Reforming Flood Insurance: Proposal to Improve Availability and Transparency - Submission

Introduction

This is the submission by the Financial Ombudsman Service ("FOS") in response to the consultation paper *Reforming Flood Insurance: A Proposal to Improve Availability and Transparency* released by the Treasury in November 2011 ("Consultation Paper").

This submission has been prepared by the office of FOS and does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessors in the resolution of general insurance disputes and responding to major insurance issues.

Information about FOS

FOS commenced operations on 1 July 2008. It is an independent dispute resolution scheme that was formed through the consolidation of three schemes:

- the Banking and Financial Services Ombudsman ("BFSO");
- the Financial Industry Complaints Service ("FICS"); and
- the Insurance Ombudsman Service ("IOS").

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre ("CUDRC"); and
- Insurance Brokers Disputes Ltd ("IBD").

FOS is an external dispute resolution scheme approved by ASIC. Membership of FOS is open to any financial services provider carrying on business in Australia including providers not required to join a dispute resolution scheme approved by ASIC. Replacing the schemes previously operated by BFSO, FICS, IOS, CUDRC and IBD, FOS provides free, fair and accessible dispute resolution for consumers unable to resolve disputes with financial services providers that are members of FOS.

Members of BFSO, FICS, IOS, CUDRC and IBD are now members of FOS. The members of those schemes included:

- BFSO – credit providers, mortgage brokers, payment system operators, Australian banks and their related corporations, Australian subsidiaries of foreign banks and foreign banks with Australian operations;
- FICS – life insurance companies, fund managers, friendly societies, stockbrokers, financial planners, pooled superannuation trusts, timeshare operators and other Australian financial services providers;

- IOS – general insurance companies, re-insurers, underwriting agents and related entities of member companies;
- CUDRC – credit unions and building societies;
- IBD – insurance brokers, underwriting agents and other insurance intermediaries.

FOS and its predecessor schemes have over 20 years experience in providing dispute resolution services in the financial services sector, and it is estimated that FOS covers up to 80% of banking, insurance and investment disputes in Australia.

FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking;
- credit;
- loans;
- general insurance;
- life insurance;
- financial planning;
- investments;
- stock broking;
- managed funds; and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice.

FOS is a not for profit organisation funded by its members, which are financial services providers. It is governed by a board with consumer representatives, financial services industry representatives and an independent chair.

Submission

FOS and its predecessors have, since the early 1990s, played a role in the insurance industry's responses to natural disasters and extreme weather events[1] as well as resolving a broad range of insurance disputes. Our experience allows us to comment on some of the issues addressed in the Consultation Paper. Our comments are set out below under headings of the relevant parts of the Consultation Paper.

[1] This role is explained in our submission made in August 2011 to the Parliamentary inquiry into the operation of the insurance industry during disaster events – see fos.org.au under "Submissions" in "Publications".

1. Operation of the proposal in practice

Data considered by an insurer when assessing flood risk for home insurance offered to a consumer could assist the consumer to consider the adequacy of the policy. The data could be available on websites or provided through publications, government agencies, local councils or water authorities.

Insurers could be required to identify this data to consumers at the policy inception and renewal stages. The insurers could meet this requirement by, for example:

- providing references to websites or accessible publications of other organisations; or
- setting out the data on the insurers' own websites.

Another initiative that could be considered is requiring insurers to offer to assist consumers, through help lines, to assess or understand assessments of flood risk.

Consistent flood risk categories/scales should be used across the industry. This would make it easier for consumers to assess and compare offers of insurance. It may be possible to introduce standard flood risk categories/scales in offer documents or renewal documents and require references to flood risk in information supplied to consumers to be expressed in terms of standard categories/scales.

2. Increasing the awareness of flood risk and flood cover

Insurance premium levels should not be relied on to indicate flood risk. Consumers may not appreciate the information about risk that a premium conveys.

If relevant flood risk data is available, insurers should provide that data to consumers at the policy inception and renewal stages. To make the data more helpful, it may need to be provided with a statement of the risk category and an explanation of the risk scale. The scale could include categories such as:

- no or minimal risk;
- low risk (meaning flood is highly unlikely or, at worst, a low risk);
- medium risk;
- etc.

Measures to ensure that risk categories are understood widely and information pertaining to risk is easily accessible could include:

- advertising campaigns;
- internet sites that map out sources of information in a straightforward way; and
- multi-lingual information.

Insurers could work with government and/or local councils to notify consumers of any changes in a particular area's risk profile or mitigation strategies.

3. Increasing the availability of flood insurance

As noted in the Consultation Paper, some insurers have offered flood cover on an "opt out" basis. Their experience could provide answers to some of the consultation questions about "opt out" arrangements.

Increased flood risk results in premium increases. Other factors contribute to premium increases including increases in reinsurance costs and the frequency or severity of storms.

It is difficult to gauge the point at which consumers will decide that, due to premium levels, they will not take flood cover and will bear the risk of flood themselves. If an "opt out" arrangement is not provided, consumers who do not want to take flood cover may opt out of insurance altogether because of premium increases.

The premiums for policies without an "opt out" arrangement for flood cover in higher risk areas are likely to increase substantially. If affordable insurance is not available in these areas, there is a risk of creating a class of uninsured/non insured.

The flood risk in a particular area may change if flood mitigation strategies are implemented. A question arises as to how such a change should be taken into account in offering insurance in particular where the consumer has opted out of cover.

4. The storm/flood distinction

Resolution of disputes about whether damage has been caused by storm or flood is complex. Generally, accurate topography and hydrology information and flood mapping is required. Site inspections should be conducted wherever possible and residents interviewed to ensure the accuracy of information and enable consistent decisions to be made.

The scale of a natural disaster and other events occurring around the time of an alleged flood will affect the timeliness of decisions. This is discussed in detail in the final report of the Queensland Floods Commission of Inquiry[2].

Detailed flood mapping, local topography maps and rainfall data can help to identify issues at an early stage in a dispute. They can act as a guide to consumers and help determine whether assessors and hydrologists should be used.

5. Which assets should be covered by the proposed "opt out" regime?

Strata title residences are regulated under State and Territory laws. This needs to be taken into account in developing proposals relating to strata title insurance.

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[2] Queensland Floods Commission of Inquiry, *Final Report* released on 16 March 2012.

The manager or secretary of a body corporate is responsible for ensuring that the risk of flood is identified and covered.

Strata title insurance is not offered by all insurers. Where it is offered, it is usually for buildings and common property, leaving personal contents to be insured separately.

To minimise confusion for consumers, the best approach may be to require flood cover to be offered on the same basis as personal contents insurance. Insurers may need to be required to provide disclosure including key facts sheets to each unit owner in a strata title residence.

6. Sub-limits and excesses

Specific sub-limits or excesses on flood cover could make insurance more affordable for some sectors. This could increase the uptake of insurance.

We acknowledge these potential benefits. However, there is a risk that policies with specific sub-limits or excesses on flood cover may have an adverse impact on those with limited financial literacy. The sub-limits or excesses may lead to "price shopping" without regard to significant limitations on cover.

If these sub-limits or excesses apply, we would expect issues and disputes to arise about whether consumers were fully informed of the ramifications of the sub-limits or excesses. Disclosure requirements need to apply in relation to the sub-limits or excesses. Information about them would, for example, need to be featured in the key facts sheet in our opinion.