



COASTAL CITIES NATURAL DISASTERS CONFERENCE

**THE INSURERS PLAN, ACTION AND
RESPONSE TO NATURAL DISASTERS**

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**WAYNE GOODALL – CLAIMS MANAGER
EIG-ANSVAR LIMITED**

EIG-Ansvar Limited
Head Office: Level 18, 303 Collins Street Melbourne, Victoria, 3000
ABN 21 007 216 506 AFSL 237 826

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Table of Contents

- 1. Introduction**
- 2. The General Insurance Industry of Australia**
- 3. The Role of the Insurance Council of Australia**
- 4. Climate Change and the Threat to the Affordability of
Insurance**
- 5. Australian Catastrophes**
- 6. Cyclone Larry**
- 7. The Challenges and Issues**
- 8. Insurance Industry Response**
- 9. The Role of the Government**
- 10. Cosgrove Task Force**
- 11. The Impact of Regulation**
- 12. The Claims Team**
- 13. Summary**

1. Introduction

Climatic Change also known as Global Warming, is generating a massive amount of interest from around the world from all walks of the business community and is impacting on insurance markets. The severe weather events linked by many to global warming is a huge concern for the insurance industry

The aim of this paper is to provide an overview of the insurance industry in Australia and analyse the role the industry played in the disaster caused by Tropical Cyclone Larry that hit far North Queensland in March 2006.

2. The General Insurance Industry of Australia

The role of the general insurance industry is ostensibly to protect community assets and businesses and is an essential component in the country's economy. The industry is in a responsible position of having to respond to natural disasters and to assist our policy holders return to the position they were in before any disaster. The challenge for the industry is to offer cover at prices that are affordable yet offer full protection and allow insurers to operate profitably.

Insurance works on the principle of spreading risk across a large number of policyholders who face similar potential losses. This "pooling" concept results in the accumulation of premiums of many to pay a small amount of claims that will hopefully keep premiums at an affordable level. In underwriting parlance, the premium charged reflects the level of risk each individual policyholder brings to the pool. As a simple illustration, homeowners who are faced with bushfire risks will be asked to pay a higher premium than a home owner in the suburbs with minimal fire risk

The purpose of this paper is not meant to be an insurance manual but it is important to recognise that insurers do an enormous amount of analysis on things such as:

- Concentration of Risk
- Potential for risks to aggregate
- Reinsurance protection
- Aggregate exposures resulting from individual incidents
- Catastrophe risks

A Non-Insurance and Under-insurance survey conducted nationally by the Australian Securities & Investments Commission (ASIC) and reported in September 2005 uncovered the following:

Not Insured

- One in six small businesses (approximately 200,000).
- one in five household owners (1.8million homes)
- 70% of tenants do not bother to insure their contents.

Under Insured

- 7.5% of home buildings are insured for less than 70% of their replacement value.
- Approximately 20% of home buildings are insured for between 70% and 90% of replacement value.
- Anecdotal evidence from this research indicated that 35% of all contents are markedly under insured.

Affordability is said to be the main reason and many industry leaders say taxes and government levies do not help this position but that topic can be debated another day in another forum.

What we do know is that greater levels of insurance coverage and quick payment of claims accelerates the recovery process following a disaster by contributing to faster rebuilding and repair of property. Underinsurance also leads to a need for greater government assistance.

3. Role of the Insurance Council of Australia

The insurance Council of Australia is the representative body of the general insurance industry in Australia. Its membership represents more than 90% of total premium income written by private sector insurers.

Council members are regulated by the Australian Prudential Regulation Authority (APRA) and recently published statistics by APRA show the private sector insurance industry generates gross premium income of \$28.8 billion and has assets of \$83.9 billion¹. The industry employs 43,000 people and pays 3.5 million claims each year against 41 million insurance policies.²

The Insurance Disaster Response Organisation (IDRO) for many years acted as a link between the insurance industry and the general community. In recent months there has been a wholesale change within the Insurance Council including an operational restructure and the development of six strategic blueprints, one of which relates to Disaster Planning, Response and Recovery. As a consequence of these changes and the new strategy, IDRO was wound up late in 2006.

The foundations of Disaster Recovery blueprint relate to identifying, assessing and promoting effective mitigation and management of disaster risk as well as playing a major role in the recovery following any disaster. A summary of the strategic objectives are;

- Contributing to the crisis management of natural and man made disaster risks.
- Creating a better understanding of what risks are insurable and are not insurable.
- Influence risk mitigation through education, web-site information and timely media releases

¹ APRA Quarterly Statistics September Quarter 2006

² APRA Selected Statistics on the general Insurance Industry – Year ending June 2002

- Identifying risks early and ensuring they are understood, measured and managed effectively.
- The importance of insurance in recovering from any disaster and its value in rebuilding the economy.

The General Manager, Policy Risk & Disaster Planning has the responsibility for catastrophe coordination. His responsibility extends to:

- overseeing various committees and working groups
- Updating members of severe weather event
- Issuing disaster recovery advises
- Coordination of education activities
- Implementing the Disaster Recovery Blueprint

The members of the Council provide input into policy issues through various Working Groups including;

- Flood
- Pandemics
- Climate Change , and of course
- Catastrophe Coordination

The Insurance Council also provides for the community with their website being an information funnel on many issues, including risk management.

4. Climate Changes and threats to affordability of insurance

The evidence of climate change is becoming more and more compelling. Warming ocean currents are being blamed for severe weather events, while here in Australia climate change is being linked to extreme heat conditions resulting in droughts and bush fires.

I think it's fair to say that insurers, economists and governments are taking real notice of climate change and the impact a severe weather event can have on the economy in general, including the insurance industry. Hurricane Katrina really hammered home this point and although Katrina would be topical for the purpose of this paper, I have elected to focus on Cyclone Larry, which is closer to home. It is worth noting that the vast majority of Australian Catastrophes have been weather related.

The impact of a major weather event or the losses from a succession of events on insurers, not only impacts on profitability (which leads to stressful solvency tests), but also has the potential to cause rating downgrades. The only remedy for insurers is significant premium increases and tougher terms - even worse, refusal of cover in high risk areas.

5. Australian Catastrophes

Natural disasters are not uncommon in Australia with some of the more notable events being

- Cyclone Tracy 1974

- The bushfires in the Victorian Dandenong ranges 1983 – also known as Ash Wednesday
- The earthquake in Newcastle 1989
- The Sydney hail storm 1999
- The bushfires in Canberra and surrounding regions in 2003 and in more recent times
- Cyclone Larry in March 2006.

The organisation I work for has been involved in all the preceding events, as well as many other severe weather related events but for the purposes of this paper, I will focus on the consequences for the insurance industry of Cyclone Larry.

6. Cyclone Larry

Tropical Cyclone Larry hit the coastal town of Innisfail in northern Queensland on the morning of 20 March 2006, bringing with it destructive wind gusts of up to 250 km per hour. Interestingly, since the 1870's, 22 cyclones have impacted the Innisfail region causing damage from severe wind, storm surge, estuarine flooding or a combination of these events.³

Significant rain fell in the four months after the cyclone which not only hindered demolition and repair it also resulted in the rapid deterioration of damaged buildings due to the combination of rain and humidity. People's possessions were also affected, especially due to the impact of mould.

It was reported that over 26,000 insurance claims were made in relation to home, contents, motor vehicles, commercial property, boats and light aircraft. The estimated loss was \$400 million and the incidence of under insured and uninsured property was significant.

Interestingly, analysis carried out by experts revealed that Cyclone Larry was not unusual in terms of severity or frequency and in fact was comparable to Cyclone Tracy which had a devastating impact on Darwin in 1974. What was also interesting was the extent of loss and damage statistically was significantly less, from which you could only draw the conclusion was as a result of improved quality building design and more robust building standards. This conclusion was underpinned by the fact the older "Queensland type homes" proved to be the most significant issue for insurers in the wake of Cyclone Larry.

7. The Challenges and Issues

I have listed some of the challenges and issues that confronted the recovery process. It is not meant to be an exhaustive list but provides an indication of what had to be overcome:

³ www.ga.gov.au/ausgeonews/ausgeonews20069/larry.jsp

- In regard to the weatherproofing of homes it became a challenge due to absentee landlords, or homeowners had been cash settled, thus removing them from the influence of the insurance infrastructure and the Operation Recovery Task Force.
- Asbestos was a big issue in buildings built pre-1970.
- Temporary accommodation for homeless victims was simply non-existent.
- The massive demand for tradesmen and suppliers which could not be sustained. The dynamics of large demand and short supply resulted in inflated costs. Tradesmen sourced from interstate had to be recompensed for travel and accommodation.
- In relation to the adequacy of insurance, it was found that many policy holders were under-insured and this situation was compounded by the high costs of building (extending to the cost of meeting government imposed cyclone standards).
- Newer houses (post-1980 construction) withstood the crunch of the cyclone more effectively than older homes. This was due to the construction and design and building materials being much more robust. It was widely reported that a common form of failure in the older homes was the attachment of the battens to the rafters.

8. Insurance Industry Response

The larger insurers were invoking their own catastrophe plans, which extended to mobilising claims staff in the region at the earliest possible opportunity.

As a small specialist insurer, we are very dependent on external specialist service providers (especially the loss adjusting fraternity) and feedback I personally received from a number of loss adjusters highlighted the following.

- Many underestimated the gravity of the situation.
- Mobile phone coverage was a major issue.
- A lack of power and the unavailability of was a major hindrance.
- Destruction and damage to roads prevented access to critical areas.
- Accommodation was scarce forcing Loss Adjusters to work out of Cairns and Townsville.
- The water was unsafe to drink for quite a few weeks.

By late March, it was estimated that there were about 140 insurance personnel in the area assessing claims in relation to homes, farms, motor vehicles, commercial properties, boats and light aircraft.

The Operation Recovery Update newsletter issued in January 2007 reported the following statistics in respect of “insurance matters”

- In excess of 26,000 domestic insurance claims to the value of \$356.1m
- 18,000 building claims – the average cost being \$16,341
- 86% of contents claims had been resolved at an average cost of \$4040

Despite the significant presence of insurance personnel and genuine endeavours to contribute to the rapid restoration of the devastated area, feedback the industry received was one of frustration. Some of the issues to emerge were;

- Perceived slowness from the assessment phase to payment.
- An obligation to use certain contractors, whereas others may be faster but just as reliable.
- Confusion concerning the certification of the re-building process
- The creation of bottlenecks due to insufficient trades people.
- Lack of understanding in the prioritisation process

As a member of the Insurance Industry team, I believe many lessons were learned from Cyclone Larry but the pivotal point is one of coordination at the earliest opportunity. I am pleased to say that the Insurance Council of Australia has taken the lead in this regard and have not only re-focussed their own internal structure but have urged member companies to provide a point of contact who has the appropriate authority to make decisions and take whatever action is necessary to ensure an immediate industry response. This is only an interim step as the Council has announced that they are currently developing a new Industry Catastrophe Coordination Plan.

9. The Role of the Government

The Queensland and Federal Governments jointly initiated the following:

- Recovery Centres that provided emergency assistance with short term needs such as food, accommodation, medical supplies and clothing. Counselling was also provided at the Centres.
- Set up a task force.
- Through Legal Aid Queensland, coordinated a free priority advice service to victims of the cyclone sort out legal problems caused by the disaster.
- Steering people who had problems coping with the stress of the disaster to organisations who were qualified to help.
- The National Harvest Labour Information Service worked closely with farmers and agricultural workers in providing a central coordinating point to obtain labour in the disaster zone.
- Queensland Health offered free flu vaccinations.
- Initiated a strategy to deal with the absence of drinkable water.
- The Queensland and Federal Governments jointly funded free transport for cyclone affected workers.
- The Federal Government redirected Work for the Dole activities to assist with the recovery effort.
- For those without insurance, the Queensland Government offered relief payments of \$4500 (families) and \$1500 (sole occupants) in relation home contents. To assist with repair to buildings, relief offered amounted to \$12,500 (families) and \$9,300 (sole occupants). These payments were subject to a means test.

- The Queensland Rural Adjustment Authority facilitated financial assistance to primary producers and small business owners through low interest loans up to \$200,000 (\$500,000 in special circumstances), with a non-repayable grant component of 25% of the total loan, up to a maximum of \$50,000. The aim of this initiative was to finance restocking, replanting, restoration of damaged areas and paying rates and rent.
- Wage assistance measures
- Introduced a Jobs Hotline
- The Office of Fair Trading monitored alleged profiteering and other similar issues.

10. Cosgrove Task Force

Once emergency services returned essential services and facilitated the provision of food, water and shelter, the Queensland Government recognised the need to have a structured coordination of the rebuilding process and appointed Major General Peter Cosgrove to head up a task force called the Far North Queensland Recovery Task Force (FNQ) to meet this goal. The key objectives of the Task Force were;

- Work with the Federal, Queensland and Local Governments to coordinate the various relief initiatives and to ensure the affected areas were rebuilt in the earliest possible time frame.
- Manage media and community expectations in relation to reconstruction activities and insurance.
- Coordinating the myriad of issues and activities that stemmed from residents, tradespeople, contractors and insurance companies on all building issues.
- Ensuring that a high priority was given to the reinstatement to commercial accommodation such as motels and caravan parks to house the additional trades people that travelled from within Queensland and interstate.
- Coordinate a large volunteer workforce.

The Building Coordination Centre (BCC) which was set up to help identify and resolve issues impacting on the regions recovery. One of the pressing issues was to waterproof all homes before the next wet season. One of the initiatives triggered by the BCC was the Home and Rebuilding Show which provided local residents with an opportunity to discuss their needs directly with insurers, building contractors, manufacturer and suppliers in one location.

Part of the BCC team included Independent Insurance Advisors and an Uninsured Project manager. It is expected the BCC will remain until the end of 2007.

One of the hindrances in the recovery process was the demolition and removal of debris. The Task Force uncovered the fact that many of the insureds received cash settlements which included demolition costs and were not using that component to arrange immediate demolition through properly licensed contractors. The task force coordinated local authorities to step up inspections and demolitions through proper channels

The Cyclone Larry Appeal Fund was set up to assist home owners that were under insured and facing financial hardship with demolition costs and some limited contribution to rebuilding costs, subject to a strict means test.

11. The Impact of Regulation

Analysis of repairs in the early stages of the recovery period showed that a high proportion of the repair work was being carried out without Development Approval or the engagement of a Building Certifier to inspect and certify the work. This practice contravened the Integrated Planning Act and the Building Code of Australia.

The Building Services Authority sought co-operation from insurers through the Australian Institute of Chartered Loss Adjusters to rectify this situation. As a consequence:

- All contractors had to have a Building Services Authority license to work in Queensland
- The regulators expected strict compliance with the building regulations and all building codes.
- The small numbers of Building Certifiers created bottlenecks as the more severely damaged buildings required multiple inspections. This of course escalated the cost.
- Undamaged sections of buildings in older homes had to be upgraded to comply with the new standards. This not only impacted on cost but also was a point of contention between policyholders and some insurers.

12. The Claims Team

The impact of claims staff domiciled well away from the catastrophe region is interesting from a number of fronts. It is a well-known fact that staff dealing with victims of catastrophes, especially dealing with people who faced injury or death does take its toll and insurers as part of their catastrophe response plan ensures that staff get reasonable breaks and receive counselling if required.

Fortunately, the impact on my team was not extreme but that is not to say they were not under immense pressure and were kept very busy in the immediate days after the event. As a small insurer, the lesson learnt for us was to put in place a technological solution that will allow all regions in Australia to support the region in which the catastrophe occurred. Two observations were as follows;

1. Cash relief was very low on the importance scale, simply because the retail network was non-existent and even when shops began trading again, there was the ongoing issue of supply of goods as the roads and transport infrastructure was severely impaired.
2. Even if we had a huge number of claims to deal with, it would serve little purpose sending a claims team into the region, due to the access and accommodation issues and poor communication facilities.

14. Summary

Clearly the initial steps put in place by both the Queensland and Australian governments lay the foundations that enabled Major General Cosgrove and his task force to play a pivotal role in the rebuilding and restoration processes following the destruction caused by Cyclone Larry.

The regulators became very strict in overseeing the rebuilding process and although this received widespread criticism and contributed to escalating cost, from an insurers perspective we can be well satisfied that buildings in the Innisfail region will be much more structurally sound to withstand future weather events.

The insurance industry learned a lot from this disaster and I have no doubt the experience will form an integral part of the soon to be released Insurance Council of Australia Industry Catastrophe Coordination Plan. Although I have not seen the draft plan I am very confident it will enhance the current interim arrangement which is based on five main platforms.

1. Assessment and if required catastrophe coordination
2. Consultation with all relevant parties
3. Communications within the industry and the external environment
4. Representation of the industry
5. Data Collection

There is no doubt there will be future catastrophic events and I am confident the industry is moving in the right direction to play a significant role in the recovery of not only the community infrastructure but also the economy.

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