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Dear Mr Hatfield

**Response to submissions re Application for Authorisation
A91086 by Insurance Council of Australia**

We refer to your email of 24 April 2008 attaching submissions made by the Australian Securities and Investments Commission (*ASIC*) and the National Insurance Brokers Association (*NIBA*) in relation to the above authorisation application.

The Insurance Council of Australia (*Insurance Council*) makes the following points in response.

1. Support for a common definition

The Insurance Council notes that both ASIC and NIBA support the concept of a common definition of flood to be applied by insurance companies.

2. Breadth of the proposed voluntary common definition

NIBA submits that the 'expansive' scope of the proposed common definition will make it more likely that an insurer will deny a claim.

The Insurance Council disagrees with the suggestion that adoption of the definition will result in insurers denying more claims because, as stated in 4.1 of the authorisation application, the common definition is not of itself an agreement as to risk acceptance. **The proposed common definition does not have the purpose or effect of setting a minimum standard for insurance cover.**

Modern flood mapping products and risk tools provide data on an increasingly descriptive basis, allowing greater discrimination between the origins of floodwater that may potentially affect a property. This enables an insurer to price cover more effectively and potentially to provide information or advice to consumers seeking cover on the nature of the known risks in their location. It is essential therefore that the definition used for inland flooding is sufficiently detailed to allow both the consumer and the insurer to identify all relevant inland flooding risks.

ASIC suggests that the effect of the proposed common definition will depend on whether it is used as an exclusion or an inclusion. Although this may be the case, it will remain open

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to insurers to assess each individual risk and then, as appropriate, to specifically use or not use the voluntary common definition in accordance with their own willingness and ability to cover the individual risk. **The main benefit and intended purpose of the definition lies in the fact that it provides a benchmark that consumers can use to differentiate between different insurance products in circumstances where no such benchmark currently exists.**

NIBA also submits that insurance brokers and their clients prefer policies with more limited flood exclusions. The Insurance Council submits that NIBA has misunderstood or misinterpreted the purpose of the common definition. We reiterate that the intent is to provide a benchmark for consumer understanding and product comparison. If an insurer, based on an individual assessment of risk, determines to modify the benchmark definition, then the consumer will be in a far better position than they presently are by being able to draw comparisons between the offered product and a common form of words used in the industry for defining flood. It is important for both the consumer and the insurer that inland flood events are defined in sufficient detail to – as far as possible – remove ambiguity over the immediately previous causation of the inundation (that is, where the water last came from) at the time of flooding. Accordingly, a robust definition with descriptions about the causation of the flood water is important.

3. Storm water

ASIC and NIBA submit that the proposed common definition differs from current definitions because it extends the definition of flood to include damage caused where stormwater cannot drain away from a house because the course it would normally take is itself overflowing. NIBA submits that this change would see many insurance companies reduce their current coverage and ultimately suggests that the third limb of the definition be omitted.

The Insurance Council disagrees with this assumption.

The proposed common definition makes reference to stormwater channels (that is, large culverts) as an example of a natural watercourse having been domesticated, as is often the case in urban environments. In the past, when these previously natural watercourses have overflowed and led to damage of insured property, there has been consumer confusion about whether the inundation is considered to be a flood event. The proposed inclusion of stormwater channels in this context is **not** designed to eliminate cover where it currently exists for inundation caused by overflow from local stormwater gutters or drains but to allow for the **inclusion** of the larger storm water channels that are in effect concreted rivers and creeks. **In fact, the inclusion of stormwater channels in the definition of inland flood serves to draw attention to the existence of this risk and inform the consumer as to the precise nature of coverage they may or may not have under a particular policy.**

The proposed community education materials to be released by the industry around the common definition will highlight this issue in order to provide greater clarity for consumers who are comparing products or who are attempting to determine what risks are relevant to their circumstances.

4. Flash flood

ASIC submits that the proposed common definition does not make a distinction between flash floods and other types of flood.

Flash flooding is not referred to in the proposed common definition for inland flood as it is not considered by insurers to be a part of inland flooding, and tends to be covered by most insurance policies even in circumstances where other water inundation is excluded.

The Insurance Council's communications campaign will assist in clarifying community awareness over the distinction between what is defined as inland flood under the proposed definition and other inundation perils.

Ability to amend the definition

ASIC submits that the definition should be either adopted by insurers in full or not adopted at all, because to qualify the term 'inland flood' by other terms of the policy would 'defeat the intention of giving this phrase a distinct and readily recognised meaning'.

The Insurance Council disagrees with ASIC's view.

Insurers cater to different sectors of the market depending on their willingness and ability to price an individual risk, as well as market demand, and must be free to develop their insurance policies in a manner that suits their business.

Individual insurers maintaining alternative definitions to the proposed common definition are unlikely to diminish the effectiveness of having a voluntary common definition in place as a consumer will be able to (and encouraged to) compare the offered terms and conditions against the definition as an industry benchmark. Consumers will therefore be in a better informed position to determine if the cover offered is best suited to their individual risks.

6. Premiums

ASIC submits that the adoption of the definition by insurers may result in a broader level of cover which would attract a higher premium and which might discourage consumers from seeking adequate flood cover. In its submission ASIC proposes that a higher excess for flood claims rather than an increase in the flood premium might be a more publicly beneficial course of action.

The Insurance Council disagrees with ASIC's view.

The Insurance Council submits that the setting of insurance premiums and excess conditions is an issue for individual insurers that is at the heart of maintaining a competitive market, and that no industry-wide provision should be made on this matter lest it stifle competition through the choices available to consumers.

Competitive forces will continue to influence the price and quality of insurance premiums in the market. Insurers need to be free to price their policies in accordance with the information available to them and the usual market dynamics in a competitive market, as is

currently the case. The adoption of a voluntary common definition will not change this position. Insurers will continue to use a number of tools to differentiate their insurance offerings on price and cover, including the use of policy deductibles, excesses and potentially alternative wordings to align respective insurers' prices with the cover provided.

The development of a voluntary common definition is merely one initiative amongst several being undertaken within a broader government and industry partnered agenda to improve consumer understanding of flood, the risks associated with floods, and the availability of flood insurance. **The proposed definition cannot and is not designed to solve all the issues associated with flood in Australia.**

Flood mitigation efforts by governments and individuals in high risk areas is a national priority and there is currently a collaborative dialogue occurring between the industry and the Council of Australian Governments on this subject.

Application of the doctrine of proximate cause

ASIC submits that, if the proposed common definition were adopted, the doctrine of proximate cause may still apply to exclude a claim where the damage is the result of a combination of causes, one covered and one not. ASIC further submits that it would be preferable for insurance policies to specifically state that cover will be excluded in such circumstances.

The application of the doctrine of proximate cause occurs at the claims assessment level and the Insurance Council submits that it is not appropriate for the proposed voluntary common definition to make reference to it except to limit its application, to the extent possible, by the framing of the definition.

What individual insurers state in their policy documents on this issue is a commercial matter for each insurer and is simply beyond the scope of the definition. **Importantly, even with the common definition in place, consumers will still need to carefully read their product disclosure statements to inform themselves of the extent of their cover.** However, the Insurance Council's communications campaign should assist in raising public awareness of the existence and effect of the proposed voluntary common definition.

8. Obligation to explain deviations from the common definition

NIBA submits that it

would like to see those insurance companies that choose not to adopt the agreed common definition explain, in a simple and concise way to potential policy-holders before entering into the policy, exactly how the policy definition varies from the agreed common definition.

The Insurance Council submits that would be a matter for individual insurers to consider.

However, the communications campaign will encourage consumer awareness of the definition within the community, giving consumers a basis for comparison between policies.

9. Law reform

NIBA submits that if a common definition is to be pursued it would be better dealt with as part of the *Insurance Contracts Act (the Act)* reform following review by Treasury.

Even NIBA acknowledges that the timing of a possible Treasury review of aspects of the Act is unclear. Any review is likely to be a time consuming process. To illustrate, an earlier review of the Act, not dealing with the flood issue, was instituted in September 2003 with a report released in May 2004. This was then followed, after release of a consultation package on 12 February 2007, by a very significant amount of work (by both Treasury and industry) to progress the results of the review. Many aspects of this review still await implementation even after four years.

The Insurance Council believes that the public benefit would be better served by not delaying the proposal for a common definition of flood for a lengthy period whilst a further review of the Act is undertaken. ACCC approval for voluntary adoption of a common definition remains the most appropriate and significant first step in assisting with the development of better community understanding of this significant public hazard.

Yours sincerely



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