Australian Finance Conference Level 7, 34 Hunter Street, Sydney, 2000. GPO Box 1595, Sydney 2001
ABN 13 000 493 907 Telephone: (02) 9231-5877 Facsimile: (02) 9232-5647 e-mail: afc@afc.asn.au

14 July 2011

Natural Disaster Insurance Review
C/- The Treasury
Langton Crescent
PARKES ACT 2600 Email NDIR@treasury.gov.au

Natural Disaster Insurance Review

The Australian Finance Conference (AFC) appreciates the opportunity provided by the Review Panel to comment on the Natural Disaster Insurance Review Issues Paper. AFC membership includes a range of financiers which provide the full range of financial services both in relation to consumer and commercial business.

Of particular interest to AFC is Chapter 14 of the Issues Paper dealing with the role of lending institutions particularly in relation to home insurance. The comments in this submission are derived from a sample of smaller members which are actively involved in home loan lending.

In response to the questions on page 52 of the Natural Disaster Insurance Review Issues Paper, we advise as follows:-

What level of responsibility do lending institutions have toward themselves and toward their home mortgage customers for:

1. the purchase of insurance

Commonly the lending institutions require all loans, which are secured by property on which residential dwellings or other improvements are present, to have property insurance.

2. the scope of insurance cover , and in particular whether it includes flood cover

Commonly, property insurance policies:

a. have the lending institution's interests noted as mortgagee;
b. have a sum insured equal to or greater than the replacement value of the property as determined by the lending institution's valuer;
c. detail one or all of the borrowers as the insured;
d. detail the risk particulars (the address must be the same as the property offered as security);

e. detail the period of cover as being current with a renewal date after the loan settlement date;

f. have replacement conditions applying (note: those dwellings/improvements that are older than 40 years may have indemnity settlement conditions applying);

g. are endorsed with any additional mandatory inclusions eg. flood. It is mandatory for all property insurance policies covering properties located in any flood area to have a "flood inclusion clause" incorporated into the policy.

3. the quantum of insurance

The sum insured is to be for *full replacement value* for an amount equal to or greater than the value specified on the valuation report. The policy document or equivalent is required to note the lender's interest as mortgagee and be in the possession of the lender prior to the advance of loan funds.

4. the continuity of insurance during the life of the mortgage

Under the Insurance Contracts Act, an interested party to a contract has certain rights under the agreement. As an interested party to the insurance, the lending institution is advised of lapsed property insurance - although this does not always happen and cannot be relied upon. If the lending institution is advised, the procedure is, as a matter of course, to ensure renewal of the policy with payment from the loan funds if necessary. The customer is contacted and requested to provide proof of currency, continuation of exiting policy or alternate cover.

Other comments

At least one lender's practice, on a biennial basis as a minimum, is to issue written reminders to mortgagors (on statements) of their obligation to keep the required insurance in force. The lending institutions may also have in place Innocent Mortgagee Cover, which provides coverage in the event of loss, if the borrower does not have insurance in place.

While it is not common practice of AFC Members to lend in flood prone areas, there are a number of areas that as a result of the recent flood events in Queensland are now classed as flood prone. Hence, there are now some loans which may now be in a flood area. The lenders are exploring options to ensure current borrowers have the required coverage.

There may be instances where a borrower obtained flood coverage at the lender's insistence. It is possible that where the original policy has lapsed the borrower may have obtained insurance that does not provide full coverage. Borrowers may provide proof of cover but it may not necessarily highlight the deletion of the flood cover.

It would be very difficult for lenders to constantly ensure the continuance of insurance. Even then, many staff would need to be employed and the cost would need to be passed onto the borrower in some form. In summary, although it can be difficult ensuring borrowers are always adequately covered, lending institutions are generally satisfied with the adequacy of current arrangements.

D Thorpe

David Thorpe
Associate Director