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29 July 2011

Mr John Trowbridge
Chairman
National Disaster Insurance Review
c/o Treasury
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Dear Mr Trowbridge,

National Disaster Insurance Review

The Australian Bankers' Association (ABA) appreciates the opportunity to provide comments on the Natural Disaster Insurance Review inquiry into flood and related matters issues paper.

1. Introductory remarks

The ABA and the banking industry recognises that a natural disaster or catastrophic event, such as a cyclone, bushfire, earthquake, storm or flood, can have a significant impact on individuals and cause major disruption to their lives and leave them facing difficult circumstances. There is no doubt that the recent floods in Queensland and Victoria were tragic disasters. The absence of flood insurance for some policyholders in Queensland was particularly calamitous in addressing the damage caused by the floods.

Banks played an important and immediate role in alleviating some financial pressure for their customers through emergency relief packages and introduction of temporary credit facilities. We note that banks' financial hardship programs have been well utilised by affected individuals, households and businesses; for example, many banks adopted a three month moratorium on loan repayments for those affected by the floods. In the medium and longer-term, banks continue to work with their customers who require ongoing assistance to identify strategies for helping them manage their finances. However, even though the recent natural disasters were tragic for many people directly or indirectly, the scale of the devastation in terms of ongoing financial hardship assistance has not been substantial.

Notwithstanding the low actual ongoing impact on affected bank customers, we believe that the recent natural disasters have highlighted significant problems which have economic, social and community consequences, in particular uncertainty about insurance cover and policy wording as well as under-insurance and non-insurance in Australia.

The fact that the banking industry has assisted their customers through the recent natural disasters demonstrates a commitment by banks to provide immediate emergency relief and ongoing financial support to help customers take control of their finances during these difficult times and a commitment to assist the broader recovery of affected communities.

However, banks responses to assist not just their customers but also more broadly members of affected communities highlights an important issue in terms of where society believes the financial risks of homeownership and property ownership should reside. Under-insurance/non-insurance is not just an issue for individual homeowners and property owners affected by a natural disaster or catastrophic event, but is also ultimately a risk and a cost borne by the entire community.

The key question: Are we satisfied with the financial impact on the broader community of assisting those homeowners that decide not to insure themselves and their property adequately?

There may be a number of reasons why a homeowner with a property at risk of flood may not purchase an appropriate insurance product, including failure to understand that a flood risk exists, confusion about insurance cover or an incorrect belief that the insurance cover they have purchased provides flood cover, actual or perceived lack of affordable insurance products, and reliance on governments to support recovery rather than the purchase of an appropriate insurance product.

The ABA believes that consideration of any possible new arrangements for insurance must only take place in a manner that does not result in unintended consequences, including:

- *Systemic risk:* Risk of moral hazard where consumers or governments behave in a riskier manner than otherwise would be the case as the model fails to create sufficient incentives for risk mitigation, loss limitation, or direct reduction of losses. Consumers must feel the need to take responsibility for managing their own risks. Governments must be compelled to take prudent actions in relation to mitigation strategies, including release of land, building standards, and infrastructure development.

- *Commercial risk:* Risk of costs of individual decisions being transferred to the private market.

- *Regulatory risk:* Risk of intervention creating artificial imbalances in the private market. It is important to establish a balanced model which achieves consumer protection without imposing additional financial obligations on banks and insurers.

Furthermore, it should be noted that only 34% of homes in Australia are being purchased by the occupier ("owner occupier" with a home loan). Around 32% of homes in Australia are rented (either private or government housing) and around 34% of homes are fully owned ("owner occupier" without a home loan)[1]. In addition, the issues paper notes the results of a survey conducted by Tooth and Barker in which only 2.2% of mortgaged properties were uninsured[2]. Therefore, using the banking system to deliver insurance will be at best haphazard, incomplete and only capture a portion of homes in Australia, and at worst, would represent substantial and unnecessary costs for all customers, especially given the high level of voluntary compliance.

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[1] 2006 Census data.

[2] National Disaster Insurance Review: Inquiry into flood insurance and related matters. Commonwealth of Australia, June 2011. p51.

1.1 Summary—ABA position

The ABA does not support the options for Government intervention in the banking system and insurance market as contained in the issues paper, including mandatory flood cover for home building insurance ('automatic flood cover without opt-out'), mandatory flood cover with an 'opt-out' ('automatic flood cover with an 'opt-out'), the establishment of a flood pool, or imposing responsibilities on banks and other lenders.

The ABA believes that intervention could significantly increase insurance risk premiums and lending costs across Australia, possibly even in areas where flood cover is not appropriate or necessary. Importantly, it is estimated that less than 1% of Australia's 6.2 million homes are subject to high flood risk. Without addressing concerns with consumer awareness, such interventions are likely to increase the under-insurance/ non-insurance problem in Australia.

Instead, the ABA believes that it is important to identify initiatives which will minimise the likelihood of similar events having a similar impact on individuals, households, businesses and the wider community in the future. We consider that under-insurance and non-insurance must be addressed via a comprehensive and multifaceted portfolio of policy responses to address transparency, adequacy, availability and affordability of insurance (see section 5 of this submission).

The ABA believes that practical initiatives are needed to assist individuals, households, businesses and the wider community take steps to put in place appropriate risk management strategies suitable for their needs and circumstances.

The ABA strongly believes that increasing the numbers of consumers who make the right insurance choice for their particular needs and circumstances is best achieved not through intervention in the insurance market such as via a mandated 'automatic flood cover' approach or intervention in the banking system such as via a legal obligation on lenders to mandate insurance cover, but rather through reform of the insurance market combined with government-industry initiatives. Competition in the insurance market should seek to provide clearer information, better disclosure and an enhanced choice of suitable insurance products.

2. The insurance market

The ABA does not support Government intervention in the insurance market. We do not believe that there has been a market failure warranting such intervention. However, we do believe that there are some actions that should be taken to address the concerns regarding appropriate insurance cover as highlighted by the recent natural disasters.

Having said that, if the Government is minded to take action to mandate insurance cover, we believe that a mandated 'automatic flood cover' approach should be considered for the following reasons:

- *Accessibility risk:* Intervention should promote the availability of insurance cover that offers comprehensive flood cover.
- *Concentration risk*: Intervention should minimise the likelihood that insurers will exit the market.
- *Distribution risk*: Intervention should avoid relying on mechanisms that fail to address coverage gaps; for example, properties without a mortgage.

- *Affordability risk*: Intervention should address the possibility that flood cover results in insurance risk premiums that are unaffordable for those homeowners with properties in identified high risk areas and avoid the likelihood of these homeowners choosing not to buy home building insurance. However, any potential funding mechanism (flood pool, rebate, subsidy) should be considered in a way that avoids financially impacting homeowners in no or low risk areas, encouraging homeowners in high risk areas not to take out their own insurance cover, and further expansion of building in high risk areas.

- *Comprehension risk*: Intervention should address the possibility that some homeowners may be confused as to the meaning of certain risks or exclusions (despite industry efforts to establish common definitions) and avoid exacerbating lack of understanding, creating inefficiencies at the point of sale, and causing disputes during claims processes.

For further comments regarding the insurance market, the ABA notes the submission made by the Insurance Council of Australia.

3. Role of lending institutions

In Chapter 14, the issues paper questions the level of responsibility that banks and other lenders have toward themselves and toward their mortgage customers for:

- Purchase of insurance;
- Scope of cover – in particular whether it includes flood cover;
- Quantum of insurance; and
- Continuity of insurance during the life of the mortgage.

The issues paper also asserts that it is in the financial interests of a bank or other lender for its housing and small business borrowers to have flood insurance given the role of the property as collateral for the loan.

3.1 Lenders mortgage insurance and home building insurance

The ABA notes that based on some media articles and commentaries by consumer representatives there appears to be some general confusion around insurance cover for consumers and insurance cover for lenders.

Lenders mortgage insurance (LMI) provides the lender with protection from default. Lenders generally require borrowers to contribute a 20% deposit towards the purchase of a property. Where a lender does not have this level of deposit, LMI is typically required to protect the lender against loss should the borrower default. A mortgage with a higher loan-to-value (LVR) ratio has a higher probability that, if the borrower defaults, the sale of the property will not cover the outstanding debt. Borrowers are required to meet the costs of the LMI based on the amount of the loan.

LMI is protection for the lender, not protection for the borrower. Other insurance cover provides borrowers with protection, such as life insurance, income protection insurance, mortgage protection insurance, trauma insurance, and consumer credit insurance in circumstances when a claimable event occurs that impacts on the borrower's ability to service their home loan repayments. In addition, other insurance cover provides homeowners and property owners with protection, such as home building insurance in circumstances when a claimable event happens that impacts on the asset, whether that is the property and/or its contents.

3.2 Purchase of insurance

The ABA is advised by member banks that insurance cover for a property is generally a standard condition of banks to obtain a loan where the property is used as collateral. Currently bank practice requires insurance cover as a condition of a home loan at the time the mortgage is taken out. Banks typically require the borrower to present an insurance certificate at mortgage origination. Similarly, insurance cover is required for small business loans where property is used as collateral.

Borrowers are obliged to ensure currency of insurance cover during the life of the mortgage. Insurance cover enables the property to be protected against damage. Banks do not prescribe the type of insurance cover that would satisfy this condition or generally require a minimum sum insured, beyond being satisfied that the insurance cover is adequate for the amount borrowed. Currently insurance required by lenders at the time the mortgage is taken out will typically need to be sufficient to cover the liability, i.e. outstanding debt owed by the borrower to the bank or other lender, rather than the replacement value of the property. The scope of the coverage, and in particular whether flood insurance is required, is generally not specified. However, these requirements and the accepted LVR will vary between lenders.

Banks do not monitor that insurance cover is renewed during the life of the mortgage due to the administrative costs associated with monitoring insurance for every loan. Currently bank systems are not integrated with insurers systems to facilitate the transfer of data which would be required to track and monitor insurance cover. Furthermore, there is no obligation on an insurer to advise lenders if a customer has cancelled or changed their insurance policy.

Banks recognise that insurance cover is one form of protection of their financial exposures. It is in the interests of the lender to ensure that there are various measures in place to minimise the likelihood that the loan becomes impaired due to an impact on the underlying security.

However, while it is generally in the financial interests of banks to have collateral protected by insurance, banks have a number of risk mitigation tools, including:

- *Not lend*: Banks can decide not to lend. This option removes any risk from the loan and is commonly used.
- *Loan to value ratio*: Banks can ensure LVRs are set prudently to act as a buffer against loss.
- *Credit enhancement*: Banks can impose requirements to address risks and improve the credit position, such as LMI.
- *Capital*: Banks can increase the amount of capital held against any particular financial exposure. The riskier the exposure, the more capital the bank must hold against the loan.
- *Risk assessment*: Banks can use historical precedence in determining a risk mitigation strategy.

Banks have many options to assess and manage lending risks. In a competitive market-based industry, banks need to determine their own strategy to manage their lending decisions and subsequent financial exposures. Additionally, while it may appear that some risks are large, in reality these risks may be inconsequential from a banking loss perspective.

The ABA is advised by member banks that despite the widespread impact of the recent Victoria and Queensland floods, lending books have not been adversely affected. Lending losses in relation to non-insurance or under insurance have been negligible. Notwithstanding this low actual impact on lending books, we understand that some banks are currently reviewing their lending practices due to their experiences with the recent natural disasters. Some banks have also reduced their maximum LVRs for loans on properties in flood risk areas.

3.3 Continuity of insurance

The ABA strongly opposes the suggestion that banks and other lenders should be subject to a legal obligation requiring them to enforce insurance cover for borrowers in Australia; for example, by mandating insurance cover beyond the outstanding debt owed, through banks acting as 'gatekeepers' to ensure that bank customers in high risk flood areas take out flood insurance as a condition of their home loan, or by monitoring continued compliance with a requirement for insurance throughout the life of the loan.

There are a number of practical, legal, technical and cost issues associated with using the banking system to deliver insurance, including:

- *Practical implications*: Banks would be required to implement a new administration process to monitor and track all home loan customers and their insurance cover. Technology systems and procedural changes and resources would be required. As noted above, lenders would have to track all customers as there is no obligation to advise lenders if a customer has cancelled or changed their insurance policy. In many cases a customer may still be insured, however, they have moved to a different insurer. Additionally, the administrative burden on monitoring compliance would be exacerbated by the fact that insurance risk premiums can be paid by consumers on a monthly basis. Consequently, lenders would be forced to monitor continued compliance on a monthly basis which would be both impractical and costly.

- *Legal implications*: Banks would be required to implement practices to address risks beyond the customer's liabilities to the lender. On the one hand, should banks have a duty to ensure that all borrowers take out insurance to protect their financial position beyond the terms of the contract? On the other hand, should borrowers relinquish their rights to adopt risk strategies commensurate to their needs and circumstances; for example, a bank customer may have other strategies or resources available to manage their individual exposures.

- *Technical implications*: Banks would be required to enforce the conditions of the home loan. If a borrower does not take out insurance and is deemed to have breached their contract with the bank – what happens? What options does the lender have? Would a bank be expected to take action if the customer does not rectify the situation and take out adequate insurance, such as a demand for a return of the loan or commence foreclosure against a borrower for beaching the conditions of the loan? In addition, a bank would likely breach the prohibition on third line forcing by requiring a borrower to take out insurance.

- *Cost implications*: In the absence of a system to differentiate those borrowers with insurance from those potential borrowers without insurance, banks would be required to check compliance of all customers. A new administration process would create additional lending costs for banks and subsequently all borrowers.

3.4 Enforcement mechanism

As noted above, only 34% of homes in Australia are being purchased by the occupier ("owner occupier" with a home loan). Therefore, using the banking system to monitor insurance would be haphazard and incomplete as not all homes in Australia would be captured by the requirement.

Furthermore, as noted above, only 2.2% of mortgaged properties are uninsured, which means that an element of soft compulsion already exists. Therefore, given banks require home building insurance to obtain a loan, borrowers who do not maintain their insurance policies are opting out of insurance cover by not renewing. This suggests that these customers have made a deliberate financial decision, and therefore would potentially resent banks playing the role of gatekeeper or policeman.

If the Government imposes a legal obligation on banks and other lenders to put in place an enforcement mechanism, it would require a new system or registry to allow banks and other lenders to monitor and track compliance. A system would need to be developed that provided a national information repository with information and data about high flood risk areas, specific properties within these areas, mortgages related to these areas, and insurance policies taken out over these properties. Establishing and maintaining this information repository would be substantially costly and complex. Information would need to be provided from all State and Territory governments, insurers, and banks and other lenders. Information would need to be accessible to insurers, banks and other lenders via an electronic interface. Apart from the technology and cost implications, there would be significant technical, practical and legal implications.

3.5 US Model

The issues paper highlights that in the United States housing lenders require borrowers to have flood insurance and will check and enforce this requirement. Where a borrower does not obtain insurance, the bank will purchase insurance on behalf of the borrower and pay for it by charging the customer. Additionally, for loans backed by the Government, lenders must determine the flood zone status of a property and if it is located within a mandatory flood zone, the lender must require flood insurance for the life of the loan. Private sector firms have been set up to perform functions for the lending institutions.

The ABA submits that the US market has fundamental differences from Australia, which preclude comparisons.

Firstly, requiring bank customers to take out flood insurance based on their residency in a "flood zone" in Australia would require flood risk thresholds to be set and extensive flood mapping to be completed and made publicly available.

Secondly, US lenders may manage insurance payments on behalf of customers. However, the linkages between the governments, insurers and lenders are highly developed in the United States. That level of interconnectivity most likely developed because mortgage lending in the US is non-recourse, unlike Australia, where banks have financial recourse to the identified borrower and borrower's collateral. Therefore, in the United States housing lenders have less security over loans than Australian banks, and therefore it is more important for US lenders to protect the value of the property and protect against a situation where in the early stages of a loan, when little principal is due, it may be in the borrower's interest not to insure. Consequently, the relevant laws in the US operate differently to Australia.

Unlike the United States, Australia does not have electronic interactive systems between insurers and lenders to facilitate the process of ensuring continued compliance with mandatory flood insurance laws. Developing such a system in Australia would cost an enormous amount and it is likely that those costs would far outweigh the benefit, especially given the high level of voluntary compliance and the probability of devastating floods.

Therefore, the only way that an Australian bank could be potentially "responsible" for ensuring that customers had insurance, is if it were a requirement that all loans automatically carried the bank's own insurance (as it would be costly and difficult from a systems perspective to ensure compliance that insurance was taken out, and maintained, with any other insurer). In that way, the premium could be added to the mortgage payment, and the bank could remit the funds to the insurer with whom the bank has a commercial relationship. However, this approach would likely give rise to third line forcing issues.

Third line forcing occurs when a supplier places a condition on the supply of its goods or services that the purchaser must acquire goods or services of a particular type from a third person nominated by the supplier and refuses to supply because the purchaser will not agree to that condition. Third line forcing is a specific form of exclusive dealing prohibited by section 47 of the *Competition and Consumer Act 2010*. Therefore, such an insurance requirement would likely breach the current law, and consequently, if such a requirement was imposed, a statutory carve-out would need to be implemented to protect banks and other lenders that make it a condition that a customer takes out flood insurance under a home loan, and in the event they do not, the lender will take out an appropriate insurance product from a certain insurance provider. Even then, buying insurance on the borrower's behalf and charging them for it, could lead to disputes over premiums or the value of the insured asset.

Furthermore, it should be noted that there have been at least two recent class actions in the United States against banks for various issues relating to banks mandating flood insurance. Therefore the mandating of flood insurance by Australian banks as a pre-requisite for obtaining finance may result in increased consumer complaints, particularly where the insurance is difficult to obtain, expensive, or unnecessary given their property or individual circumstances.

The ABA does not support imposing a legal obligation on banks and other lenders to enforce borrowers to maintain continuity of insurance during the life of a mortgage. Borrowers should maintain the obligation pursuant to the terms of their relevant mortgage. Imposing a legal obligation would be costly and impractical for banks and other lenders, would reduce consumer choice for homeowners, and would be a haphazard and incomplete solution for the community.

4. Role of governments

The ABA believes that instead of intervening in the insurance market or banking system, governments should target efforts towards risk mitigation, financial literacy, and community support. Specifically, we consider that governments should pursue a number of initiatives, including:

- *Risk mitigation*: The ABA believes that the Council of Australian Governments (COAG) should implement strategies to remove or reduce the flood threat to the community; for example, provide access to flood mapping data, implement flood risk disclosures for property owners and tenants, and agree on principles for land-use planning and building codes. Governments should provide information prior to purchase or tenancy.

- *Financial literacy*: The ABA believes that the Government should adopt targeted initiatives to improve community awareness of the importance of insurance and understanding of risks, including flood (see section 3.3 of this submission.)
- *Community support*: The ABA believes that alternative arrangements to the establishment of a flood pool should be considered. Such arrangements should provide financial assistance to those homeowners that require assistance; for example, local councils and State and Territory governments could use tax and rate mechanisms and revenue already raised from existing taxes, duties and levies to subsidise premiums for homes in high risk flood areas. Governments could relinquish revenue to carry out targeted risk mitigation strategies and be penalised for practices which are contrary to sustainable land-use and building and infrastructure management. Policyholders could be supported in addressing high to extreme flood risk, in particular where this risk is a result of lack of mitigation and inappropriate land-use planning. Taxpayers should not generally be relied upon to fund disaster recovery, in particular where there is a lack of mitigation or inappropriate land-use planning. Banks and insurers should not be required to discount premiums, in particular as this is unsustainable and would transfer costs to the private market without putting in place the right incentives for addressing inadequacies in planning, standards and mitigation strategies.

The ABA believes that if the Government is minded to establish a flood pool (or natural disaster pool) that the Productivity Commission should be asked to conduct a thorough review of the costs and benefits to government, the insurance market, policyholders, homeowners and property owners, and the wider community. We consider that the establishment of a flood pool would be complicated and costly, distort the provision of insurance, transfer the costs to individuals and households with no or low risks and increase moral hazard as there is no incentive for governments to take actions to introduce mitigation strategies or individuals, households and businesses to take actions to protect their properties from damage caused by such events.

Importantly, all key stakeholders (homeowners and property owners, insurers, local councils and State and Territory governments) need to have a vested interest in order to avoid moral hazard and to maintain incentives for good risk management, including mitigation of flood risk. We note that alternative subsidies using existing taxation and rate mechanisms and government revenues to provide premium discounts and funding arrangements would need to be closely considered to avoid unintended consequences; for example, subsidies should target premiums (not claims) and be available for low income earners (means testing combined with flood risk threshold) to address concerns with affordability. Furthermore, other possible unintended consequences should be closely considered; for example, inequity of providing subsidies only to homeowners in high risk flood areas, and not assist with insurance premiums for other weather-related, natural disaster or catastrophic event insurance.

5. Consumer awareness of risk and insurance

The ABA believes that removing consumer choice is not a solution. We consider that promoting customer choice and insurance options as well as improving consumer awareness of risk and insurance products through initiatives to address transparency, adequacy, availability and affordability is vital to ensuring that consumers make informed choices and understand the consequences of choosing whether or not to take out insurance cover.

It is important that consumers are provided with adequate and accessible information regarding flood risks to make a risk appropriate decision before accessing the insurance marketplace, as well as clear and adequate disclosure in the insurance marketplace.

If proposals are implemented to improve disclosure and enhance consumer awareness, then consumers should not be restricted in their choice of insurance cover. Consumers should be able to purchase an insurance product that suits their particular needs and circumstances.

However, it should be noted that proposals to increase the uptake of insurance, particularly through enhanced risk disclosure and consumer education, do not address the risk of flood or solve the problem of flood damage occurring in the first place. Therefore, it is important that governments work to mitigate flood risk, for example, through more stringent land-use planning and zoning laws, improving building standards and codes, and ensuring that the flood exposed population does not increase in order to manage the flood threat.

The ABA believes that consumer awareness and understanding about insurance and risk should be improved through a number of initiatives, including:

- *Definitions*: The ABA acknowledges the efforts of the insurance industry to develop a common definition of flood. Consistent definitions should assist in addressing some consumer confusion and providing greater certainty regarding insurance cover for damage caused by water-related events.
- *Disclosure:* The ABA believes that consumers should be provided with adequate information at the point of sale and at renewal:
    - *Point of sale:* The Government should work with the banking and insurance industry to improve product disclosure for insurance products. We note that the Government and industry are working to produce a disclosure document that provides succinct, clear and unambiguous disclosure in general insurance policy terms and conditions documentation. We consider that it is critical for any new disclosure document to be consumer tested prior to implementation. Insurance documentation should be able to be delivered via electronic disclosure methods.
    - *At renewal*: Policyholders should be provided with sufficient information at insurance renewal to assist them in making a decision about the continued appropriateness of their insurance cover, including whether or not the sum insured should be modified, or whether cover should reflect replacement cost, or whether they should have cover for specific events, such as flood.
    - *Online tools*: Consumers should have access to information and tools to assist them understand their risks. Many banks and insurers provide calculators on their website to assist customers understand the cost of insurance and decide what is suitable for their needs.
- *Law reform*: The ABA believes that the definition of personal financial product advice should be amended to clarify the extent to which the provision captures simple advisory situations and general insurance products. Law reform should complement regulatory reforms aimed at facilitating 'scaled advice'. (We note that pursuant to the FOFA reforms, ASIC is due to revise its regulatory guidance regarding the extent to which simple or scaled advice can be provided to consumers pursuant to the requirements of the Corporations Act. Additionally, the regulatory requirements applicable to the provision of personal advice should be reassessed with a view to reducing the regulatory burden and associated compliance costs, and thereby encourage the insurance industry to provide innovative products and services in general insurance. Legal requirements applicable to the provision of insurance documentation should be amended to facilitate online disclosure.

- *Information*: The ABA believes flood mapping data, property metrics and resilience measures should be produced to assist all homeowners and property owners get access to pertinent risk information, to understand the risks associated with their property, and to take action to mitigate those risks:
  - *Flood mapping data*: Independent experts should produce flood maps. More accurate and comprehensive flood mapping data will enable insurers, lenders, consumers and governments to make better decisions about flood risk, risk premium pricing, emergency management responses, flood mitigation measures, and property purchase and finance decisions.
  - *Information repository*: A national information repository or web portal (including specifically flood risk measurement and property metrics) should be developed in partnership between government and industry. Homeowners and property owners should be provided with information and tools to help them make initial purchase decisions and ongoing planning decisions. Policyholders should be provided with additional information about insurance risks and links to these information repositories.
- *Research*: The ABA believes that the Government, as part of its *National Financial Literacy Strategy*, should undertake consumer research to better understand the behavioural economics implications of consumers faced with complex or incomplete information, tendencies to underestimate risks and probability of risks, and the impact on decisions about insurance.
- *Consumer campaign*: The ABA believes that the Government, as part of its *National Financial Literacy Strategy*, should conduct a campaign to raise consumer awareness about the importance of insurance to financial wellbeing and the importance of making risk appropriate decisions about insurance cover. In 2006 the ABA, Insurance Council and Financial Services Council (then Investment and Financial Services Association) published a consumer booklet *Smarter Insurance: Protect your assets and secure your future*. A consumer campaign could be developed in partnership between ASIC and industry. In addition, industry and government should utilise the consumer campaign to educate consumers about the differences between LMI (as a protection for lenders) and consumer insurance products.

The ABA believes that it is important to provide incentives to encourage greater availability of insurance in the marketplace, to foster the development of insurance products suitable for differing consumer needs and to promote consumer awareness of the importance of insurance as part of homeownership and wealth creation, asset and retirement planning and self-sufficiency. The benefits that can accrue to the wider community from a broader take up of insurance is not only about helping individuals, households and communities recover from natural disasters and catastrophic events, but also in apportioning the costs more equitably.

6. Concluding remarks

The ABA believes that rather than mandating flood insurance, and potentially imposing a legal obligation on banks and other lenders to require and enforce flood insurance compliance, consumers should be given clearer and better information regarding flood risk to enable them to make an informed choice and risk appropriate decision regarding their insurance cover. Determining the appropriate level and type of cover should be the responsibility of the consumer and supported by better information provided by governments and clearer disclosure provided by the insurance industry.

The ABA believes that enhancements to disclosure and information access should be undertaken by the insurance industry in partnership with the Government to facilitate access to risk information:

1. Prior to consumers entering the insurance marketplace, e.g. representation of flood risk to the property;

2. Once consumers have entered the marketplace at point of sale, e.g. standard definition of flood as well as clear disclosure regarding insurance products and options for flood cover; and

3. When consumers are seeking to renew their insurance policy.

Banks are not in a position to determine whether flood cover is required or not, nor are banks the appropriate mechanism to enhance flood insurance uptake. Frontline staff are not trained or qualified to determine the most appropriate insurance cover for each property. Requiring banks and other lenders to enforce insurance cover would present a number of practical, legal, technical and cost issues for banks and their customers, and ultimately such an approach would be haphazard and incomplete.

Consumers should retain their discretion to make decisions regarding the type and scope of their insurance needs. Consumers should also have access to pertinent insurance and risk information as well as access to assistance measures where there are concerns regarding high-risk flood areas and insurance premiums.

The ABA believes that there is significant moral hazard associated with attempts to transfer risk from one party to another or other parties. In the absence of promoting initiatives which directly deal with the reasons for under-insurance/non-insurance, there are real risks of these interventions creating other problems. Mandating certain insurance cover will result in interventions in the insurance market that will impact pricing, distribution, service delivery, and customer-provider relations for all consumers.

The ABA believes that improvement of consumer awareness and understanding of insurance and usability of insurance product disclosure and risk information is vital to addressing the under-insurance/non-insurance problem in Australia. Additionally, improving disaster resilience and incentives for governments to focus on risk mitigation is vital to addressing the risks associated with future events and encouraging all stakeholders to make informed choices and mitigate and plan for the event.

If you have any queries regarding the issues raised in this submission, please contact me or Diane Tate, Policy Director on (02) 8298 0410: dtate@bankers.asn.au or Jade Clarke, Senior Policy Analyst on (02) 8298 0404: jclarke@bankers.asn.au.

Yours sincerely

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