

MARKET BULLETIN

REF: Y4540

Title	Australian Flood Insurance – Review Panel Publishes Findings
Purpose	To update the Market on the key recommendations of the Australian Natural Disaster Insurance Review
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Deadline	20 January 2012

Background

This bulletin is addressed to all Lloyd's market stakeholders dealing with the placement and underwriting of insurance in Australia.

On 4 March 2011 the Treasury announced an independent review into disaster insurance in Australia. This was in response to the widespread floods in Queensland, New South Wales and Victoria in January 2011.

The [Natural Disaster Insurance Review's final report](#) was released on 14 November 2011. This was accompanied by a [response from the Government](#) which includes a [public consultation](#) on the various recommendations made by the Review. The focus is chiefly on the Review's proposals for a standard definition of flood, the mandatory offering of flood cover and the compulsory inclusion of a 'Key Facts Sheet' disclosure document.

The Government has also released [draft Amendments and Regulations](#) to the Insurance Contracts Act in relation to, inter alia, a standard definition of 'flood'. The Insurance Contracts Act regulates the terms of insurance contracts and insurer conduct in relation to such contracts.

The deadline for responses to the full Review consultation is **30 March 2012**. The consultation on the Insurance Contracts Act regulations runs until **3 February 2012**.

Key Recommendations

The final report of the Review focuses on a few key areas and makes 47 formal recommendations across 16 chapters. The Government will consult further on these recommendations, but has to some extent already indicated the areas that it has identified as being of primary importance. In July 2011 [Lloyd's made a submission to the Review](#) which covered issues related to a number of the recommendations below.

Mandatory 'Opt Out' of Flood Cover

In Recommendation 1 the Review has proposed that all insurers be required to offer flood cover in home building and home contents insurance policies. This would be based on a standard definition of flood, the details of which are below.

Insurers would be able to give consumers the ability to 'opt out' of purchasing flood cover. Where consumers are at risk of flood they must be informed of that fact at the time at which they 'opt out'. There is, however, no prescribed control on the pricing of flood cover.

Recommendation 13 calls for the same provisions to be applied to all insurers offering small business insurance in all of their small business package policies. In Australia, under the Corporations Act 2001 Section 761G, a small business is defined as having less than 20 employees if it is a manufacturing business, or less than five for other industries. However, the Review defines a small business as any business which purchases a small business package policy. The Government will continue to work on a definition into 2012 and this forms part of the consultation.

The Government is also not proposing to mandate the way in which insurers offer flood cover or how they give consumers the option to 'opt out'. There must be an initial offer of flood cover but insurers may provide two quotes simultaneously (one inclusive and one not).

These measures are currently being consulted on by the Government and steps will be taken in 2012. In the past Lloyd's has voiced concerns about these proposals and has suggested alternatives. Lloyd's is also keen to see that these measures are not extended to commercial policyholders.

Standard Definition of Flood

The Government is proposing a standard definition to underlie the mandatory 'opt out' of flood cover. This definition would apply to prescribed contracts, which include those contracts covering loss and damage to small businesses and strata titles in addition to home building and home contents contracts. The definitions applied to small business and strata title are detailed in the draft regulations and are under [consultation](#). The standard definition of flood reads:

"The word 'flood' means the covering of normally dry land by water that has escaped or been released from the normal confines any of the following:

- (a) a lake (whether or not it has been altered or modified);*
- (b) a river (whether or not it has been altered or modified);*
- (c) a creek (whether or not it has been altered or modified);*
- (d) another natural watercourse (whether or not it has been altered or modified);*
- (e) a reservoir;*
- (f) a canal;*
- (g) a dam."*

The Government is seeking stakeholder views on whether this definition is appropriate and whether the standard definition should include the escape of water from man-made watercourses.

The Review has noted, through Recommendation 28, that this definition does not cover policyholders for damage from storm surge, tsunami and landslide and as such calls for all home buildings and contents policies to cover policyholders against these perils.

The Government notes that for home building and home contents contracts standard cover is already prescribed under the *Insurance Contracts Act* as including “*storm, tempest, flood, the action of the sea, high water, tsunami, erosion or land slide or subsidence*”. Currently, insurers may decline to offer flood cover if they inform a policyholder in writing and definitions of flood vary across the market. The Government has asked for suggestions as to how disputes over which peril has caused damage might be resolved quickly.

In the Regulations the Government has attempted to capture businesses which are so small that they are likely to purchase insurance directly. These are defined as:

“The business is a small business if:

- (a) its turnover in the last completed financial year was less than \$1 000 000; or*
- (b) it has 5 or fewer employees.”*

The Government has invited comments on whether the test should be narrowed to only include businesses which have five or fewer employees and a turnover of less than \$1m.

Flood Risk Reinsurance Pool

To make flood cover more affordable for homeowners and small businesses the Review has proposed, in Recommendation 21, that a flood risk reinsurance pool be established. In Recommendation 22 the Review goes on to suggest that the government should guarantee the payment of claims from the pool by covering any funding shortfall that the pool encounters.

In its response to the Review the Government has acknowledged that a pool represents “*one possible approach to the delivery of flood insurance premium discounts*” but also notes the “*potentially significant budgetary implications*” that such a facility presents.

In July 2011 Lloyd’s made it clear to the Review that government intervention in private insurance markets should be kept to a minimum and warned that the creation of insurance programmes or pools limits the effectiveness of the insurance industry, can be hugely costly for governments and hampers the application of sound actuarial and risk-based principles.

Key Facts Sheet

In Recommendation 33 the Review notes that there needs to be further disclosure of contract terms in insurance policies. The Government is proposing to further enhance the current regime by introducing a ‘Key Facts Sheet’. This will be in addition to current requirements relating to Product Disclosure Statements and will set out key information relating to home building and contents policies. The format of the Key Fact Sheet is still being determined.

Disputes

Recommendation 39 of the Review stipulates that the Insurance Council of Australia should amend its Code of Practice, of which Lloyd’s is a member, to impose a four month time limit to make a determination as to liability and nature of loss and damage for a natural disaster claim. Should there be no determination within the four month limit the Review recommends that the claim should be escalated to an internal dispute resolution complaint. The Government is consulting industry on this currently.

Next Steps

- The deadline for the consultation on the Insurance Contracts Act Regulations is 3 February 2012.
- The deadline for the Government consultation on the Review is 30 March 2012.
- **Underwriters should prepare their comments on the proposals and send them to [Lloyd's International Regulatory Affairs](#) by **20 January 2012**.**
- The Government will release further details in relation to the Key Facts Sheet and Regulations as soon as possible. These will be subject to further stakeholder consultation in 2012.

Further Information

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