
NATIONAL DISASTER INSURANCE REVIEW

SUBMISSION BY
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IN RESPONSE TO THE EXECUTIVE SUMMARY AND
QUESTIONS POSED BY THE NATURAL DISASTER
INSURANCE REVIEW PANEL

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Section 1.

OVERVIEW OF THE PRESENT SITUATION

1.1 The Development and Role of Private Insurance

The modern business of property insurance underwritten by private insurers has its origins in England, following the Great Fire of London of 1666. Stock companies were formed with cover initially against the peril of 'fire'. The range of insurable perils has expanded considerably over time.

Insurers have a vital interest and role in reducing in the incidence of loss and property damage wastage in the community. Insurance premium rates are structured to reward favourable features that lessen the risk of loss and to penalise those that are adverse.

Underwriting is a conservative business, requiring proper definition of the cover provided, the assessment and quantification of the risks underwritten, and the management of the portfolio of insurance business within the financial capacity of the company...history well documents the failure of insurers proceeding otherwise.

The development of property insurance and reinsurance practice has shown that insurers, far from being risk-adverse, have accommodated the challenges of providing property insurance coverage from the earliest of colonial times in Australia. Property insurances then, and now, have delivered the security needed for growth in trade and commerce.

Many types of insurance cover initiated by private insurers are now regarded as essential, and some are now mandatory.

1.2 Private Insurance and Government Responsibilities

Traditionally, certain risks to property have been regarded as beyond the capacity of private insurance companies to underwrite. This situation has prevailed not only here, but overseas as well. War and flood were originally placed in this category and, whilst protection against war damage remains the province of national Governments, there have been advances in providing cover against flood damage, with riverine flooding and water released or escaping from dams or water storages providing the major difficulty both here and overseas.

An Earthquake & War Damage Insurance Commission was established in New Zealand to deal with the potential national disaster and/or national perils risks faced by the community across the Tasman. Yet despite the formation of flood pools and various national flood damage schemes overseas, there is no universal fix for coverage of damage from riverine flooding in high-risk areas in Australia.

Since the Brisbane floods of 1974, there have been significant developments in the availability of flood cover in Australia, with insurers showing more risk appetite in meeting the needs of consumers for property losses resulting from flash flooding caused by run-off rainwater and riverine flooding for commercial risks. Some insurers have moved towards providing riverine flood cover across their portfolio of property insurances, but those attempting to underwrite the risk with an appropriate premium reflecting the risk have been disappointed by the take up.

The result of this, in current dollar terms the Australian Insurance Industry will pay out much more following the 2011 Brisbane floods than then did following the 1974 Brisbane floods despite the height of the water being lower as shown in the following table:

Item	1974	2011	Difference
Water Height	6.7 metres	4.43 metres	34% less
Population (Australia)	12.6 million	22 million	75% increase
Population (Greater Brisbane)	0.911 million	2 million	120% increase
Cost to insurance industry	\$468 ¹ million	\$2,600 ² million	555% increase

Providing insurance cover against loss from riverine flooding in high-risk areas remains a problem for private insurers for several reasons, all of which are quite valid:

- 1) Corporate governance, that is, managing risk with an indeterminate loss potential.
- 2) Financial risk to policyholder funds and capital.
- 3) The growing accumulation of property values and the question of capacity for the insurer and the cost of backup reinsurance catastrophe support.
- 4) Absence of mapping upon which to properly underwrite such business.
- 5) Failure of town planning in Australia, resulting in continuing development of property on land subject to riverine flooding with little or no focus in many areas on engineering or other matters to mitigate the risk of damage, thereby adding to the accumulated damage when such events recur.
- 6) Policyholders not affected by the problem, not wishing to subsidise the insurance costs of others who place themselves at the risk from the ownership of property located on land subject to riverine flooding.
- 7) For those Insureds facing major flood loss from riverine flood waters, the inability to afford an appropriate commercial premium for the risk as required by private insurers to underwrite the risk of their property.

1.3 Current Challenges in Relation to Residential Property Damage arising from Riverine Flood

- 1) Some householders have no insurance policy.
- 2) Some householders are uninsured against the risk of riverine flood.
- 3) Some householders have insurance, but an inadequate sum insured.
- 4) Some householders have adequate insurance cover.
- 5) Some householders may have guaranteed replacement cost insurance cover, but they number in the minority.
- 6) Building costs rise in the aftermath of any natural disaster based on the law of supply and demand, specifically in relation to the availability of tradesmen to undertake the work.
- 7) Subject to the adequacy of the sum insured, home insurance policies will cover the cost of upgrading to comply with current building regulations in force at the date of loss.

¹ Source Insurance Council of Australia

² Ibid

- 8) Subject to the adequacy of the sum insured, some home insurance policies cover the cost of upgrading to comply with amended building regulations introduced following the damage.
- 9) Some insurers have added a sum insured escalation component of 20% to 25% after a state of emergency has been declared following any event, to assist with issue 6) above.
- 10) Some householders will, with justification, want to hold the insurer to its promise to manage the reconstruction process at the existing site, or elsewhere if allowed, under the terms of the policy.
- 11) Limited or lack of choice of building contractor.
- 12) Some householders want a cash settlement in order to leave the area without incurring the cost of reinstatement as provided by the policy conditions, raising the attendant problem of whether their payment will be based on the actual (indemnity) value of the property or the cost of reinstatement.
- 13) Cash settlements based on the quotations or price indications of people or firms who will never do the work. Not a satisfactory situation without safety checks.
- 14) Alternative accommodation expenses limited to 12 months may be inadequate due to delays in obtaining approval to rebuild and the limited availability of contractors to undertake the work.
- 15) Damaged property is mostly being replaced *in situ* merely adding to the level of accumulated damage when the next event occurs.

1.4 Factors Necessary to the Mitigation of Riverine and Other Flood Damage

- 1) Improved local and State Government management and control of water infrastructure, waterways and water flows, to mitigate the risk of loss or damage to property from flood in any area.
- 2) Improved local and State Government management and control to mitigate against loss from property development and land usage of land subject to riverine flooding, including the declaration of land in high-risk areas as not being suitable for residential development.
- 3) The establishment of engineering standards that are written into the Building Code, to be applied to all new constructions and restoration of property on land subject to riverine flooding that is deemed suitable for continuing residential development.
- 4) Development of programs for the relocation of residences and other property from land declared to be subject to the high risk of riverine flooding and not suitable for residential development, to safer ground (Grantham example).
- 5) With respect to engineering concerns, addressing building of permanent levies and barriers where necessary in built-up areas over time (as in Europe) to safeguard all property in these areas from riverine flooding.
- 6) Ensure that any new power infrastructure developments and essential services facilities are not located on land that is subject to flooding from any cause, and that existing facilities are permanently banded to avoid loss, damage or interruption.

1.5 Factors that Act as a Disincentive for Individuals to Personally Undertake Loss Mitigation

- 1) The cost of proceeding alone and the absence of appropriate engineering responses or standards and community programs.
- 2) The current situation has developed over many years and inevitably results in the circumstances, and assets of the householder being rehabilitated at the expense of the rest of the community by a combination of money and goods from:
 - Federal and State Government grants in the aftermath of such events;

- the commendable compassion of fellow Australians donating to disaster funds to alleviate hardship for those affected; and
 - major charities responding to the human crisis;
- 3) The practice of insurers and government to cover the cost of upgrading to new building standards after such events provides no motivation to householders to do anything beforehand.
- 4) *"It's not my fault."*

Section 2.

ANSWERS TO THE QUESTIONS POSED IN THE NATIONAL DISASTER INSURANCE REVIEW

2.1 Model Recommended for Residential Property and Household Contents

We make this recommendation in the best interests of everybody to establish a way ahead that will provide a solution to current problems. Our recommendation may be seen as extreme, but will not prevent the involvement of private insurance at some stage in the future when appropriate risk mitigation programs have been implemented.

The action of some insurers moving to provide flood cover is highly responsible and commendable. However, it is apparent that no individual insurer has the capacity or a sufficient portfolio of residential home insurance to make a difference and provide the overall solution needed at this stage of Australia's development. If we are wrong, we would be pleased to see the insurance industry provide an acceptable alternative.

The change we suggest may impact on pay-back arrangements under treaty reinsurance arrangements for riverine flood damage (as opposed to rainwater flash flooding damage), which insurers now face for residential risks. However, we would expect that the implementation of the model we suggest would require 18 to 24 months, during which time some of the pay-back costs under existing arrangements will already have been paid and catastrophe premiums chargeable on residential property would reduce in any case if the riverine flood risk exposure for residential property is no longer required.

When first considering this question, we had concerns as to whether the proposed models would adequately address the situation and if the separation of riverine flooding risk from private insurance was needed.

2.2 Our Recommendation

After deliberating on all of the required tasks ahead, we came to the conclusion that achieving desirable outcomes would require a private insurer/government partnership ("PIGP") and the need to establish an Australian National Flood Authority ("ANFA"), the liabilities of which will be secured by the Crown. The matters driving this conclusion are listed below:

- 1) The need to have public support.
- 2) The need to urgently get on with risk mitigation.
- 3) The high level of existing fire and perils (non-flood) insurance already in force with reinstatement and extra costs coverage for conventional perils.
- 4) Any attempt to introduce riverine flood insurance with a more limited range of cover options, including relocation, would mean unhappy people who would not see the current matter as their fault and would increase the risk of fraud arson.
- 5) Private individuals are generally unable to afford the true risk premium for riverine flood cover applying to their property in a high-risk area.
- 6) The inevitable involvement of government funding to achieve any satisfactory outcome.
- 7) A government authority is best placed to manage the process and, vested with the responsibility of providing flood disaster relief insurance, can access the catastrophe insurance market on its own account, providing the vehicle by which insurance funds can be separated between risk management and control (risk mitigation), and insurance and accumulated funds on a tax-free basis.

- 8) The need to contain administration costs and avoid delays in responding in times of need.

The management attack on the riverine flood problem encompasses the following steps:

- 1) Engineering studies of affected areas to determine the impact of constructing flood barriers (as in Europe) along rivers, and to protect property on low-lying land.
- 2) Such studies are required for the important task of placing riverine flood plains into their appropriate category for prioritising and managing risk. That is:
 - i) moderate risk and manageable;
 - ii) high risk, but manageable with a combination of protective barriers and new structural engineering standards; and
 - iii) declared areas not suitable for residential development and on which further residential development should cease.
- 3) Agreement with private insurers as to a definition of the catastrophe loss embracing riverine flood, dam bursts or water released from catchments, lakes and rivers, thereby separating these losses from those insurable water perils capable of meeting the requirements of the community for insurance of residential property and household effects.

2.3 The Model

- 1) The establishment by the Federal Government of an ANFA, as stated above.
- 2) ANFA will have an appointed board of members experienced in civil engineering and project management, structural engineering, hydrology, capital raising, accounting, actuarial studies, and the law.
- 3) The recurrent costs of administration of ANFA will be funded by the Federal Government. Flood mitigation projects will be funded by both Federal and State Governments, and from the transfer of a flood premium charged on home insurance policies, plus the levies collected on residential property located on a flood plain.
- 4) ANFA will be empowered to accumulate reserves in a tax-free environment, and will issue bonds for public subscription to access savings and finance the required work.
- 5) Home policies in Australia are to exclude flood in accordance with the definition agreed between the industry and government.
- 6) Home insurance policies in Australia are to have an Automatic Flood Extension expressed in the same terms as the agreed Flood Exclusion, which will be reinsured in full to the ANFA.
- 7) The existing home insurance policy records of the private insurance market will provide confirmation of policyholders' entitlements when events occur. Defalcations or record keeping errors by private insurers or financial services advisers will not affect the policyholders' interest or entitlements.
- 8) The additional premium charged for flood cover under all home insurance policies in Australia is to be calculated at a flat rate of 0.02% of the sum insured regardless of location, as the consideration for the extra cover. The reinsurance transfer will be in bulk, monthly, to ANFA with a letter of certification signed by the insurer's auditors. Such funds transfer will be by way of reinsurance as a component of premium, subject to an exchange commission of 20%, and will not appear on the insurer's documentation as a government levy. This calculates as follows:

(7 million homes x estimated average sum insured of \$300,000 x 0.02%) - 20% = \$336,000,000 net. The gross cost to the policyholder is \$60 per home, plus separate contents insurance contribution.

- 9) The justification for the charge on all policies is that all Australians should contribute to the protection afforded, which is additional to riverine flood. At a time when fire services levies and their related superimposed stamp duty and GST imposts are being withdrawn, it could not be more opportune to introduce this important development and investment in future risk reduction to benefit all stakeholders.
- 10) Local Government will, in consultation with ANFA, also declare a flood levy on residential property located on flood plains, payable on the rateable value of the building for the assessment of rates, and agree a collection process. Those directly affected by the problem should make, and be seen to make, a financial contribution to the solution.
- 11) State Government will be responsible for the supply of land where relocation is deemed necessary.
- 12) These levies will be used in funding the expenses of ANFA, mitigation work, reinsurance and claims, and will be supplemented by government contributions.
- 13) Staffing of the ANFA should be kept to a minimum, with the outsourcing of functions as follows:
 - Hydrologist services, although the ANFA may retain a senior hydrologist on staff.
 - Engineering services, although ANFA would require some senior engineering personnel on staff to manage the responsibilities of the organisation.
 - Claims services to be outsourced and provided by the insurance industry, subject to an agreed claims handling (special charge) fee payable as a claims cost by ANFA, or by a Third Party Administration organisation such as Gallagher Bassett Services Pty Ltd supplying similar services in New Zealand on a fee-for-service basis. We favour the first option under PIGP arrangements.
 - Claims service delivery to be subject to agreed performance standards.
 - IT services compiling essential data for the management of ANFA's risk, including accumulation of risk values and claims cost by area or postcode to be compiled by an independent IT consultancy service from electronic data supplied by insurers and claims service providers.
- 14) Liaison between parties comprising the PIGP as mitigation work proceeds, through a working committee consisting of government and insurance industry personnel.

Benefits of this Arrangement

- 1) Provides the most efficient use of available services and expertise, and should limit bureaucracy numbers.
- 2) All of the necessary capital funding for risk mitigation is vested in, and managed by, one authority.
- 3) Builds on the framework of existing insurance in an acceptable fashion.
- 4) Will reduce the problem of no flood insurance, but not the problem of no insurance.
- 5) Enables the government to re-determine policy and, in fixing the level of grants to those who do not have insurance or adequate insurance, ensures the grants paid do not act as a disincentive for people to arrange insurance and be responsible for their own affairs.
- 6) Creates a situation that imposes a cost on everyone, but is not seen as unreasonable and is not a tax.
- 7) Avoids the government imposing mandatory insurance on private companies and their shareholders, which could result in some insurers withdrawing from the market.
- 8) Will free up some private insurer capacity to provide wider commercial insurance cover.

Section 3.

ANSWERS IN RELATION TO SOME MATTERS RAISED BY THE REVIEW PANEL

Chapter 2

Question	<p><i>Home insurance cover for flood</i></p> <p><i>Are there any other models besides Automatic Flood Cover and Automatic Flood Cover with Opt Out, supported in either case by a high flood-risk discount and funding arrangement, that could materially improve the availability and affordability of flood cover within home insurance policies?</i></p>
Answer	<p>The proposition that the flood premium might be 150% of the underlying risk premium has all the hallmarks of the inequitable situation identified with fire services levies, whereby the person with the prestige policy could pay 100% more for the same service as the person with the basic policy. The Opt Out model achieves nothing, and the <i>status quo</i> would remain.</p> <p>Whatever model is decided upon, it will not provide all of the desired outcomes of protection of property and loss mitigation without government involvement and financial support. We consider that the model we have suggested will provide a practical and achievable outcome in Australia's best interests.</p> <p>The problem of allowing development on land subject to riverine flooding is a failure of town planning and a government responsibility. We hold firmly to the view that it will only be government interest and action that will solve this matter going forward.</p> <p>While there may be no solution to under-insurance or no insurance, the model we have suggested will vastly improve the situation.</p>

Chapter 3

Question	<p><i>Identifying the homes with high flood risk</i></p> <p><i>How practical is the implementation of each of an engineering threshold and a price threshold?</i></p> <p><i>What are the requirements for each to operate successfully?</i></p> <p><i>What are the relative merits of these two approaches?</i></p> <p><i>Are there any other concepts that might be applied to establish a high-risk threshold?</i></p>
Answer	<p>We consider that the model we have suggested overcomes the issues raised in Chapter 3. Whilst, the public will always respond generously to assist fellow citizens in times of adversity, they would not expect to do so at the current levels gratuitously into perpetuity for riverine flood risk. The public would expect the future to be better managed by local, State and Federal Governments.</p> <p>If trying to pursue inquiry to establish a realistic indication of what is a reasonable high-risk threshold, insurers offering automatic flood cover may be able to better indicate what is seen by them as the appropriate rate and what the public see as affordable. We understand that those insurers seeking to underwrite flood cover across their portfolio have not had a satisfactory take up of renewal business in areas subject to riverine flooding.</p>

Chapter 4

Question

A high risk flood insurance system

If the Automatic Flood Cover model or the Automatic Flood Cover with Opt Out model is introduced:

- *what premium formulae and premium discounts would be appropriate for homes with high flood risk?*
- *what are the relative merits of the different possible ways of operating the Flood Insurance Pool in relation to transfer of risks and premiums from insurers to the Pool?*

How might the Flood Insurance Pool be structured regarding its legal existence, capital, financial modus operandi and governance?

What resources and what level of access to flood mapping and related information would be needed by the Pool in order to carry out its full pricing responsibilities for the high flood-risk threshold and high flood-risk homes?

In the interests of a competitive market for home insurance with flood cover, how would the Pool need to operate in the field of flood risk measurement to maintain low barriers of entry to smaller insurers?

Which parts of the community (some or all taxpayers, ratepayers or policyholders) should ultimately fund the premium discounts and how should the subsidies be allocated?

What eligibility criteria would be the most equitable and the most effective for owners of high flood-risk homes?

Answer

Refer to the recommended model that we have put forward.

Flood mapping and revision of the Australian Building Code to incorporate new engineering requirements appropriate to the risk of safeguarding residential structures located on flood-prone land, is fundamental to improving the current situation. It will enable the prioritisation of mitigation work.

Previous failure to address these matters has resulted in the increasing cost of damage in Australia from inappropriate residential developments on land that is unfit for such purpose.

The model we have suggested going forward with the formation of ANFA, brings together all the resources to deal with the current problem and mitigate the tremendous wastage being suffered by the Australian community.

The solution we suggest still enables insurance companies to provide the most competitive premiums to Australian consumers by separating riverine flood from other perils.

Chapter 5

Question ***Flood cover for contents insurance***

If the Automatic Flood Cover model or the Automatic Flood Cover with Opt Out model is introduced for home insurance, to what extent should the flood cover in home policies be reflected in contents insurance, for each of owner occupiers and renters?

What practical issues could arise if home insurance policies were required to include Automatic Flood Cover but contents insurance policies were not required to include Automatic Flood Cover?

Answer Refer to the recommended model that we have put forward.

As mentioned previously, the importance of flood mapping and revision of the Australian Building Code to incorporate new engineering requirements appropriate to the risk of safeguarding residential structures located on flood-prone land, cannot be stressed too strongly.

Chapter 6

Question ***Flood cover for strata title and other residential property***

If the Automatic Flood Cover model or the Automatic Flood Cover with Opt Out model is introduced for homes:

- *How far should these arrangements apply to strata title properties?*
- *How far should these arrangements apply to company title properties?*
- *How far should these arrangements apply to mixed use strata properties (residential and commercial)?*
- *How far should these arrangements apply to retirement villages and aged care facilities?*
- *How far should these arrangements apply to caravans and mobile homes?*

What would be the implications of these arrangements for bodies corporate, their members and insurers?

Answer We are of the opinion that the protection afforded under the suggested model should include strata title property.

Recent feedback suggests that some private insurers are declining to quote on strata title insurances, and this may be due to the impact of the high sums insured on data collected for the assessment of catastrophe risk exposure and reinsurance costs.

Whilst many strata units may well be located along river frontages, future action on risk mitigation and engineering is needed to bring the risks under control and, in our view, including strata title units within the framework of the suggested model is important.

We place retirement villages and aged care facilities in the same category. The occupants are dependent on assistance, and their location is the result of a failure of town planning.

Chapter 7

Question

Flood cover for small business

What, if any, are the impediments for the insurance industry in providing flood insurance for small business?

If new arrangements for flood cover for home insurance are introduced, is there a case for introducing similar arrangements for small business? And if not, what could be done to improve the affordability of flood insurance for small business?

What options are there to improve the take-up of flood insurance by small businesses?

Is there a case for any form of regulation or any other government intervention to reduce the current high levels of non-insurance by small business?

Is there a demand for insurers to extend the scope of cover for business interruption insurance? If so, what initiatives could be taken by the insurance industry and the small business community to meet this demand?

If no new arrangements are introduced for small business insurance or the Automatic Flood Cover with Opt Out model is introduced, should there be a standard definition of flood to apply to small business insurance?

Answer

Property owned and occupied by small business is usually only a smaller portion of overall property values located in high-risk areas. However, in many older townships, such commercial property is usually concentrated in main streets closer to a river.

Some insurers have developed cover for small businesses and, in many places, the owners have marked with some pride the various flood peaks for past events, so their buildings have remained and the loss potential is, in most cases, never total.

There is an increasing tendency for commercial insurers to now quote on the basis of providing flood cover subject to a combined limit of liability for material damage and business interruption. This limit may be well less than what is required, particularly if there are several premises for the one organisation and the combined limit is applied per event and not per situation.

The establishment of the ANFA and the implementation of our suggested model may free up capacity for commercial insurers to do better for SME businesses, particularly as mitigation work proceeds. Commercial property insurers would benefit from any reduction in risk exposure.

As discussions proceed, there may be a role to include SME commercial risks within the ANFA arrangement, say on the basis of providing 'Top Up Excess Cover' above any combined sub-limit applying under primary insurance. This extension of our suggested model should only be considered if it becomes clear that the private insurance sector is unable to provide such cover.

Major industrial, commercial and retail organisations with greater buying power and stronger risk management procedures than SMEs are usually able to negotiate cover with commercial risks insurers, working through their corporate brokers.

Chapter 8

Question

Natural disasters other than flood

If new arrangements are put in place for flood cover by the Automatic Flood Cover model or the Automatic Flood Cover with Opt Out model, is there a case for extending the scope of cover to landslide and actions of the sea?

What, if any, are the impediments to the insurance industry in providing automatic cover for actions of the sea and landslide for home insurance policies?

How might these impediments be overcome?

Answer

Whatever model is introduced, it is believed that there is enough statistical data for the extension of storm/cyclone coverage to include storm surge arising from such events. Many major properties already have this cover, which applies commonly elsewhere in the Pacific region. While global warming may be raised as an issue, at this point there is no evidence to say that at current seas levels, the risk is uninsurable.

We are concerned about the continuing write-out of coverage for damage by a tsunami under Australian insurance policies. Tsunami is not storm. Tsunami is covered under Mark IV and Mark V ISR policies and the Commercial Business Package insurance policies sold by the major broking cluster groups. As far as we are aware, the position is the same under the Home insurance policies of broker cluster group-badged wordings.

Policies sold by direct writing insurers such as AAMI no longer provide cover for Tsunami, whereas the policies of other members within the Suncorp Group grant this protection.

The developing situation will result in a very embarrassing reputational issue for the insurance industry, with strong criticism from governments should such an event occur. The Tsunami risk is wrongly mentioned with storm and tempest as an insured peril in the standard policy wordings promulgated in the Insurance Contract Regulations.

Unfortunately, there is misunderstanding of the situation by many insurance staff who link tidal wave with storm and tempest and cyclone, rather than arising from a seismographic disturbance. In our view, the issue of tsunami needs to be resolved as part of these discussions.

As regards landslide, it is possible to obtain landslide cover where the landslide occurs within 48 hours (or other nominated period) following a storm. Cover would also apply automatically where the damage results from a burst pipe or water mains.

There are several places in Australia with a known landslide risk. Insurers have uniformly refused to provide any extension of cover, regarding the risk as uninsurable and therefore excluded by their treaties. We would not expect this situation to change as it invites inevitable loss.

Chapter 9

Question

Measuring flood risk

What are the merits of developing a single national standard for flood mapping in Australia?

What, if any, impediments are there in doing so?

Who would be best placed to develop such a standard?

Who should bear responsibility for producing and maintaining relevant flood maps? Who should fund this activity?

To what extent do land use decisions take flood risk into account?

What, if any, are the potential impediments to councils making flood maps publicly available in a way similar to the Brisbane City Council?

To what extent is the lack of consistency and availability of flood maps limiting the insurance industry's ability to offer flood insurance?

To what degree is not having a single source for flood maps an impediment to national consistency, both in terms of how maps are developed and how they are used?

Answer

We regard the development of a national standard for flood mapping as a fundamental component to working through this whole issue. Some insurers and local governments have already carried out work themselves at considerable expense, but that should not be a barrier to developing a national standard, which is to be applied in the future.

The present situation, including land use management, has suffered accordingly. This has resulted in poor town planning decisions. We would see ANFA being charged with this responsibility.

Such information needs to be publicly available to citizens and business. Parties proceeding independently for their own purposes have naturally previously refused to share such information, seeing it as their own intellectual property. While private interests can maintain this situation, local, State and Federal Government should make such information available on a fee-for-service basis.

Historically, this situation is no different from the mapping of city blocks; a service provided by Mahlstedt's to former insurers underwriting fire insurance policies so that they could calculate retentions and monitor aggregate exposures in each city block that was regarded as comprising the one risk.

Flood mapping is something much wider and required for Government work, including town planning and the development of engineering standards to apply to property construction on land subject to flooding.

There is obviously a case for charging insurers a fee-for-service for the supply of maps and overlays to assist with underwriting of commercial insurance business, and vice versa where the information held by a private insurer will assist ANFA in carrying out its mandate.

Chapter 10

Question

Risk mitigation and insurance

How have the building codes that have been developed in response to cyclones affected the underwriting and pricing practices of insurers and reinsurers?

How much weight can be given by insurers to flood mitigation measures in areas subject to flood risk?

To what extent are responses to the recommendations of the Victorian Bushfires Royal Commission expected to reduce bushfire risk in Victoria? How are these responses being reflected by insurers in their pricing of home insurance?

To what extent are insurers able and willing to undertake repair and reconstruction of a home following a natural disaster so that it incorporates enhancements to improve resilience before formal changes to building standards?

To what extent should decisions on these matters require the agreement of the homeowner?

Answer

Starting with the last question first, we would be surprised to see insurers (or their reinsurers for that matter) agreeing to voluntarily incorporate enhancements to improve the resilience of any building that was not part of the insurance indemnity, unless the cost of doing so is no more than that required to reinstate the property as was. We understand that reinsurers have been conducting claims audits of ceding insurers' records to ensure that payments by them are strictly in accordance with the policy conditions.

As regards the second question, it is too early to tell the impact of changes. On the one hand, there have been improvements such as including the removal of surrounding vegetation and changes to comply with the new building code, while on the other hand, the old 'stay and protect' rules have been replaced by an evacuation process, so that in the absence of any CFA presence, many properties saved in the past by owners, may now burn down.

Only time will tell, however, competition is such that if the risk of loss by fire is substantially reduced, then this will be reflected in the 'burning cost' of claims and will flow through to premium rates.

In relation to the first question, insurers need to be involved in these matters through PIGP committees in future, and become part of the process. Insurers seem to have been marginalised by the current ICA structure and the abandonment of a technical (engineering) services department. We would recommend that insurer participation in any PIGP committee work be at two levels, namely underwriting management and engineering.

Chapter 11

Question ***Non-insurance of homes: should home insurance be compulsory?***

Given the high rates of voluntary take up of home insurance, the historical right not to insure and the significant changes to the legislative framework and administrative infrastructure that would be required, is there nevertheless a case for making home insurance compulsory?

Are the data that suggest four per cent of owner occupiers do not hold home insurance reflective of the overall level of non-insurance of homes across Australia, taking into account other classes of residential property owners such as strata title

Answer We do not have data in relation to the extent of non-insurance, excepting that after any major occurrence it is obvious that a percentage of those living in that area do not have any insurance.

It is evident from newspaper reports that fires regularly occur at residential property where there is no insurance against the risk of fire.

The records of the various fire brigade services throughout Australia may provide some data as to the number of properties where fires have happened in any given year and there is no fire insurance policy in force, to ascertain whether the situation with no insurance is improving or worsening.

The removal of fire services levies and the attendant overlay of stamp duty and GST obviously makes insurance more affordable as a product. ICA may have some data from those States where the change has been introduced.

We do not consider that it is possible to stamp out under-insurance. It cannot be made into a crime, nor should it be the subject of a fine. However, we do consider that failure to effect insurance should not be rewarded by excessive Government grants following major events. Such grants are merely a disincentive for people to look after themselves. In some past situations, those with no insurance have finished in a better financial position with grants and support services, than those who have insurance, but not enough sum insured.

Any grants should be fixed at levels that reflect the need for temporary assistance, and demonstrate that those in this category are not abandoned by the rest of the community.

Chapter 12

Question ***Under-insurance of homes***

To what extent would the substitution of replacement cover for sum insured cover eliminate the under-insurance of homes?

To what extent does sum insured cover plus 'top up' address the under-insurance of homes?

What are the relative merits of replacement cover and sum insured cover with a 'top up'?

Whatever form(s) of cover is to be preferred, should insurers be encouraged to offer it or should it be mandated that they offer it?

If under-insurance of homes is to be minimised, should homeowners be able to purchase replacement cover only or sum insured cover with 'top up' only, or either? Or are there other possibilities?

In the event of total loss of a home, is there a case for changing the practices of insurers around cash settlements and other policies on rebuilding?

What arrangements could be put in place to minimise the possibility of disputes if a cash settlement is offered under a replacement cover policy?

What factors should be considered in determining whether homeowners should have the right to reject a cash settlement in favour of their insurer arranging rebuilding or repairing?

Answer

Care is needed here. Terminology used in Australia is confusing. In the USA, there are three types of cover:

- *Indemnity;*
- *reinstatement with sum insured; and*
- *guaranteed replacement cost.*

In our experience, USA insurers had a contractual situation in place where properties offered for insurance in the third category were subject to a drive-by inspection by building consultants to verify, the condition of the property, that the size of the property was properly stated on the proposal form, that any unusual features of which the insurer should be aware were noted, and an approximation of the cost of rebuilding was given.

It is our experience that in the 1970s in Victoria, with home insurance policies moving from an indemnity to a reinstatement (with sum insured) cover, the level of properties totally lost by fire increased four-fold and, in the second year, further increased. The properties concerned were mainly older homes and some were under finance where the owners were found to be in financial difficulties. This led to the introduction of upgraded proposal forms, the removal of instant issue policy pads from brokers with poorly performing accounts, and the increased effort in conjunction with the industry to manage fraud arson better in conjunction with the police. These times also saw insurers then seeking access to data held by the financial services sector Credit Reference Association.

At that time, a New South Wales insurer also introduced a guaranteed replacement home insurance policy, promoted with an extensive TV advertising program. That policy was withdrawn from the market within a short timeframe. It is interesting to note that AAMI has now introduced a similar product. Perhaps Australian society has moved on in the meantime, but experience has usually shown for governments and insurers that making easy money available has its downside.

The model we have suggested is designed to work within the framework of existing covers sold by insurers, and we believe it is best to start there rather than attempting to turn home insurance building policies into guaranteed replacement policies and something that will add to the cost of insurance, with the risk of sullyng the introduction of this important development .

We were responsible for the introduction of catastrophe top-up cover under Business Package policies, which was quickly taken up by the rest of the market. We initially tried for 33.33% and had to settle for 20%. The home insurance market has quickly followed with 25%.

The need for this cover is only in the affected areas after an event has occurred giving rise to a state of emergency. The principle of providing top-up as an extension is the correct way to go, and contains the cost of insurance. The percentage may need to be increased reflecting the real cost, as more information comes to hand from these events.

Settlements are always at the option of the insurer. Notwithstanding this, it is somewhat short of an Insured's expectation of the support often depicted in TV advertising, that is, of being helped and supported through the process of restoration, when a cash settlement is made at the insurer's option. Whilst there are times that a cash settlement is made with the agreement of all parties, when this is not the case, so the reality is less than the insurer's promise...unless, of course, the sum insured is not adequate.

We are concerned about the process of cash settlements being made on the sole basis of figures supplied by builders who are employed by the insurer, when the sum insured has not been exhausted, even where the insurer has two quotes. Our view is that the figures must be based on a specification and scope of works prepared by a structural engineer, with allowance for contingencies.

Where the sum insured is adequate for the repair or reinstatement of the property, we consider that the insurer or its representatives should manage the process for the Insured until completion. We also believe that when any reinstatement is completed, the services of a structural engineer should be employed to sign-off on behalf of the Insured. Otherwise, whilst the insurer's brand is not worthless, it is diminished and worth less than the original promise.

Chapter 13

Question

Non-insurance and under-insurance of contents

To what extent is the level of non-insurance for contents of concern to the community or to governments?

To what extent is the level of under-insurance for contents of concern to the community or to governments?

Should measures to improve affordability of contents insurance be considered?

What measures could be implemented to improve affordability?

If premium discounts are to be offered for homes with high flood risk should they also be offered for contents insurance?

Answer

This is quite a conundrum. Under-insurance and non-insurance is always a problem to the individual and the community. It is a particular problem for elected governments not wishing to be seen as lacking in compassion. However, we seem to be in a situation in Australia where the money available from governments and appeals is supplanting insurance in some respects.

We were surprised to read that some of the appeal monies donated in the aftermath of the Victorian bushfires was being spent on replacing road signs and infrastructure, when surely this is the responsibility of councils.

Removing the imposts of government charges for fire services from the cost of insurance products is a step in the right direction, but the double loading of government charges for stamp duty and GST is unsatisfactory, and stamp duties should go. The removal of this tax was expected with the introduction of A New Tax System (GST), but not delivered by State Governments. This needs to be addressed.

Discounts are an issue better left aside by adopting our suggested model solution. The additional cost of complying with a new Building Code for flood will impact on fire damage claims as well. The method of charging for flood cover recommended by us bears no relationship to risk, and therefore the question of discounting for flood on insurance premiums does not arise. The discount, if any, will be in the amount of the flood levy charged by local Government and ANFA after the mitigation works have been completed and paid for.

Chapter 14

Question ***The role of lending institutions***

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

- *the purchase of insurance;*
 - *the scope of insurance cover, and in particular whether it includes flood cover;*
 - *the quantum of insurance; and*
 - *the continuity of insurance during the life of the mortgage?*
-

Answer We do not have the information to respond to this question. We believe that under the *Trade Practices Act*, a financial institution cannot make the insurance with their product mandatory, so the insurance could move at renewal unless the premium is included in the monthly repayments and is not exposed to the normal renewal process.

Chapter 15

Question ***Consumer awareness of risk and insurance***

What measures could improve consumer understanding of their insurance cover, particularly if purchased over the telephone?

How would consumers benefit from being provided with personal advice that takes account of the insurer's assessment of the consumer's risk?

What are the benefits for consumers being provided with scaled advice? What, if any, are the impediments for insurers and insurance brokers providing it?

Is there a particular need for unfair contracts laws to protect policyholders in natural disaster insurance?

Answer It is clear that policyholders do not read their policies. As such, all the expense of producing the current documentation and the costly procedures put in place by Government and ASIC following the Wallis Inquiry and report, have not created any improvement. The size of the PDS in itself has probably added to the problem.

Home insurance policies now provide very comprehensive cover, bringing together several classes of insurance business, and consumerism, and the need for plain English explanations has resulted in an increase in the number of exclusions seeking to spell out more clearly the extent of cover provided. The amount of paper involved continues to increase.

The issue in relation to whether policies cover flood damage should be a matter of public notoriety. Older members of the community will well remember the old movietone newsreels in the late 1940s and after, highlighting riverine flooding in New South Wales and Queensland. There has been plenty of sequels since then.

We do not believe there is a need for unfair contracts laws to protect consumers in relation to flood insurance. If our recommended model is followed, this will remove any need for consideration of this item.

Chapter 16

Question ***Processing of Claims***

What have been the causes of delays in processing claims other than delays caused by the need to determine whether damage was caused by storm or flood?

In cases of delayed claims processing and settlement:

- *how adequate and appropriate is the nature of communication between insured and insurer?*
- *how adequate are the clarity and frequency of updates from insurers on the progress of the claims?*
- *should the insurer initiate the communication or should the onus rest with the claimant?*

Should there be a time limit for decisions to be made on insurance claims arising from natural disasters? If so, how long should it be and should it be imposed by statute or under a voluntary code of practice?

Answer All claims need to be managed to agreed performance standards.

With our suggested model, determining the cause will not be necessary at the time of loss, but will follow later for the purpose of determining reinsurance recoveries. The onus of timeliness in this regard shifts to the primary insurer and ANFA.

Effective communications are always necessary following major loss events giving rise to a state of emergency, as it is a very distressing period, not only for the householder but also for those insurance personnel working in the frontline in the delivery of services. In consequence, the experience of hostile media and political involvement from Day 1 of the recent floods was unprecedented and quite unfair.

Greater focus is necessary on major event loss management, based on lessons learned from all recent occurrences.

The onus of reporting damage must always rest with the Insured. Insurers coping with an influx of claims do not have the time, nor should they be obliged to incur the expense of visiting all properties insured by them in the area or districts affected.

The model we have suggested overcomes the issue raised in the last question. The matter comes within the existing Code of Practice requirements.

Chapter 17

Question

Resolution of claims disputes

Should there be a mandatory time limit for insurers to respond to disputes following a natural disaster and, if so, how long should it be and should it be regulated through the industry Code of Practice or legislated?

Is there a case for improved monitoring and transparency of insurers' internal dispute resolution processes?

What, if any, changes are needed to the responsibilities of insurers and policyholders during the dispute resolution process?

How can policyholders' access to information during the dispute resolution process be improved with regard to reasons for decisions, documents relied upon in decision making and independent legal advice?

What can be done to improve the integrity of insurers' internal dispute resolution processes including full disclosure of any multi-tiered dispute resolution, adequate decision making powers for dispute resolution personnel and structural separation from claims personnel?

Should consumers have access to independent legal advice in rejected insurance claims, particularly in natural disasters? If so, from whom and how should it be funded?

When a claim is not resolved because of a dispute between broker and insurer, what legislative and other steps could be taken to protect the client's interests by obliging broker and insurer to act together in the first instance to resolve the client's claim, and then to embark separately on their own dispute over liability?

Answer

If our suggested model is implemented, it will eliminate many disputes, and the existing processes are not unreasonable.

One concern is the tendency of claims personnel to send off rejection letters when matters have not been fully investigated to determine the facts. Where brokers are involved and maintain a claims department, these matters are usually addressed, either when there is an indication provided that the claim will be rejected or when the rejection is first received. We believe that the majority of brokers already play a large part in resolving disputes. Policyholders dealing with a direct writing insurer must run this process themselves.

Experience shows that some claims staff have an inadequate knowledge of insurance law, and the rejection is on a wrong premise. It is recommended that rejections require more investigation by senior claims personnel to consider whether the issues have been properly enquired into and that the interpretation is correct, before such rejections are formally given.

The Financial Ombudsman Service appears to be catering for dispute resolution on a timely basis.

Disputes arising from alleged errors and omissions on the part of brokers are already covered by a resolution process.

Resolution of disputes by recourse to litigation is a normal commercial process, and we would not think it appropriate for insurers to have to finance the cost of legal process against them other than by way of ordered costs when the matter is decided in favour of the Insured.

Chapter 18

Question ***Funding public infrastructure***

Would there be benefits to the States in equity and effectiveness if the NDRRA funding formula were to apply to expenditure gross of reinsurance recoveries rather than net of reinsurance recoveries?

What, if any, are the impediments to this approach?

Answer As some States do not insure their State assets and others do, the current arrangements are inequitable and need to be addressed.

We consider that all States should be obliged to effect an agreed level of insurance over their own assets in any case. If this is not possible, then a change in the NDRRA formula is needed.

Chapter 19

Question ***International comparisons***

Are there particular lessons to be learned from international schemes, whether featured in Appendix 4 or not, that should be considered in evaluating different models for application in Australia?

Answer We believe that the lesson learned from the information supplied is that there are systems in place to address catastrophic loss, which involve Government and private insurance working in partnership.

Our suggested model provides a framework for matters to move forward, uncomplicated by any need to assess what is a reasonable flood premium.