One Company Many Brands
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21 October 2014

Jonathan Coppel and Karen Chester
Commissioners
Natural Disaster Funding Arrangements
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Email: disaster.funding@pc.gov.au

Dear Commissioners

Natural Disaster Funding Arrangements – Draft Report

Suncorp welcomes the opportunity to respond to the Productivity Commission's Draft Report on Natural Disaster Funding Arrangements (the Draft Report). Suncorp is one of Australia's largest general insurance groups and plays a significant role managing financial risks associated with natural hazards.

Australia's growing exposure to natural hazard risk has increased the need to transparently and robustly manage disaster risks. The Draft Report proposes significant improvements to the funding mechanisms and regulations that are used to deliver sound natural disaster risk management. Suncorp broadly supports the Draft Report and believes the reforms recommended will place the community, and the economy, in a better position to withstand future disasters.

Our submission is enclosed and contains further specific comments on the Draft Report including budgeting processes, insurance processes, improved hazard risk information sharing, land-use planning policy, insurance taxes and underinsurance.

Suncorp is happy to provide further information to the Commission to assist with this inquiry. Should you have any further questions regarding our submission, please contact me

Yours sincerely

Duncan Bone
Senior Manager, Public Policy

Productivity Commission Natural Disaster Funding Inquiry – Draft Report

Suncorp General Insurance Response

October 2014

One Company
Many Brands

SUNCORP GROUP

Executive Summary

Natural disaster risk has been changing throughout Australia with urbanisation, economic growth and population shifts combining to significantly increase our exposure to hazards. In response to growing levels of risk, it is important that natural disaster funding arrangements support best-practice risk management both within government and throughout the community.

Suncorp strongly supports a shift in focus towards preventative measures designed to reduce the impacts of future natural hazard events. Economic analysis of flood mitigation in Roma, St George and Grafton shows that disaster mitigation can deliver strong returns, with respective benefit cost ratios of 4.9, 5.4 and 2.2 over 50 years.

More broadly, a $250 million annual investment in disaster mitigation across all levels of government has been modelled to deliver a $6.5 billion increase in GDP over 10 years. This suggests the proposed $200 million annual investment in disaster mitigation by the Australian Government, with matched state and territory funding, would deliver significant and widespread economic benefits.

The benefits of disaster mitigation also extend far beyond the economic case, with significant social benefits for protected communities. The stress and anxiety associated with natural disasters should never be underestimated.

In addition to increased investment in disaster mitigation, Suncorp also supports moves to improve risk management within government. The Draft Report recommends a base level of natural disaster recovery expenditure be included in the Australian Government Budget to improve pre-disaster decision making. The amount provisioned could potentially be informed by catastrophe modelling to ensure consideration of exposure levels and the statistical likelihood of natural hazard events.

Improving the mechanisms used to collect, store and share natural hazard risk information will also support improved risk management. Suncorp supports further exploration of data sharing and collaboration targeted at improving government, insurer and community awareness of natural hazard risks.

Data sharing and collaboration initiatives should be carefully designed to manage the capacity, funding and technical constraints of all stakeholders. Suncorp also believes that the market incentive for insurers to continually improve risk modelling should be preserved by respecting the commercial nature of detailed risk pricing information.

Insurance is an integral part of natural disaster risk management and Suncorp supports improved consumer understanding of product coverage, natural hazard risks and potential rebuilding costs. The needs of consumers are rapidly evolving and as technology improves, insurers have an increasing range of options to meet those needs in new and meaningful ways.

Suncorp believes it is our responsibility to deliver products and offer information to improve consumers' understanding of insurance. It is important that regulations do not restrict insurer innovation and allow market led reform to better match the pace of consumer and technological change. For example, legislation enabling insurers to communicate with customers through email was not passed until 2013, long after the technology was broadly in use and clearly a preferred communications channel for many consumers.

Finally, we support reforms at the state and territory level to improve risk management in land use planning. It is particularly important that local government is provided with the technical, legal and political support they need to make risk-informed planning decisions and better manage exposure to hazards. Improving the fairness and efficiency of taxation through removal of state and territory based insurance taxes is also welcomed.

Overall, Suncorp believes the Draft Report proposes a number of important reforms that will significantly improve the management of natural disaster risk throughout Australia and result in a stronger, more resilient economy. Most importantly, communities will be better protected from natural hazards and will be able to enjoy the full range of benefits associated with resilience, including more affordable insurance premiums.

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About the Suncorp Group

Suncorp is one of the largest general insurance groups in Australia offering a range of personal and commercial insurance products, protecting the financial wellbeing of millions of Australians. As a Group, Suncorp has nearly 15,000 employees and more than nine million customers across the country. The General Insurance business alone paid out $5.2 billion in insurance claims in 2013-14, averaging more than $14 million each day.

Suncorp offers a range of personal insurance products including car, home and contents, travel, boat, motorcycle and caravan insurance. The key to Suncorp's success in personal insurance is its portfolio of well-known brands. These include Suncorp Insurance, Apia, AAMI, GIO, Vero, Shannons, Just Car Insurance, Insure My Ride, Bingle, Terri Scheer, CIL Insurance and Resilium. These brands have built reputations for insurance innovation, outstanding customer service and trustworthy products.

Suncorp also offers commercial insurance products that serve the needs of a wide range of business customers, from small business operators to global companies. The commercial insurance portfolio of brands includes GIO, AAMI, Suncorp Insurance, Vero and Resilium. Suncorp is also Australia's largest personal injury insurer offering workers compensation and CTP insurance, which serve the needs of governments, employers and the community.

Investing in Disaster Mitigation

DRAFT RECOMMENDATION 3.2

If the Australian Government reduces the relief and recovery funding it provides to state and territory governments, it should increase annual mitigation expenditure gradually to $200 million, distributed to the states and territories on a per capita basis. The amount of mitigation spending could be adjusted over time to reflect the imputed ‘savings’ from reduced relief and recovery funding.

Increased mitigation funding should be conditional on matched funding contributions from the states and territories and best-practice institutional and governance arrangements for identifying and selecting mitigation projects. These would include:

- project proposals that are supported by robust and transparent evaluations (including cost–benefit analysis and assessment of non-quantifiable impacts), consistent with National Emergency Risk Assessment Guidelines risk assessments and long-term asset management plans, and subject to public consultation and public disclosure of analysis and decisions
- considering all alternative or complementary mitigation options (including both structural and non-structural measures)
- using private funding sources where it is feasible and efficient to do so (including charging beneficiaries)
- partnering with insurers to encourage take-up of adequate private insurance and private mitigation through measures such as improved information sharing and reduced premiums.

Suncorp strongly supports this draft recommendation. Increased mitigation funding offers a broad range of social and economic benefits for the community. Increased funding is also an important prerequisite to the proposed reforms to the Natural Disaster Relief and Recovery Arrangements as each dollar invested in mitigation will reduce the need for relief and recovery funding. Reducing relief funding without investing in disaster mitigation is unlikely to be economically or politically achievable.

In our first submission to the Commission, Suncorp included economic modelling conducted by KPMG on the material economic impacts of switching from current arrangements to a $250 million annual investment in disaster mitigation. Over a 10 year period, the proposed disaster mitigation program was modelled to produce a $6.5 billion increase to GDP.

This recommendation proposes $200 million of Australian Government funding with matched funding by state and territory governments. The resulting $400 million annual investment is larger than the program modelled by KPMG and could be reasonably expected to provide a GDP benefit significantly exceeding $6.5 billion over 10 years.

Suncorp supports this level of investment and is confident it will deliver economic and social benefits far surpassing the costs.

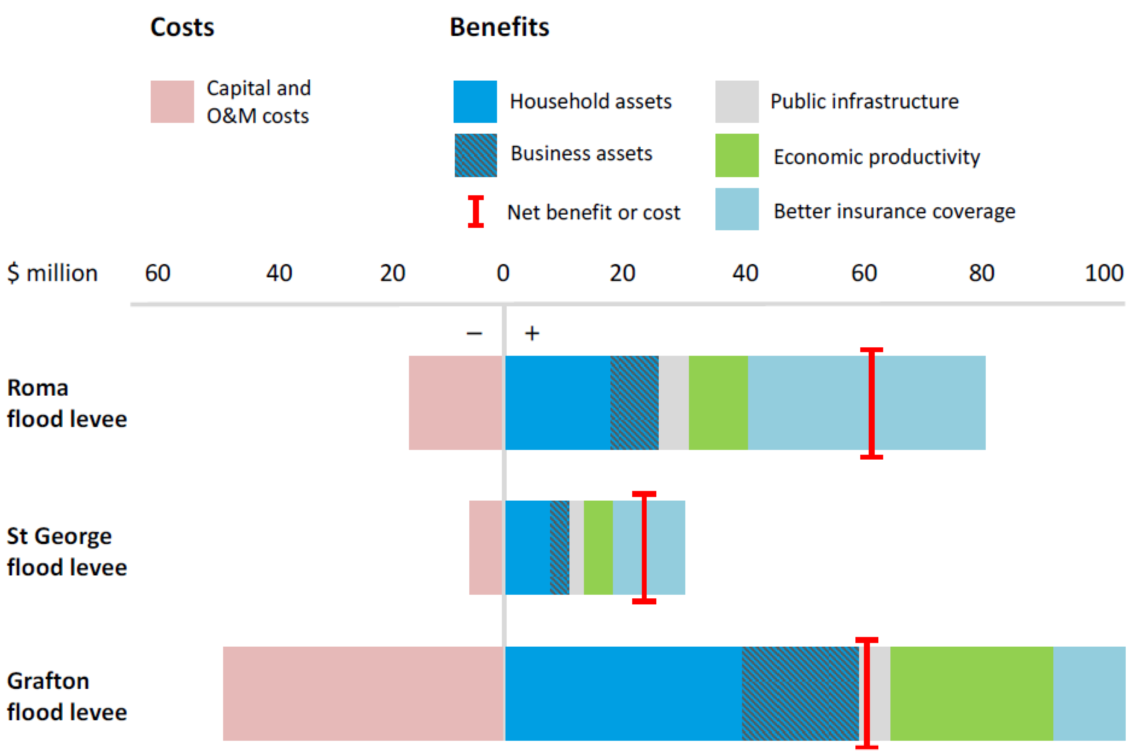
Economic Case Studies

To further bolster the case for investing in disaster mitigation, Suncorp also commissioned Urbis to conduct a case study analysis of flood protection investments in the south west Queensland towns of Roma and St George, and the northern New South Wales town of Grafton. The Urbis report *Economic benefits of flood mitigation investments* is attached to this submission.

The case studies of Roma, St George and Grafton highlight the strong economic returns that can be achieved by investing in flood mitigation, an important aspect of broader disaster mitigation investment.

As part of the study, Urbis worked with Suncorp and local governments to obtain a range of economic and technical data for the three towns. Based on the protective capacities of flood mitigation and underlying weather risks, the recent flood mitigation investments in Roma and St George showed a net benefit of $64.7 million and $25.7 million respectively over the next 50 years. The legacy flood mitigation structures in Grafton show a long term net economic gain of $59.2 million.

Figure 1 - COST AND BENEFITS OF FLOOD MITIGATION INVESTMENTS



(Source: Urbis, *Economic benefits of flood mitigation investments,* 9 October 2014)

The Roma flood levee is expected to produce a benefit cost ratio of 4.9 over the next 50 years. Similarly, flood mitigation in St George produces a benefit cost ratio of 5.4. Even the much older 1970s project in Grafton showed a benefit cost ratio of 2.2. These studies are showcases of the broader benefits that can be expected from a smarter approach to disaster mitigation. Importantly, this analysis has been conducted in line with the Commission’s advice on best-practice economic analysis of disaster mitigation.

Alongside the economic and social benefits of disaster mitigation is the key benefit of lower insurance premiums for consumers. Suncorp notes the Commission states "For large mitigation projects, the post-mitigation premiums should be subject to some independent review."[1]

Suncorp suggests that independent review of premiums following mitigation projects is likely to be resource intensive for both government and insurers, and is ultimately unlikely to deliver benefits beyond those of a competitive market. All insurers have a strong incentive to offer the lowest possible premiums to attract and retain customers. We are highly confident that where mitigation materially reduces risks and insurers are made aware of this through data sharing, then premiums will be reduced through competition.

Overall, Suncorp strongly supports this draft recommendation. As reinforced by KPMG and Urbis analysis, investing in disaster mitigation offers strong economic returns.

[1] Productivity Commission, *Natural Disaster Funding Arrangements Draft Report Volume 1,* 2014, pg.22

Budgeting for Natural Disasters

DRAFT RECOMMENDATION 3.3
The Australian Government should publish estimates of the future costs of natural disasters to its budget in the Statement of Risks. It should also provision through annual appropriation for some base level of natural disaster risks that can be reasonably foreseen. For more catastrophic, less quantifiable risks, it is likely to be more efficient to finance the related costs if and when the risks are realised.

INFORMATION REQUEST
The Commission seeks feedback on approaches for the Australian Government to provision for some base level of natural disaster risk in the budget each year.
• What would be the advantages and disadvantages of using historical averages?
• Are there more sophisticated models available to estimate potential future liabilities?
• How should 'imputed savings' from changes to the Natural Disaster Relief and Recovery Arrangements be estimated?

Suncorp supports inclusion of expected natural disaster expenditure within the Australian Government budget. Estimating future costs is achievable using insurance methodologies and doing so will significantly improve the management of natural hazard risks.

Estimating and accounting for the costs of future natural disasters will provide an important counterbalance to risk growth. In particular, improved cost transparency will assist governments to better manage asset exposure growth that can occur during benign periods.

Insurers account for future natural disaster expenditure through natural hazard allowances. Each annual budget includes an allowance based on the long-run estimate of disaster expenses that can be expected in a typical year, known as an Annual Average Loss (AAL). This calculation takes into account exposure data and the statistical probability of extreme events.

Allowances are set by considering catastrophe models that forecast exposure to risk by simulating thousands of events over hundreds of years. These simulations cover:

– different types of hazards – such as bushfire, storm, cyclone, flood and earthquake among others,

– varying levels of severity and frequency – including at differing levels of Annual Exceedance Probability (AEP) (e.g. 1% AEP or "1 in 100" or 0.5% AEP or "1 in 500"), and

– impact on assets – including damage curve estimates that model costs based on number, condition and location of insured assets.

A high number of simulations are run with the result of each individual simulation used to determine AAL. This figure is then used throughout the budget process to account for disaster expenses that the insurer is likely to incur in an average year.

Importantly, the natural hazard allowance process does not attempt to provision for the full cost of all natural disasters in any given year. The process seeks to appropriately fund anticipated expenses considering a broad range of factors in an average year. In this way, funding is not required to be held against the most extreme natural hazard events that can occur on an infrequent basis with this risk instead managed through reinsurance arrangements.

This is significantly more advanced than the simple historical average of past payments that the Draft Report highlights is currently in use for the New South Wales Government budget. A simple average over a given time period is likely to be significantly over or under estimated given the statistical severity of events during the chosen timeframe and likelihood of exposure growth over time.

For example, annual average flood losses over a 20 year historical period could be significantly influenced by an extended drought. Each year of nil flood losses during the drought would draw the average lower and lower, despite the overall level of flood risk being likely to increase as a result of asset exposure growth.

Conversely, a particularly extreme event such as a Category 5 cyclone impacting a major town is likely to be highly costly and significantly increase the annual average loss calculation, if the statistical severity of the event is not accounted for.

There are a range of private sector catastrophe modelling providers that could be engaged to conduct modelling on government risks. A probabilistic approach based on broad assumptions could be initially undertaken with a more deterministic approach adopted as governments improve asset liability management. The proposed road asset register is an example of highly valuable input data that can be used to inform the development of a catastrophe model.

INFORMATION REQUEST
What governance and institutional arrangements would be required to implement the Commission's 'top-up' insurance option? Could premiums be estimated by the Department of Finance, the Australian Government Actuary, Comcover or another body?
• How could reinsurers be involved in this process?
• What timeframe would be required before such a model could be operational?

In addition to allowing cover for a lower small disaster criterion, smaller annual expenditure threshold and higher rate of cost sharing from the Australian Government, would there be merit in the 'top-up' insurance option also providing cover for broader eligible expenditure?

Catastrophe modelling may also help to facilitate implementation of the Commissions 'top-up' insurance option. Model results could potentially be used to inform decision making across all levels of government on the extent, price and availability of cover above standard NDRRA entitlements.

Suncorp believes it would be relatively straightforward to adapt catastrophe modelling with state and territory governments placed in the role of an ‘insurer’ and the Australian Government placed in the role of ‘reinsurer’. This would assist state and territory governments in making decisions regarding the proportion of financial risk they retain or seek to transfer to the Australian Government.

The purchase of ‘top-up’ insurance could also be facilitated by a reinsurance broker that assists the states to model risk and develop a reinsurance style proposal. The proposal would then be reviewed and ‘underwritten’ by the Australian Government. Engaging a broker would help to minimise the impact on existing government operations and reduce the need to develop specialist skills within each level of government.

Collaboration and Data Sharing

DRAFT RECOMMENDATION 4.2
State and territory governments, local governments and insurers should explore opportunities for collaboration and partnerships. Partnerships, for example, could be formed through the Insurance Council of Australia and state-based local government associations (or regional organisations of councils). Consideration could be given to the Trusted Information Sharing Network model, and involve:
- governments sharing natural hazard data that they already hold and undertaking land use planning and mitigation to reduce risk exposure and vulnerability
- insurers sharing expertise and information (for example, claims data) to inform land use planning and mitigation
- collaboration to inform households of the risks that they face and adequacy of their insurance to fully cover rebuilding costs, and to encourage private funding of mitigation through incentives such as reduced premiums.

Suncorp is supportive of increased transparency and availability of natural hazard risk information as a fundamental step toward improving risk management for individuals and organisations. This is particularly important for existing communities already exposed to natural hazard risks that do not benefit from improved building and land use planning regulations.

The exploration of a Trusted Information Sharing Network (TISN) model may help identify and address some of the key barriers to greater data sharing such as ownership, quality, updates and appropriate use issues that arise when data developed for one purpose is used for another purpose. We see this as particularly relevant between and within levels of government.

It is important that such a TISN be carefully set up to operate at scale for the benefit of customers, insurers and government. For example, the exchange of separate flood, bushfire and earthquake datasets between each individual local government, each emergency response agency and each insurer in the marketplace would be time consuming and resource intensive for all stakeholders involved.

Insurers have a market incentive to minimise operating costs in order to deliver low premiums to market. This commercial constraint is the driver behind requests to centralise and simplify access to government held data. Conversely, the Commission highlights the potential costs associated with a national level repository of natural hazard data.

Simple access to data, however, remains important to promote competition and the availability of cover. New market entrants would face a significant barrier to entry should natural hazard data be available only to larger insurers that have entered into formal arrangements with multiple local governments and government agencies. For example, many insurers would not have been able to implement flood coverage so quickly after the Queensland floods to meet market demand without access to the National Flood Insurance Database (NFID).

Suncorp therefore advocates for initiatives that enable simple access to bulk natural hazard data sets, preferably at the national level. Improving the way data is collected, stored and shared at may also improve cross sector collaboration.

The recent Queensland Government Memorandum of Understanding on flood information sharing is a good example of collaboration arising from improved data management. The exchange of information had minimal impact on local government and direct insurer resources, while enabling a greater degree of collaboration on flood risk information throughout Queensland.

Suncorp believes it is important that any collaboration and data sharing initiatives have the explicit objective of retaining the competitive forces that currently drive ongoing improvements in insurer risk modelling. Insurers can gain a competitive advantage through improving risk modelling ahead of the industry and this drives ongoing improvement in risk models. This translates into more accurate pricing for customers that is more likely to reflect personal risks and provide an appropriate price signal.

Undermining this competitive advantage by, for example, requiring insurers to publish detailed risk data would remove this competitive advantage. It is therefore important to respect the commercial nature of most detailed risk information held by insurers and explicitly account for this in the design of data sharing initiatives.

Data sharing can still occur if appropriately structured. For example, Suncorp has recently entered into a partnership with the James Cook University (JCU) Cyclone Testing Station to provide researchers with claims, policy and assessment data for buildings in cyclone prone areas.

This data is highly valuable to inform research into cyclone risk but is also commercially valuable information to inform risk pricing. A rigorous review of privacy, legal and commercial implications was completed and the partnership was able to be structured to deliver both commercial benefits for Suncorp and broader benefits for the public. JCU is able to publish key high-level findings identified in the research.

Overall, Suncorp acknowledges that there are both private and public sector barriers to the development of a complete set of data across all hazards that is ‘held’ at the national level. There does, however, remain significant ground to be made in defining guidelines and standards at the national, or even international level, on the collection and dissemination of natural hazard data.

INFORMATION REQUEST
If guidelines for the collection and dissemination of hazard mapping and modelling are developed:
- *who would be best placed to develop these guidelines?*
- *what hazards could be covered?*
- *how could guidelines for hazard types be prioritised for development?*

Suncorp believes improved standards that describe how to collect, store and share hazard risk information will facilitate greater exchange and collaboration between all stakeholders going forward. This will help improve the transparency and accessibility of risk information for the community.

Guidelines for the collection and dissemination of hazard risk modelling should not be viewed as an inflexible set of data requirements, but rather common standards agreed between stakeholders that reduce unnecessary variances and improve interoperability. Standardised guidelines are a fundamental enabling step toward improving data collaboration and sharing.

There are an incredibly broad and diverse range of stakeholders involved in the collection and dissemination of hazard information and there is often common 'foundational' data shared across hazards. For example, data on the location and size of buildings is collected from scratch by a large number of organisations and is highly relevant to the full range of natural and manmade hazards.

The breadth of stakeholders and potential commonality across data sets creates the opportunity to develop at least some level of coordination in the way risk is collected and articulated in data form. The recently updated National Flood Guidelines, part of the National Flood Risk Information Project, is a good example of removing unnecessary differences between flood study design approaches to facilitate collaboration going forward.[2]

Developing hazard mapping and modelling guidelines involves a mix of policy, technical and research challenges that requires input from a variety of organisations and technical experts. This work should be carefully coordinated and prioritised across hazards via the Australia-New Zealand Emergency Management Committee (ANZEMC). Prioritisation should be informed by the current level of understanding of hazards, the cost of improving this understanding and the expected benefits this will deliver for the community.

Suncorp views the standardisation of cyclone risk information to be the next priority hazard. For example, we are aware that several Queensland local governments hold "Form 21" data that certifies the extent to which building upgrades or repairs meet modern cyclone building standards. This information is important to determine

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[2] See: Geoscience Australia, *National Flood Guidelines,* available: http://www.ga.gov.au/scientific-topics/hazards/flood/capabilities/about-national-flood-risk-information-project/national-flood-guidelines

cyclone risk, but is not stored in an accessible or standardised format. It is therefore challenging for Suncorp to access and use this information to improve cyclone risk assessments and deliver more accurate pricing for our customers.

If appropriately structured, improved data sharing and collaboration partnerships will help improve risk management for the community, government and insurers. In particular, this will help communities already exposed to natural hazard risks to become more aware of risk and take steps to reduce risk.

Role of Insurers

DRAFT RECOMMENDATION 4.9
Insurers should provide additional information to households regarding their insurance policies, the natural hazards they face and possible costs of rebuilding after a natural disaster. This work could be led by the Insurance Council of Australia to ensure consistency in the provision of information across insurers.

Suncorp is committed to providing our customers with meaningful and easy to understand information that will assist them to make informed choices about their personal risks and our insurance products.

Suncorp supports this recommendation and notes it includes three distinct areas covering product disclosure, communicating the risks consumers face and potential rebuilding costs. It is important to acknowledge some current limitations that require additional work before insurers can fully implement this draft recommendation as proposed. Despite the limitations outlined below we are supportive of ongoing work led by the Insurance Council of Australia and continue to develop our own improvements to directly meet the needs and expectations of consumers.

Product Disclosure

Product disclosure is an important aspect of the information consumers need to purchase insurance products. It is crucial that a considered approach is taken to ensure consumers receive product disclosure information that is clear and informative. Simply providing information in more places and more documents is unlikely to improve consumer understanding of insurance products. It is important information is provided in a way that meets consumer needs.

The Commission suggests that the Key Facts Sheet (KFS) should include whether a policy is sum insured or total replacement cover. The level of cover chosen is, however, already a key part of the sales process and is required to be included on the policy schedule. The schedule also contains other important information on customer’s choices such as the excess and period of cover.

Including variable coverage information, such as the sum insured or total replacement cover choice, on the currently static KFS would duplicate information already provided to consumers. Although a minor example, this is illustrative of the broader risk of layering disclosure and providing *more* information rather than meaningful information to consumers.

The framework of financial services product disclosure is currently under review as part of the Financial Systems Inquiry (FSI). Suncorp believes it is important to consider the outcomes of the FSI review prior to further adjusting the current disclosure regime. The FSI outcomes will better inform policymakers and insurers on ways to provide product information more aligned to consumers' needs, while not restricting product innovation and competition.

For example, in 2004 it was first proposed that insurers should be able to communicate through email, long after the technology was well-entrenched and broadly accessible. However, enabling legislation did not pass into law until 2013 meaning that for almost a decade regulation prevented communication through what was clearly a preferred channel for many consumers.

Similarly, the KFS is relatively prescriptive to achieve cross-product comparability for consumers. This is an important aim, however does generate a risk of driving product standardisation as features unable to be listed are likely to be removed from products. Over time this could result in reduced consumer choice in the market.

These examples demonstrate the importance of a robust disclosure framework that seeks to deliver simplicity for consumers while also enabling innovation and competition. Overall, Suncorp views product disclosure as an insurer responsibility and we constantly look for better ways to communicate directly with consumers about our products. We will continue to work with policymakers, regulators and the Insurance Council of Australia to meet this responsibility and improve consumer understanding of insurance.

Communicating Natural Hazard Risks

Suncorp is supportive of communicating natural hazard risk information to our customers. A range of programs are already provided directly by Suncorp and via the Insurance Council of Australia. Suncorp also supports government programs designed to raise risk awareness and, more importantly, provide information about mitigating risks such as the GIO and NSW Fire Brigade Home Fire Safety Audit website.[3]

These existing programs have highlighted some challenges that need to be resolved as we move towards improved education around all natural hazard risks for consumers. A critical challenge is translating technical insurance pricing data such as damage curves, exceedance probabilities, historical loss averages and catastrophe model outputs into a consumer facing piece of information, such as a low, medium, high or extreme rating. The estimates we currently hold are developed for pricing purposes only and require supplementary information to be overlayed to develop a risk message meaningful to consumers.

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[3] See: http://www.homefiresafetyaudit.com.au

There are also challenges downscaling risk information as our risk modelling has been developed to support operation of an insurance portfolio at a national level. This means that in many cases data can contain an error for one individual home that is not material to the business, but is significant in the context of an individual homeowner. Suncorp is cautious of providing any message that may result in an underestimation of risk.

Complete transparency of all pricing data is also subject to commercial considerations. Suncorp has invested significant financial resources into advancing our natural hazard risk information capabilities to create a competitive advantage over less advanced insurers. Sharing too much of this detail may enable competitors to copy or derive advanced modelling at no cost and erode this competitive advantage.

Finally, there remains an understandable level of scepticism in risk messages provided from insurers and many consumers view messages as inflated for commercial purposes. For example, Suncorp has previously contacted customers to educate them about potential underinsurance risks and suggest sum insured increases. In response, it is normal for a small proportion of customers to actually reduce their sum insured, rather than increase it as suggested.

Despite these challenges, communicating hazard risk information is an important and fundamental role of an insurer. If consumers are not aware of the risks they need to manage, or have limited incentive to do so, then insurance pools can fall subject to moral hazard resulting in significant increases in claims costs. Suncorp therefore continues to explore ways of communicating meaningful risk information to consumers in innovative ways.

Rebuilding Costs

Shortfalls between the sum insured and the final rebuilding cost after a disaster results in underinsurance and can cause significant financial loss. Suncorp is acutely aware of these pressures and has extensive underinsurance programs in place to manage this risk for our customers and for our business.

Underinsurance is a catch-all term that describes a variety of different financial outcomes consumers experience from insurance products. These may be planned or unplanned and can be driven by a range of personal choices, behavioural biases or information asymmetries. As a result, this issue is difficult to define and quantify.

This draft recommendation appears to be targeted at unconscious underinsurance driven by a lack of knowledge of the replacement value of their assets and level of risk. This type of underinsurance is partly driven by the difficulty consumers can have estimating rebuilding costs, but can also arise as a result of demand surge following major disasters as well as step changes to building codes.

To address this type of unconscious underinsurance, Suncorp has fully integrated a rebuilding cost calculator into our insurance policy system. This calculator is used to estimate post-disaster rebuilding costs and provide guidance to our customers on an appropriate sum insured choice. A minimum sum insured is also imposed based on the calculator to manage deliberate or extreme underinsurance.

Importantly, the calculator estimate is offered automatically and involves no additional consumer action outside of Suncorp's standard quote process. This ensures that all new customers have information available to assist them in making an informed decision.

Upon renewal, the sum insured is re-estimated through the calculator and adjusted to the new value automatically. This allows for improvements in the accuracy of calculator estimates to be reflected in the renewal sum insured. The increase is, however, rate limited to manage dissonance with the customer's perception of cost inflation. We have found that customers can perceive large changes to be a commercial tactic and this often results in requests to reduce their sum insured back to original levels, with no allowance for inflation.

Despite our best efforts, the wide range of factors at play in rebuilding costs makes it challenging to accurately estimate rebuilding costs pre-disaster. This has been clearly highlighted with underinsurance in the Blue Mountains, where building code changes have driven cost increases well above what government, insurers or consumers had anticipated. In some cases additional costs of more than $100,000 have been experienced. Where best-effort measures have been taken to estimate rebuilding costs, and there remains underinsurance post disaster, this can be viewed as residual underinsurance.

INFORMATION REQUEST
What is the prevalence of sum insured versus total replacement cost cover in household building and contents insurance policies? Has this changed in recent years? Are there any impediments to insurers disclosing an indicative estimate of the difference between the sum insured and the replacement value of the property?

The risk of residual underinsurance is essentially the risk of a pre-disaster estimate falling short of final post-disaster rebuilding costs. In this way it can be viewed as a new 'hazard' and the risk associated with this hazard can either be borne by consumers or transferred through insurance in return for an additional premium.

On one hand, many believe that insurers are best placed to estimate pre-disaster rebuilding costs and should bear the risk of residual underinsurance by providing total replacement coverage. On the other hand, total replacement cover comes at an additional cost and consumers may be better placed to estimate rebuilding costs using their in-depth knowledge of the building, its size, features, materials and local influences on costs.

Suncorp believes that neither view is correct in all circumstances. As a result, we have taken a market based approach and now offer a range of products for our customers to choose from.

These product options include a low cost sum insured policy that also covers some additional ‘hidden costs’ such as removal of debris, a mid-level sum insured plus safety net product that offers an additional margin to cover demand surge and a full AAMI Complete Replacement Cover (CRC) policy. This range of options ensures that the cost of transferring residual underinsurance risk through insurance is transparent and the customer is able to choose an appropriate level of cover based on their financial needs.

Complete replacement cover is not common in the Australian market however it is relatively prevalent in New Zealand. The cost of CRC claims following the Christchurch earthquakes surpassed insurance company estimates, and resulted in substantial reinsurance claims. This highlighted the potential upper-end costs involved with offering an uncapped sum insured cover, and premiums have increased to be commensurate with this new understanding of risk.

As a result of the increased cost of providing CRC coverage, Suncorp has begun offering AAMI customers the choice between sum insured and CRC to enable a cost informed choice between the two covers. Around 90% of AAMI customers overall remain on CRC cover, with approximately 30% choosing a CRC policy when creating a new policy.

This means that CRC cover is available in the marketplace and is chosen by a significant number of Australians. Transferring residual underinsurance risk is not free for consumers and Suncorp cautions against calls for regulated CRC coverage. Mandated CRC cover is likely to significantly increase the cost of insurance and may result in increased levels of non-insurance.

As the majority of consumers choose sum insured cover, it is important they are empowered to make informed choices. Suncorp believes the best approach for a sum insured policy is for the insurer to offer its best-effort estimate of rebuilding costs, with the final decision on cover left to the consumer.

There are, however, some barriers to providing advanced sum insured guidance to customers. For example, Suncorp recently launched a direct mail campaign contacting around 40,000 bushfire exposed customers to educate them on the potential impact of building code changes to their sum insured. As a result of personal advice regulations, this letter could not be customised to provide an indicative range of potential underinsurance and only general information was provided. Suncorp remains of the view that personal advice regulations are unnecessarily restrictive in the general insurance context and can pose a barrier to more meaningful conversations between insurers and consumers.

Are there barriers to insurers recognising property-level mitigation through reduced premiums? Where commercial insurers adopt more risk-reflective pricing are reinsurers adjusting their prices accordingly?

Currently, the key barrier to recognising property-level mitigation for Suncorp is the acquisition of trustworthy data. Collecting a full range of data for each building is not possible through current new business processes either online or over the phone.

Our ability to acquire detailed data is limited by both the customers' willingness to dedicate time to providing this data, and their actual ability to communicate key attributes of their homes in technical terms. Insurers also face commercial constraints to minimise operating costs and so cannot, for example, invest in a local presence to collect property-level data or engage in lengthy and detailed interviews with consumers about their homes.

Suncorp believes this barrier can be overcome through increased data collaboration and sharing as covered earlier. For example, access to a trustworthy and state-wide dataset of homes certified as cyclone wind resistant by local government would provide a low cost way of improving recognition of property level mitigation through lower premiums. Suncorp is working with the Queensland Government to obtain this information and believes further data sets like these are a key outcome of the proposed Trusted Information Sharing Network.

Financial Inclusion

Suncorp notes the Commission highlights a responsibility for insurers to offer products tailored for low income Australians at page 183. To improve financial inclusion, Suncorp has recently partnered with Good Shepherd Microfinance to conduct a pilot on contents insurance for low income renters.

A key outcome of this pilot is improving our understanding of customer needs in this segment. Data from this pilot will also be used to design suitable products for low income Australians. Suncorp's purpose is to create brighter futures, including for those currently struggling with financial exclusion.

State and Territory Reform

DRAFT RECOMMENDATION 4.4
State governments should:
- clearly articulate the statewide natural hazard risk appetite in land use planning policy frameworks
- provide local governments with guidance on how to prioritise competing objectives within land use planning
- provide local government with guidance on how to integrate land use planning and building standards. Consideration should be given to Victoria's Integrated Planning and Building Framework for Bushfire in this regard.

Furthermore, local governments should publish the reasoning behind development assessment decisions.

DRAFT RECOMMENDATION 4.5
The onus is on state governments to ensure that local governments in their jurisdiction are sufficiently resourced to effectively implement their land use planning responsibilities. State governments should review the adequacy of local governments' resources and capabilities, and provide further resources and support where they are not adequate.

Suncorp supports this draft recommendation. As stated in our first submission, land use planning has a critical relationship with the level of risk in a community and its resilience to disasters. It is clear that urban planning is a challenging policy area with a range of competing priorities, making regulation difficult for governments.

Recent natural disasters, including the 2009 Victorian Bushfires, the 2010-11 Queensland floods and Cyclone Yasi, have highlighted weaknesses in planning regulations throughout Australia. It is crucial that governments quickly respond to the changing levels of risk in Australia by improving the management of natural hazard risks throughout the land use planning system.

Perhaps the most important aspect of land use planning reform will be to ensure that local governments have the technical, legal and political support they need to make risk informed planning decisions. We welcome the focus of draft recommendation 4.5 on ensuring appropriate support of local governments and see empowering local planners as a key aspect of managing natural disaster risk going forward.

DRAFT RECOMMENDATION 4.8
State and territory taxes and levies on general insurance should be phased out and replaced with less distortionary taxes.

Suncorp strongly supports this draft recommendation. As outlined in our original submission, the case for reform is clear. Insurance taxes currently form a significant barrier against Australians purchasing affordable insurance cover and in 2012-13 contributed $5.53 billion in revenue across all levels of government, more than the amount collected through gambling taxes. [4]

[4] Australian Bureau of Statistics, *5506.0 - Taxation Revenue, Australia, 2012-13*, 28 May 2014.

Conclusion

Suncorp broadly supports the Commissions Draft Report and the direction it establishes for improved natural disaster risk management going forward. Australia's natural hazard risks are well known and living with risk is a part of the Australian lifestyle.

Natural hazard risks are however increasing and action must be taken to better manage the impacts of disasters. Correcting the imbalance between pre-disaster mitigation investment and post-disaster recovery spending is an important first step in addressing the historical levels of risk built into the community.

Improving the way governments budget for disaster recovery will also help to transparently manage historical risk and improve decision making. Similarly, increased collaboration and data sharing will allow government, industry and the public to make better decisions about the level of risk they accept and measures they take to mitigate risks.

Reduced government intervention in the insurance market and an evolving use of technology by insurers to better inform consumers will enable a stronger market that better meets the rapidly changing needs of consumers. Finally, reform to reduce insurance taxes and improve land use planning will drive a better approach to risk management, with new homes and business built in smarter places.

Overall, Suncorp believes these changes will significantly improve the management of risk throughout Australia and markedly reduce the harsh social and economic impacts of natural disasters on the community.