

April 2011

## NATURAL DISASTERS INSURANCE REVIEW

### Submission

Thank you for the opportunity to contribute to the Review. The Terms of Reference do not explicitly refer to bodies corporate; owners corporations etc. We assume they are implicitly within the Review's scope as these are the vehicles for providing key insurance covers for a large proportion of individuals and businesses (eg ~22.5% of households nationally based on 2006 Census).

Industry estimates suggest approximately 400 such entities were directly affected by the Brisbane floods. Very few if any had flood coverage; losses which in many cases run into six figures will be borne collectively by the owners through reserve or sinking funds. It is common in normal circumstances for these to be significantly under-funded. As a result the floods are having a significant impact on the financial position of many of these buildings and will require substantial injections of funds from individual owners and/or significant borrowings.

The reasons for the lack of flood coverage are twofold: availability and affordability. Anecdotally, some buildings were unable to obtain quotes for flood cover. Others found that the price was a multiple of the standard policy excluding flood and chose not take it up.

The Brisbane floods have raised questions about the fiduciary duties of both professional strata managers and individuals on executive committees for these buildings in taking out appropriate insurance. It is possible if not likely that these questions will be tested at some point in the form of claims against professional indemnity and/or directors and officers covers.

This would be an unsatisfactory and highly inefficient means for recouping these losses if such claims were to be successfully brought. The more pressing issue is to ensure greater availability and improved affordability of flood covers. We are seeing similar situations unfold in cyclone-prone areas of northern Queensland where the exit of some insurers is having a domino effect as their competitors seek to avoid increasing their own exposure to these risks.

In our view a sustainable solution is unlikely to occur without further government intervention in the market. Arguably, governments at least at state and local level have some moral if not legal responsibility for the risks created by past planning and development decisions. Some financial exposure to the consequences of these decisions may concentrate their minds on avoiding such risks in the future as well as help the economic case for investment in mitigation.

Government intervention should also acknowledge the implicit of not always explicit current exposure of community finances, whether through government-funded disaster relief and recovery programs or charity appeals, to situations where there is no insurance.

In the strata and community titled property sector, government intervention already takes the form of statutory obligations to take out insurance in every state and territory's legislation governing the operation of these schemes. A schedule of the relevant provisions is attached.

Generally speaking, the public policy objective behind these provisions is to protect individual owners from the collective risks attached to the schemes. However the legislation in most cases does not contemplate the situation where the necessary covers are either unavailable or uneconomic. Nor does it consider the unlimited liability of owners corporations/bodies corporate and the joint and several liability of individual owners to these legal entities, specifically in cases where the cover is either unavailable, sub-limited, or exceeded by a loss. These unfunded liabilities of the owners corporations/bodies corporate must be met in full by its members.

In compulsory motor accident schemes, nominal insurer arrangements protect claimants where the responsible party is uninsured or cannot be identified. Historically, governments have also intervened in insurance markets in the form of statutory monopolies when access and affordability became an issue eg compulsory motor, workers compensation, home owners warranty.

Strata and community title property is a specialised market segment where, like many others, insurers compete through risk selection as well as growth and retention strategies. Generally the market works well and any government intervention should be carefully targeted to encourage rather than discourage individuals, businesses and bodies corporate/owners corporations to provide for their own risks.

Ideally, this would take the form of a geographic- and risk-specific mechanism that reduces the exposure of insurers to extreme weather events while allowing them to continue to offer affordable covers for other, more generic risks in those locations. It should also include provisions to ensure disclosure of the prescribed risks to prospective purchasers of these properties.

Critically, this mechanism must explicitly provide for owners corporations and bodies corporate. It should recognise the different types of exposure in high- and low-rise settings, the compulsory insurance requirements of state and territory legislation and the collective rather than individual nature of the risks.

It is likely that the more efficient model will involve some form of reinsurance or claims recovery process that directly reduces the exposure of insurers' capital, rather than a premium subsidy which must necessarily also cover the considerable cost of capital associated with those risks. In this context it is noteworthy that these issues do not arise in the Northern Territory where the Territory Insurance Office (TIO) is able to provide extreme weather covers on a sustainable and commercial basis.

Yours sincerely

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