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John Trowbridge
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Natural Disaster Insurance Review
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Dear Mr Trowbridge

Natural Disaster Insurance Review

I am pleased to provide the enclosed submission to the Review's Issues Paper from Allianz. The body of the submission can be made public. The Appendix to the submission, which contains commercial-in-confidence information, is provided on the basis that it remains confidential.

Allianz is prepared to provide further assistance to the Review on any of the material in our submission or other issues being considered by the Review.

Any questions or comments on Allianz's submission can be directed to Nicholas Scofield, General Manager Corporate Affairs on 02-9390 6596 or nicholas.scofield@allianz.com.au

Yours sincerely

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Natural Disaster Insurance Review

Submission by

Allianz Australia Insurance Ltd

Overview

Allianz generally supports the submission to the Natural Disaster Insurance Review (NDIR) by the Insurance Council of Australia (ICA). In particular, Allianz supports:

- The introduction of a common definition of 'riverine flood' and a Key Facts Statement to improve consumer understanding of home insurance cover so that policyholders are better able to choose the policy that best suits their individual circumstances;

- The establishment of a central, national flood mapping capability, located in an appropriate Australian Government agency, such as the Bureau of Meteorology, to address Australia's current information inadequacies in this critically important area. Such information is crucial for the future planning and development by a wide range of industry sectors (eg tourism, mining, agriculture, manufacturing, energy) and governments (eg land-use planning for residential and commercial development, and infrastructure such as roads, rail and ports);

- Improved disclosure of flood risk information to consumers by government. The vast majority (around 93%) of homeowners do not have a flood risk. In order for consumers to be able to make appropriate decisions about their insurance (eg "Do I need flood cover?"), they need better information about their risks. The responsibility for producing and disseminating flood risk information lies squarely with governments;

- Greater investment and better coordination is needed in the area of flood risk mitigation (eg levees, barrages and dams) by governments at all levels. Not all flood risk can be mitigated, however, it has been highly successful in many areas and much more could be done. Around 7% of domestic properties have a flood risk, but only because successive governments have allowed residential development on flood prone land. While those governments cannot turn back time, there is much more they could do to save the property (and even the lives) of Australians in the future through better flood mitigation and related actions;

- Regulatory changes should be made to curtail the 'creation' of even more flood risk property by stopping further development on high flood risk land. Without improvements, such as more stringent controls in areas such as land-use planning/zoning and building regulations, to limit the 'creation' of more property flood risk, the cost of flood to the Australian community will only further increase in the future; and

- State taxes on insurance should be removed to improve the affordability of insurance generally and flood insurance in particular, and would help reduce existing levels of underinsurance and non-insurance. Some Australian States have the highest taxes on insurance in the world. The cumulative effect of Fire Services Levy (where it applies), Stamp Duty and GST means that, in NSW, for example, 32% of a policyholder's home insurance policy is paid in tax. Put another way, in NSW, taxes on insurance add 47% to the home insurance premium charged by the insurer to cover the risk and hence significantly increases the price paid by the homeowner to protect their property.

Allianz is opposed to the imposition of mandatory requirements on insurers and consumers in respect of various issues raised in the NDIR Issues Paper as set out below.

- Allianz does not support mandating the purchase of home insurance by property owners. Consumers should retain choice in their risk management decisions.

- Insurers offering home insurance should not be forced to provide flood cover. This would likely see some insurers withdraw from the home insurance market, reducing competition and economic efficiency.

- Allianz does not support requiring that all insured homeowners purchase flood cover, that is, consumers should be able to 'opt-out' of flood cover. Consumers should retain the choice between the options of flood risk management, mitigation and adaption.

- Allianz strongly opposes forcing all home building insurers to provide 'full replacement cover'. This would result in significant increases in premiums for all homeowners, particularly those that live in areas prone to natural disasters, such as floods, cyclones and bushfires. At present, consumers have a range of choices if they are concerned about the risk of underinsurance, including insurers that offer full replacement cover and policies that provide an automatic sum insured 'top-up' in the event of a total loss. Consumers can also voluntarily add a 'buffer' by increasing their sum insured if they wish;

- The 93% of homeowners that do not have a flood risk should not be required to pay higher insurance premiums to subsidise the provision of flood insurance to cover the relatively small proportion domestic properties that do have a flood risk. Allianz strongly opposes such cross subsidisation between policyholders, whether through (another!) tax on insurance or through some less transparent and 'hidden' mechanism such as "additional premiums for all policyholders … in the *nature of a levy* on them[1]." [emphasis added]

In Allianz's view, if any flood insurance subsidy mechanism, such as a flood 'pool', is to be established it should be based on the following principles.

- Subsidies should only be provided to residential property owners that face high flood risk premiums,

[1] Natural Disaster Insurance Review, Inquiry into flood insurance and related matters. Issues Paper June 2011, page 78.

- flood insurance subsidies could also be provided to strata title homeowners, Landlord insurance policies and home contents insurance, but should not be provided for non-residential commercial or other business-related insurance policies.

- Property owners receiving flood insurance subsidies should make a financial contribution to their flood cover in a way that reflects their flood risk and also takes into account their capacity to pay.

- The cost of providing flood insurance subsidies should be minimised by focusing them on the direct compensation of the property loss itself, and in a way that minimises any additional cost and administrative burden on all stakeholders, including consumers, insurers and government agencies involved in the provision of flood insurance subsidies.

- Flood insurance subsidies should not be funded directly or indirectly by insurance policyholders that do not have a flood risk.

- Any subsidy scheme should be funded by those governments, generally at the State and Local level, that, through decisions made in the past have effectively 'created' property flood risk, and have the ability and responsibility for mitigating existing flood risk where possible and limiting the creation of more property flood risk in the future.

- State and/or Local Government funding contributions should be based on the amount of flood risk (existing and future) within their boundaries in a way that provides appropriate mitigation and land-use planning incentives.

The ICA's submission contains a brief discussion of flood pool proposals from the NDIR Issues Paper and other options (see p25). Most of the remainder of Allianz's submission discusses in more detail the potential operation of one of those other options, referred to in the ICA submission as "Private Insurance Capped Claim".

The cost of flood insurance – is there a flood insurance affordability problem?

As last Summer's floods demonstrated, the amount of damage caused by floods can be extremely high. One of the reasons for this is that the number and cost of claims associated with flooding can be very high relative to other natural weather events. The following table highlights these relativities.

Table 1: Extreme natural weather events: claim numbers and cost relativities

Event	*No of claims*	*Cost of claims*	*Average claim cost*
2010/11 Qld floods	56,200	$2,550m	$45,374
Cyclone Yasi	68,300	$1,090m	$15,959
Feb 11 Vic severe storms	48,000	$370m	$7,708
3/10 Melbourne hail storm	138,151	$1,044m	$7,557
3/10 Perth Hail storm	165,000	$1053m	$6,382
2/09 Vic bushfires	10,000	$1070m	$107,000

Source: Insurance Council of Australia

Table 1 demonstrates that a key difference between a flood and other extreme weather events is that it can result in relatively high average claims costs (eg compared to cyclones and storms) in combination with relatively large claims numbers (eg compared to bushfires).

Another feature of flood risk is what insurers call 'accumulation' risk, which relates to the risk of receiving relatively large numbers of claims due to, for example, a geographic concentration of exposure to a particular risk. As last Summer's floods also demonstrated, flooding can occur across vast areas virtually simultaneously, and while those floods were widespread, previous flooding events, such as those that occurred across Eastern Australia in 1954, effected an even larger area. And if such a flooding event was repeated, potential claims numbers (and hence costs) could be even much larger than was experienced recently.

Another unique feature of flood is that it, despite the large potential cost of flood events, the risk is focussed on a relatively small proportion of properties. For example, only around 7% of domestic houses are subject to risk of damage from riverine flooding. Due to this fact, the premiums that need to be charged to cover flood can be very high. Despite the challenges facing insurers in providing flood insurance, cover is available in the market place to any domestic home owner that wishes to purchase it.

In general, Allianz does not currently provide domestic household insurance cover for riverine flood. Allianz has for some years, however, been working on developing the significant internal capability required to offer flood insurance in a financially sustainable way. Our current expectation is that flood cover will be offered in NSW by the end of 2011. Allianz does not regard the flood mapping information on other States made available (mainly by Local Councils) to the insurance industry's National Flood Information Database (NFID) to be of sufficient quality and comprehensiveness to contemplate offering flood cover elsewhere in Australia at this stage.

While flood cover is quite widely available and will become more available, including from Allianz, as the NDIR Issues Paper correctly suggests, flood insurance premiums for properties subject to high flood risk are in some, possibly many, cases unaffordable for the owners of those properties. Allianz estimates that the cost of a NSW home building insurance policy (for a house insured for $350,000) in an extreme flood risk area would be at least $7,500 per annum. Much of the remainder of this submission discusses potential options for the design of a flood pool that could deliver more affordable flood insurance premiums.

Alternative approaches to a flood pool

According to the NDIR paper, there is a:

> "…need to establish some kind of central pool (the Flood Insurance Pool) that would receive, from whatever source or sources that are designated, additional funds to top up the aggregate discounted premiums and thereby have the means to pay flood claims when they arise." (p77)

Two of the possible variations of a flood pool are a Flood Insurance Pool, as mainly discussed in the NDIR's Issues Paper, and a Flood Claims Pool. Key features of these two flood pool variations are set out below.

1 Flood Insurance Pool

- the pool receives the 'affordable' flood risk premiums collected by insurers, provides cover for flood risk, and pays and manages flood claims;

- additional funds are transferred to the pool to top-up the shortfall arising from the fact that flood cover is provided at 'affordable' premiums;

- when claims occur, money from those additional funds are used by the pool to pay those flood claims (or part thereof) not funded by the flood risk premiums collected from property owners.

2 Flood Claims Pool

- an insurer that covers flood retains the 'affordable' flood risk premiums received from the policyholder, provides cover for flood risk, and pays and manages flood claims;

- additional funds are transferred to the pool to top-up the shortfall arising from the fact that flood cover is provided at 'affordable' premiums;

- when claims occur, money from those additional funds are provided to insurers to pay those flood claims (or part thereof) not funded by the flood risk premiums collected from property owners.

Under a Flood Insurance Pool, the pool effectively undertakes all the activities and functions (and incurs the cost) of a fully-fledged insurance business. As such, the pool would need to have at its disposal all the expertise, skills and capacities of an insurance company, such as those related to actuarial, underwriting, premium pricing, claims assessing, claims handling, etc, etc. This approach underpins most if not all of the discussion of a flood pool in the NDIR Discussion Paper. Indeed, the paper suggests that:

> "The pool could operate as a quasi insurance company whose only portfolio is high flood-risk flood cover." (p78)

A potential Flood Claims Pool model

If the Government was to implement a flood pool, it is Allianz's view that the most efficient approach would be the establishment of a Flood Claims Pool. The underlying principle of such a pool is the sharing of risk between the pool and insurers in such a way as to make full flood cover available to high flood risk properties, while also making flood insurance premiums more affordable for the owners of those properties. This risk sharing could be based on a variety of different 'thresholds' above which the pool would share in the cost of paying a flood claim. For example, the threshold could be based on the pool subsidising the cost of a flood claim over and above a certain dollar amount. Alternatively, the threshold could be based on some measure of an 'affordable' level of flood insurance premium paid by the homeowner. An approach outlined in a recent paper on the issue by the actuarial firm Finity was based essentially on a similar approach.

Another option, outlined in more detail below, would be to base the threshold on the sum insured of the property. For example, such a pool could have the following key design features:

- For insurers who offer flood cover, the premium paid by the property owner could be calculated on the basis that the insurer's liability to pay a flood claim would be capped at a certain proportion of the property's sum insured

(eg 5%[2]). For example, if a property's sum insured was $350,000, in the event of a flood claim, the insurer's liability would be capped at $17,500.

  - The flood cover component of the premium would reflect the sum insured and the flood risk of the property, thus still providing an appropriate flood risk price signal to property owners and other relevant stakeholders (eg Councils).

- A Flood Claims Pool would be established to pay the cost of flood claims over and above the capped amount paid by the insurer. In other words, any difference between the capped flood claim amount (eg $17,500) and the total value of the flood claim would be paid out of the pool to the insurer.

- Insurers would manage the claim as per normal based on their policy wording and policyholder's preferences (eg manage re-build or cash settlement).

- An overall per-event cap would limit insurers' exposure to a particular flood event. This could be based on a proportion of the insurer's annual domestic home and contents gross written premium (eg 10%). The cost of flood-related claims in excess of the per-event cap would be paid by the pool.

- The total annual amount of an insurers' potential exposure would be capped by a limit on the number of events the insurer would be liable to cover in any year (eg two events per annum). The total cost of all flood claims relating to events in excess of the annual event limit would be paid by the pool.

  - The capping of an insurer's potential flood exposure would limit the capital and reinsurance implications of providing flood cover and 'accumulating' large concentrations of flood risk exposure.

- Capping the amount of a flood claim that an insurer is required to pay, reduces (but doesn't eliminate) the premium an insurer would need to charge a homeowner to cover flood and hence provides a mechanism for subsidising flood insurance.

- In order to top-up the cost of flood claims from homeowners in receipt of subsidised flood premiums, a Flood Claims Pool would need additional funding. It is Allianz's view that the most appropriate source of funding for a Flood Claims Pool would be State and Local Governments.

Generating affordable premiums

Limiting insurers' exposure to flood risk, particularly on a per claim basis, provides a way to generate 'affordable' flood premiums for policyholders. Basing the flood risk premium paid by the policyholder on a capped proportion of the sum insured reduces the premium faced by the home owner. However, this approach also has positive equity outcomes. This is because the owners of more expensive properties, who would generally be expected to have a greater capacity to pay for flood insurance, would make a personal contribution to their flood cover that reflected this financial capacity.

[2] The choice of the appropriate proportion of the sum insured would be based on generating a premium that meets the Government's affordability objectives to the maximum extent possible.

Basing the flood cover premium on the property in question results in the premium also reflecting the flood risk of the property. This means that a flood risk price signal is retained in the premium faced by the policyholder. The policyholder would also reap benefits from a reduction in flood risk from, for example, flood mitigation initiatives carried out by their Local or State Government.

Such an approach is vastly superior to an 'engineering threshold' approach as discussed in the NDIR Issues Paper. Under this approach, access to the pool would be based on the ARI-based flood risk zone (see Box 1) in which the property is located and would be restricted to properties in 'high' flood risk areas. However, this approach ignores the fact that the flood risk faced by a particular property (and hence the flood premium faced by the policyholder) is not based solely on the probability of a flood affecting the property.

The flood risk premium can also vary for a range of factors unrelated to the probability of a flood occurring at a particular location, such as the cost of damage when a flood does occur and the height of the property's floor level off the ground. This means that some properties in a high flood risk zone can have a small or even zero risk of suffering significant flood damage and that some properties in a low flood risk zone can have a risk of suffering significant flood damage.

Box 1: Understanding ARI

In the context of understanding 'flood risk' in an insurance context, the concept of ARI can be misleading, especially for consumers. This is due to the implied relationship between ARI and a specific 'period' of time. In terms of insurance pricing, ARI is not seen as a measure of the 'frequency' of a flood event over time, but a measure of the probability of a flood happening in any one year. Thus, an ARI of 1 in 20 years is not interpreted as meaning that an area is only likely to flood once every 20 years, but that in any single year, there is a 5% probability that the area will flood. This is why more than one '1 in 100 year' events can occur in the same location over a much shorter timeframe.

As noted, analysis by Allianz indicates that the total premium (inclusive of flood and non-flood risk) including taxes[3] for a NSW property with a sum insured of $350,000 in a very high flood risk area (ie an ARI of 1 in 19 years), would be $7500 per annum. Applying a flood claims cost cap of 5% of the sum insured would reduce this premium by 70% - see Table 2.[4]

Table 2: Comparison of flood insurance premiums (NSW)

Flood Risk	Total Premium - uncapped claims cost, incl. FSL	Total Premium – capped claims cost	Total Premium – capped claims cost without FSL	FSL component of capped Total Premium
Very High (ARI 1:19)	$7,501	$2,285	$1858	$427

Among other things, Table 2 highlights the following:

- The premiums in the table are based on a property with a very high flood risk, they would be commensurably lower for properties with a lower flood risk;

[3] Taxes on NSW insurance policies: Fire Services Levy (23%); Stamp Duty (9%); GST (%10).
[4] More detailed information on how Allianz prices flood and premiums relating to properties with a lower flood risk are contained in a Confidential Appendix to this submission.

- Limiting insurers' flood claims exposure significantly reduces premiums for property owners with a flood risk;

- As noted above, premiums would be lower for properties with a lower sum insured and hence the 'capped' premiums would be even more affordable;

- The removal of the Fire Services Levy in NSW would make a substantial contribution to the affordability of insurance generally, and of flood risk insurance premiums in particular;

- The removal of Stamp Duty on insurance, which applies in all States and Territories, generally at a rate of 10%, would also materially improve the affordability of insurance;

- The affordability 'benchmark' can be calibrated by moving the level of the flood claims cost cap threshold to a level above or below 5% of the sum insured;

- The relativities between the premiums for the different flood risk categories could also be adjusted through various means, however, any move away from actual flood risk-related relativities would introduce greater levels of complexity (and cost) into the premium setting process.

As flood risk is still a part of the premium setting process under the capped flood claim approach, premiums still reflect flood risk. Allianz is of the view that an appropriate and proportionate flood risk price signal to those with a flood risk should be a part of any flood insurance subsidy regime. In other words, all things being equal, flood insurance premiums should be positively related to flood risk. However, as noted above, the capped flood claim model can be calibrated to target any desired affordability 'benchmark'.

For equity reasons, any mechanism to provide 'affordable' flood cover should focus not only on the size of the premium but also on the capacity to pay of the homeowner. The sharing of flood risk between relevant home insurance policyholders and a Flood Claims Pool as outlined above focuses mainly on the first part of this equity equation. Although, one of the advantages of an affordability 'threshold' based on a property's sum insured (rather than a fixed flood claim dollar threshold, for example) is that those that own (and hence can afford) higher value properties, make a commensurate contribution to insuring their flood risk. Thus, to the extent that home value is a proxy for income and/or wealth, this approach encompasses the capacity to pay side of the equity equation.

The NDIR may wish to consider additional ways of taking a home owner's capacity to pay into account. However, in doing this, it would need to ensure that it did not introduce unnecessarily burdensome administrative complexities and costs into any flood insurance subsidy provision arrangements.

Cost of funding a pool

In terms of the build-up of an insurance premium, the starting point is the cost of claims and the ratio of the cost of claims paid by an insurer to the total premium is referred to as the net loss ratio. An insurer's target net loss ratio on a domestic home insurance policy might be around 50%. The remainder of an insurance premium is

made up of various on-costs and a profit margin. These can vary for a range of reasons, for example, depending on the distribution channel through which the product is sold (eg broker commissions). In terms of broad averages, the full breakdown of the components of home insurance premium in terms of the proportions of each component relative to the total premium might resemble those in Table 3.

Table 3: Theoretical make-up of a home insurance premium

Home premium cost component	Proportion of total premium
Claims cost (ie Net Loss Ratio)	50%
Reinsurance cost (ie Gross Loss Ratio)	20%
Acquisition cost (eg commissions, advertising)	15%
Operational expenses (eg wages, rent, utilities etc)	10%
Profit margin (ie return on capital)	5%
Total Risk Premium (Combined Operating Ratio)	**100%**

Note: The full premium paid by the policyholder will also include taxes. Thus, the full premium will be the risk premium plus (in NSW and Victoria) Fire Services Levy (around 20%), GST (10%) and Stamp Duty (around 10%). In NSW, this adds another 47% to the cost of a home insurance premium.

Under various versions of a Flood Insurance Pool, in addition to the cost of paying flood claims, the pool would need to be funded for a range of additional on-costs associated with its operation. For example, if the pool took on flood insurance risks and operated as a 'quasi-insurance' company, as outlined in one of the options in the NDIR Issues Paper, it would incur many of the costs of a regular insurance company. The same would apply under alternative models outlined in the Issues Paper such as "Funding Version 2: the Pool subsidises insurers", where the flood risk was retained by insurers and "the Pool would pay premiums to insurers" (p79). This is because in order to know that it was paying the correct premiums to insurers the pool would require all the capabilities needed to determine what those premiums should be. In practical terms, this would in fact be impossible because the premiums charged by different insurers for the same risk will not be the same due to different cost structures (eg reinsurance costs). And for this reason, if the pool paid the same premium (ie some theoretically determined 'average') to all insurers some would be over-compensated (resulting in an excess return on the risk) and some under-compensated (resulting in an inadequate return on the risk).

Under a Flood Claims Pool as outlined above, the subsidy effectively provided to the flood risk property owner (via their insurer), and hence the funding needed, is limited to the proportion of an actual flood claim the pool is required to pay. In other words, in terms of the flood cover subsidy, the pool would only need to be funded for its share of the actual claims cost rather than for a higher amount that incorporated premium on-costs (let alone insurance taxes). Allianz would argue therefore that the funding burden of any flood insurance subsidy and hence the efficiency of such an arrangement would be lower under a Flood Claims Pool than under any alternative pool model.

Source of funding of a pool

The Flood Claims Pool should be funded by State and Territory Governments based on their flood risk (ie the number of flood prone properties and degree of flood risk). States could reasonably seek to recoup some or all of their funding contribution from Councils, based on their flood risk. This would provide appropriate mitigation and land-use planning incentives because State and Local Governments' contributions

would fall if they reduced flood risk (eg through mitigation works) and increase if they expanded flood risk (eg by allowing further development on flood prone land).

Flood damage to domestic property is estimated to average around $450 million per annum. However, there is significant variability in the cost of flood damage from year to year. In the absence of extreme flooding events, the annual cost of flood damage in most years would therefore be lower than $450 million. Under a Flood Claims Pool, where the risk is shared between the pool and insurers, ongoing annual pool funding requirements would be reduced further when the insurers' share was factored in. Taking these factors into account, pool funding would need to be sufficient to pay the pool's share of flood claims in a 'normal' year, the ongoing administration costs of the pool, and for the pool to purchase catastrophe reinsurance so that it has access to additional funds to pay its share of flood claims in years when an extreme flooding event occurs.

In Allianz's view, home and/or contents insurance policyholders (or any other policyholders for that matter) that do not have a flood risk and hence would not be beneficiaries of any flood insurance subsidy scheme, should not be forced to pay more to fund flood insurance subsidies. This objection applies whether such cross-subsidies were explicit or transparent, for example, through (another) tax on insurance premiums, or whether they were collected through some form of hidden tax, for example, what the NDIR Issues Paper described as "additional premiums for all policyholders that would be in the *nature of a levy* on them to subsidise the high flood-risk properties" (p78, emphasis added).

Other Flood Claims Pool issues

Pool coverage

The pool should only subsidise flood claims for domestic building and/or contents policies (including Landlords policies and residential strata properties). However, given the high rise nature of many residential strata properties and hence their different flood risk profile compared to house, different claims cost thresholds could be devised to ensure that property owners made an equitable contribution to the premiums for their flood insurance cover. The pool should not cover non-residential commercial property or business-related insurance policies. Commercial insurance premiums are tax deductible and businesses should face the true costs of their choice of location.

Consumer opt-out

Consumers should not be forced to insure for flood and should be able to opt-out of flood cover if they wish. This would reduce the risk that the additional impost of even a heavily subsidised flood insurance premium may lead some consumers to not take out home insurance at all. Consumers forced to make that decision would not have insurance protection against any insured peril (eg storm, fire) and would be far more vulnerable to a loss resulting from insurable property damage. Any flood insurance subsidy arrangement that forced some consumers to drop home insurance altogether would be a retrograde development.

Should all insurers be forced to provide flood cover

Pricing flood cover requires significant technical and IT capabilities by an insurer. At present 54% of the home insurance policies in the marketplace in Australia offer flood cover and the ICA estimates that this will grow to over 80% within two years.

On the other hand, only around 7% of Australian homeowners have a flood risk and hence require an insurance policy that covers riverine flood. Requiring all insurers to offer flood insurance is not required in order for all consumers to have a wide choice of insurance companies. Moreover, if policyholders are able to opt-out of flood cover if they wish, it is not necessary that all insurers offer flood.

An insurer needs much more in terms of flood underwriting and pricing capability than is gained through access to the flood mapping information in the NFID. Forcing all insurers to offer domestic flood insurance would more than likely result in insurers that do not have a flood pricing capability, and for which a business case for developing or obtaining one could not be made (eg smaller insurers), exiting the domestic home insurance market altogether. This would reduce competition in the market for the 93% of home owners that do not need flood insurance (and those that have a flood risk but prefer to opt out of paying to insure it), and would be detrimental to consumers overall.

Other Matters - Full replacement cover

Allianz strongly opposes the mandating of full replacement cover as it would lead to a significant overall increase in home insurance premiums for all policyholders.

Consumers currently have a range of choices in the market if they are concerned about the risk of underinsurance. These include insurers that offer full replacement cover and policies that provide an automatic 'top-up' of the sum insured if it is not sufficient to replace a total loss with a property of the same size and standard in the event of claim.

Consumers can also voluntarily add a 'buffer' to their sum insured. Consumers are sometimes not aware that such a buffer can be added to their property's sum insured for a modest additional premium. For example, based on an average home building policy with a sum insured of around $350,000, an additional 20% or $75,000 could be added to the sum insured for around $10-$15 per month in additional premium (depending on State factors such as insurance taxes and average premiums).

Insurers generally provide information or other assistance (eg online building cost calculators) to help consumers estimate an appropriate level of sum insured for their home insurance. Some insurers also have automatic 'red flags' incorporated into the underwriting process that alert them if a policyholder is choosing a sum insured that appears too low in relation to the property being insured. If triggered, these will prompt the call centre operator (or the internet quoting engine) to highlight the potential risk of underinsurance to the customer. Thus, in 'normal' circumstances, consumers are not likely to face a high risk of underinsurance and any measure that effectively 'forces' consumers to over-insure will simply increase premiums for most policyholders for no additional benefit.

However, after large natural disaster events, other factors can increase the ultimate cost of rebuilding, for example, post-event changes to building regulations (ie sovereign risk) and building cost inflation due to supply constraints in relation to building trades and, at times, materials.

Given the choices available to consumers if they want to protect themselves against these risks, no regulatory response is required. Improvements in the provision of information and disclosure to highlight the risk of underinsurance however could be of assistance and this issue is already under active consideration in the context of discussions between the Government, consumer representatives and insurers in the context of the development of the proposed Key Facts Statement.