that the combination of the complexity of insurance policies and PDS and standard cover under section 35 of the Insurance Contracts Act 1984 (the Act) does not accord with consumer behaviour and has not met consumer expectations and the need for relevant and understandable information and documentation.”<sup>13</sup>*

This was because the standard cover regime, according to the NDIR:

*“...does not reflect the reality of consumer behaviour which, as has been noted earlier in this Chapter, is that policyholders do not read insurance policies or PDS in detail. Accordingly, all too often consumers will simply not be sufficiently ‘clearly informed’ of deviations from standard cover by the provision of a PDS. This is no better reflected than in confusion about whether policies include or exclude flood cover.”<sup>14</sup>*

The NDIR recommended:

*“That subsection 35(2) of the Insurance Contracts Act 1984 be amended so that policyholders are not deemed to be clearly informed of a deviation from ‘standard cover’ by simply being provided a copy of the insurance policy or product disclosure statement.”<sup>15</sup>*

The (then) Government did not accept this recommendation for reform of the standard cover regime from the NDIR, on the basis that the issues would be addressed by the planned introduction of a ‘Key Facts Sheet’ requirement (see below).

Issues around standard cover were again considered in the 2017 Senate Economics References Committee report *Australia’s general insurance industry: sapping consumers of the will to compare* (Senate general insurance inquiry).

The Government response to the Senate Committee’s report committed Treasury to examining the issue of standard cover with particular regard to the efficacy of current disclosure requirements and this work has commenced.<sup>16</sup>

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13 The Australian Government the Treasury, September 2011, *Natural Disaster Insurance Review: Inquiry into flood insurance and related matters*, page 99, available: [http://www.ndir.gov.au/content/report/downloads/ndir\\_final.pdf](http://www.ndir.gov.au/content/report/downloads/ndir_final.pdf)

14 *Ibid.*, page 101.

15 *Ibid.*, page 102.

16 Australian Government, December 2017, Response to the Senate Economic Reference Committee, *Australia’s general insurance industry: sapping consumers of the will to compare*, available: <https://treasury.gov.au/publication/p2017-t248756/>

## Standard Definitions

Variations in the definition of 'flood' in insurance contracts became apparent at the time of the 2010-11 floods. Differences in the definition caused confusion and perceptions of unequal treatment arising from policyholders' misunderstanding of what was and was not covered in their policies.

In April 2011, after the NDIR had commenced but before it had been completed, the (then) Government released the *Reforming Flood Insurance: Clearing the Waters* paper. The paper contained two proposals for reform:

- A standard definition of flood in insurance contracts.
- A requirement for insurers to issue a Key Facts Sheet with insurance policies.<sup>17</sup>

The proposal for a standard definition of flood was adopted but is again being reviewed due to deficiencies identified in the definition adopted.<sup>18</sup>

The *Clearing the Waters* paper identified that the term 'flood' could conceivably cover at least three classes of event each of which were treated differently by insurers:

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17 The Australian Government the Treasury, April 2011, *Reforming flood insurance: Clearing the waters*, pages 9-10, available: [http://archive.treasury.gov.au/documents/1995/PDF/clearing\\_the\\_waters\\_april2011.pdf](http://archive.treasury.gov.au/documents/1995/PDF/clearing_the_waters_april2011.pdf)

18 Australian Government, December 2017, Response to the Senate Economic Reference Committee, Australia's general insurance industry: sapping consumers of the will to compare, op cit

*“A. Stormwater/rainfall runoff: These terms refer to high intensity, short duration storms producing localised flooding. Most insurance policies (but not all) cover this risk. Some insurers also use the term ‘flash flooding’ with similar intent.*

*B. Riverine/inland flooding/flooding: Inundation caused by watercourses or catchments overflowing their banks due to long duration rainfall over large areas. Some insurers provide cover for this risk, but many exclude it. Whether included or excluded, the definitions of this risk can vary greatly.*

*C. Actions of the sea/sea level rise/storm surge: Inundation caused by movement of seawater. Few insurance policies cover this risk.”<sup>19</sup>*

Due to the confusion caused by conflicting definitions of ‘flood’ in insurance contracts, the primary objective of the *Clearing the Waters* paper was to provide greater clarity on whether or not policies provided cover for Category B (riverine flooding).<sup>20</sup> It was proposed that this be addressed by the introduction of a standard and mandatory definition of flood. This was endorsed by the NDIR. In June 2012, the Insurance Contracts Act was amended to implement this proposal for home building and contents and residential strata title insurance policies, as well as insurance policies that related to small businesses.<sup>21</sup> The standard definition of flood was prescribed in the Insurance Contracts Regulations.

The standard definition of flood does not include ‘actions of the sea’. In 2011, greater urgency was given to addressing the classes of events classified as Categories A and B and consideration of a definition for Category C was deferred. This reflected the challenges arising from defining such terms and the identification of Categories A and B as being more immediately pressing.

The Senate general insurance inquiry heard evidence regarding some of these matters, including varying definitions of Category C events in insurance policies.

The Government response to this inquiry committed Treasury to assessing the implementation of standardised definitions for key terms for general insurance and this work has commenced.

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19 Commonwealth of Australia, April 2011, *Reforming flood insurance: Clearing the Waters*, page 3, available: [http://archive.treasury.gov.au/documents/1995/PDF/clearing\\_the\\_waters\\_april2011.pdf](http://archive.treasury.gov.au/documents/1995/PDF/clearing_the_waters_april2011.pdf)

20 *Ibid*, page 4

21 *Insurance Contracts Amendment Act 2012 (Cth)*, available: <https://www.legislation.gov.au/Details/C2012A00041>

## Key Facts Sheet

The proposal for a requirement for a Key Facts Sheet to be issued with insurance policies was outlined in the *Clearing the Waters* paper.

The drivers for the Key Facts Sheet proposal were outlined this way:

*“Concerns have been raised by a number of stakeholders that the PDS rules for general insurance, as currently implemented, may not be as effective as they could be for informing consumers about the policy, and enabling comparisons between policies. This is likely to be connected with the length and complexity of PDSs and the variations in presentation.*

*If key information about policies is not readily accessible to consumers, there is a greater risk of consumers acquiring insurance that does not fully match their requirements, and may contribute to underinsurance.”<sup>22</sup>*

In its Final Report the NDIR endorsed this proposal. In 2012, the Insurance Contracts Act was amended to include a requirement for insurers to provide a Key Facts Sheet for home building and home contents policies.<sup>23</sup> The Insurance Contract Regulations require the information in a Key Facts Sheet to include whether or not certain kinds of natural disaster events (which are included in the standard cover regime) are covered by the policy (but note the Act expressly provides that the Key Facts Sheet does not discharge the ‘clearly inform’ requirement under section 35 or 37 (s. 33D)).<sup>24</sup>

Concerns have been raised regarding the efficacy of Key Fact Sheets with the argument that they can be misleading to consumers and can ‘oversimplify’ the information presented.

Evidence regarding the efficacy of Key Facts Sheets was heard by the general insurance inquiry. The Government response to the Senate inquiry committed Treasury to assessing the usefulness of Key Facts Sheets and this work has commenced.<sup>25</sup>

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22 The Australian Government the Treasury, April 2011, *Reforming flood insurance: Clearing the Waters*, pages 9-10, available:

[http://archive.treasury.gov.au/documents/1995/PDF/clearing\\_the\\_waters\\_april2011.pdf](http://archive.treasury.gov.au/documents/1995/PDF/clearing_the_waters_april2011.pdf)

23 *Insurance Contracts Amendment Act 2012* (Cth), available:

<https://www.legislation.gov.au/Details/C2012A00041>

24 *Insurance Contracts Amendment Regulations 2012 (No 2)* (Cth), available:

<https://www.legislation.gov.au/Details/F2012L02163>

25 Australian Government, December 2017, Response to the Senate Economic Reference Committee, available <https://treasury.gov.au/publication/p2017-t248756/>

## Improving disclosure in insurance

The insurance industry, led by the Insurance Council of Australia (ICA) has been undertaking work on improved disclosure, releasing a report in October 2015 titled *Too long; Didn't Read: Enhancing General Insurance Disclosure*. This report's authors considered that "the industry should test how natural hazard data held by insurers can be effectively provided to consumers in an informative and constructive fashion."<sup>26</sup>

In February 2017, the ICA released a report on *Consumer Research on General Insurance Product Disclosures*, which made the following five key findings:

1. There is no single pathway to purchase and the use of information in decision-making is highly varied.
2. While most consumers report they have evaluated the details of their policy, most do not access the PDS.
3. While most consumers are confident in their understanding, comprehension appears to be poor.
4. Many consumers do not consider the specific risks for which they need to purchase cover as a criterion for decision-making.
5. The accessibility of the PDS can be improved, although there are other opportunities for stronger consumer engagement

Transparency and disclosure were also considered by the Senate general insurance inquiry.

The Government response to the Senate inquiry committed Treasury to examining ways to improve disclosure and transparency in insurance policies and this work has commenced.

## Unfair contract terms and insurance

Since 2010 a national unfair contract terms law has applied through the Australian Consumer Law (ACL) and, for financial products and services, through changes to the *Australian Securities and Investments Commission Act 2001*.

Contracts of insurance were, however, excluded from the unfair contract terms regime and this has resulted in some contracts containing unfair terms. The reasons for the exclusion were set out in the NDIR Final Report:

*"General insurance is currently exempt from unfair contract terms laws as it was argued that general insurance was sufficiently different from other financial*

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26 Insurance Council of Australia, October 2015, *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, page 3, available: <http://www.insurancecouncil.com.au/assets/Effective%20Disclosure%20Report.pdf>

*products to demand different treatment under the law. The general insurance industry has resisted unfair contract terms legislation being applied to general insurance contracts, arguing that the duty of utmost good faith under section 13 of the Insurance Contracts Act 1984 (the Act) provides consumer protection equivalent to or better than that provided by the unfair contract terms laws. In addition, it is argued that insurance contracts are already subject to review both under the Act and the Terms of Reference for the Financial Ombudsman Service (FOS).”<sup>27</sup>*

A number of reports have recommended that insurance be subject to the unfair contract terms regime. The Government has committed to release proposals to effect the application of unfair contract terms to insurance in 2018.<sup>28</sup>

## **CLAIMS HANDLING AND THE EFFECTIVENESS OF THE GENERAL INSURANCE CODE OF PRACTICE**

The NDIR heard evidence of insurers not meeting community expectations in terms of handling of claims and complying with the General Insurance Code of Practice. Issues identified included:

- Failures by insurers to process claims in a timely manner;
- Poor practices with regard to the collection and use of evidence;
- Failure to communicate refusal of claims in a timely manner, including failure to provide proper reasons and evidence for refusals; and
- Failure to adequately inform consumers of their rights to internal dispute resolution and external dispute resolution in relation to refused claims or claims related complaints.<sup>29</sup>

A key issue that has been identified regarding claims handling is the extent of ASIC’s ability to respond to poor practices.

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27 The Australian Government the Treasury, September 2011, *Natural Disaster Insurance Review: Inquiry into flood insurance and related matters*, pages 105-106, available: [http://www.ndir.gov.au/content/report/downloads/ndir\\_final.pdf](http://www.ndir.gov.au/content/report/downloads/ndir_final.pdf)

28 Australian Government, December 2017, Response to the Senate Economic Reference Committee, Australia’s general insurance industry: sapping consumers of the will to compare, available at <https://treasury.gov.au/publication/p2017-t248756/>

29 The Australian Government the Treasury, September 2011, *Natural Disaster Insurance Review: Inquiry into flood insurance and related matters*, page 110, available: [http://www.ndir.gov.au/content/report/downloads/ndir\\_final.pdf](http://www.ndir.gov.au/content/report/downloads/ndir_final.pdf)

The need to remedy ASIC's limitations in dealing with claims, was reiterated (in respect of insurance claims handling generally) in ASIC's October 2016 report on *Life insurance claims: An industry review*<sup>30</sup>

Treasury was asked to examine this matter further and undertake targeted consultation on the merits of regulating claims handling conduct as a financial service. Given the potential to overlap with the work of the Royal Commission, however, the Minister for Revenue and Financial Services announced in March 2018 that the work being done by Treasury to enhance ASIC's oversight of insurance claims handling would now be considered pending the outcome of the Royal Commission.<sup>31</sup>

In relation to the effectiveness of the General Insurance Code of Practice, the NDIR made a series of recommendations about the content of the code, and recommended that every APRA-authorised general insurer adopt and comply with the code.<sup>32</sup>

It should be noted in this context that the General Insurance Code of Practice was reviewed in 2014 and is again under review. An interim report of this latest review was released in November 2017.

The ASIC Enforcement Review Taskforce Report has made a series of recommendations about industry codes in the financial sector, including that ASIC approval should be required for the content of and governance arrangements for relevant codes; and that entities should be required to subscribe to the approved codes relevant to the activities in which they are engaged.<sup>33</sup> At present, ASIC approval of relevant codes is optional. ASIC has the power under the Corporations Act to approve codes, though it is not required to do so and only issues approvals on application. To gain ASIC approval, the industry code must conform to the guidelines contained in the Regulatory Guide 183: *Approval of financial services sector codes of conduct*.<sup>34</sup> The Government has accepted the recommendations of the Taskforce report in principle but has deferred implementation until the Royal

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30 Report is available at <https://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>

31 Minister for Revenue and Financial Services, 7 March 2018, Address to the *Insurance Council of Australia Annual Forum*, available: <http://kmo.ministers.treasury.gov.au/speech/005-2018/>

32 The Australian Government the Treasury, September 2011, *Natural Disaster Insurance Review: Inquiry into flood insurance and related matters*, op cit, page 114

33 The Australian Government the Treasury, December 2017, *ASIC Enforcement Review Taskforce Report*, pages 33-34, available: <https://static.treasury.gov.au/uploads/sites/1/2018/04/ASIC-Enforcement-Review-Report.pdf>

34 *Ibid.*, page 51.

Commission has reported, having regard to the fact that the effectiveness of codes of practice is within the Commission's Letters Patent.<sup>35</sup>

## **THE LEVEL OF COMPETITION IN INSURANCE MARKETS AND WHETHER INSURERS ENGAGE IN ANTI-COMPETITIVE PRACTICES OR 'PRICE GOUGING'**

Competition is an important determinant of price and the absence of effective competition means that consumers can pay too much for their policies. The high cost of insurance in areas at high risk of natural disasters has led to allegations that insurers are price gouging in those regions. A number of reviews have looked at this issue but have not found evidence of anti-competitive practices.

The Government has also undertaken work to improve the operation of markets.

### **Market Studies**

The Australian Government Actuary (AGA) was commissioned to examine the causes of insurance premium increases in North Queensland in 2012 and 2014. The AGA produced three reports – two on strata title insurance (2012 and 2014) and one on home and contents insurance (2014).

Based on the available data, the AGA found that while insurance premiums across the north of Australia are generally elevated compared to southern cities, this was due primarily to historical under-pricing, the cost of reinsurance, and insurer claims experience as a result of a series of cyclones. The AGA specifically found that insurers had not been "price gouging". The AGA noted, however, the evidence suggested that competitive pricing pressures in North Queensland were not as intense as in other Australian markets.

In May 2017, the Government directed the Australian Competition and Consumer Commission (ACCC) to undertake a wide-ranging inquiry into the supply of residential building, contents and strata insurance in Northern Australia due to concerns about affordability and availability of insurance in the region. The inquiry is considering the competitiveness of markets, consumers' access to information, regulatory issues and the key cost components for insurance pricing, especially catastrophe risk.

The inquiry commenced on 1 July 2017 and will continue for three years.

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35 Australian Government, April 2018, *Australian Government response to the ASIC Enforcement Review Taskforce Report*, available: <https://static.treasury.gov.au/uploads/sites/1/2018/04/Aus-Gov-response-ASIC-Enforcement-Review-Taskforce-Report.pdf>

On 8 June 2018 the ACCC issued preliminary observations on the northern Australia insurance market following public consultation and information gathered from insurers. Early analysis shows that while northern Australia makes up only five per cent of the number of policies, it accounts for about 10 per cent of premium revenue. Further analysis will be undertaken on claims and expenses to obtain a view on profitability of insurers.<sup>36</sup>

The interim reports of the inquiry are due to be submitted to the Treasurer by 30 November 2018 and 30 November 2019. The inquiry is to be completed and a final report submitted to the Treasurer by 30 November 2020.

## **Improving the Operation of Markets**

In October 2014, the Australian Government announced it would establish a comparison website to help consumers located in North Queensland to compare home building and home contents insurance products. ASIC launched the North Queensland home insurance comparison website in March 2015. As part of the 2018-19 Federal Budget, a further two years' funding was provided in order for ASIC to continue administering the website.

In October 2017, a Project Agreement between the Australian Government and the Queensland Government was signed to develop and implement an engineering assessment program for strata properties in North Queensland to improve information available on a building's susceptibility to weather damage and ways to make properties more resilient. The intention behind these initiatives is that improvements to resilience will be reflected in lower risk and consequently lower insurance premiums.

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36 ACCC Media Release, 8 June 2018 *Update on northern Australia insurance inquiry*, available at <https://www.accc.gov.au/media-release/update-on-northern-australia-insurance-inquiry>

# RELATED REFORMS AND DEVELOPMENTS

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## NATIONAL FLOOD RISK INFORMATION PROJECT

In July 2012, the four-year National Flood Risk Information Project was launched as part of the response to the NDIR with the aim of improving the quality, availability and accessibility of flood information across Australia and, in doing so, raise community awareness of flood risks. This project delivered three products:

- Australian Flood Risk Information Portal, a portal which enables flood information to be accessible from a central location;
- Water Observations from Space, a web service displaying historical surface water observations derived from the satellite imagery for all of Australia from 1987 to present day; and
- Australian Rainfall and Runoff Guidelines, a national guideline document, data and software suite that can be used for estimation of design flood characteristics in Australia.

Further information on this project can be found on Geoscience Australia's website at <http://www.ga.gov.au/scientific-topics/hazards/flood/afrip>.

## INSURANCE COUNCIL OF AUSTRALIA DATAGLOBE

One of the factors that hampered the availability and affordability of insurance for natural disasters prior to the 2010-11 floods was the lack of information and understanding of risk. Local councils were sometimes reticent about providing access to insurers or other external parties regarding flood risk studies conducted in their areas. This led to insurers sometimes not offering insurance in the relevant area or not being able to correctly price the risk. The insurance industry's knowledge and understanding of risks from natural disasters have greatly increased since the time of the 2010-11 floods. This knowledge is being collected in an ICA 'DataGlobe'. The ICA describes the current status of project this way:

*"The DataGlobe provides visualisations of collected hazard data (Earthquake, Bushfire, Flood, Cyclone, Hail, Storm etc.) that can be used to provide a meaningful insight into natural perils, risk-based insurance premiums and the mitigation measures that may reduce the impacts of disaster in specific locations.*

*For example, the DataGlobe identifies flood risk for 14.1 million addresses in Australia, including each of the:*

- 80.46% of addresses that have no known flood exposure.
- 12.17% of addresses that are exposed to known/mapped flooding, comprising:
  - : 0.95% First exposed to flooding at 5% probability
  - : 0.61% First exposed to flooding at 2% probability
  - : 3.73% First exposed to flooding at 1% probability
  - : 6.88% First exposed to flooding at probable maximum flood (PMF).
- 7.37% of addresses that are flood exposed, but where the severity is unknown/unmapped.”<sup>37</sup>

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37 An extract from the Insurance Council of Australia DataGlobe website, available: <http://www.icadataglobe.com/>