Inquiry into Insurance and the Temporary Flood and Cyclone Levy

NATIONAL DISASTER INSURANCE REVIEW, TREASURY OF AUSTRALIA 2011

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Executive Summary[2]

Currently Australia is being increasingly subjected to a number of devastating catastrophic events.[3] These events have huge economic implications in terms of the loss of lives, property losses and disruptions to communities. This submission will focus upon the property losses which are endured after a natural disaster. These property losses will be looked at in light of the viability of the current insurance and regulatory regime. In particular the submission will look at the existing problems with the insurance regulatory regime in dealing with natural disasters and the institutional factors which may prevent access to insurance.

Although the particular focus of this inquiry is upon the recent flooding in Queensland[4] which saw 37 fatalities and losses exceeding $6 billion. Simultaneously there was flooding in Victoria[5] and losses were also created by Cyclone Yasi.[6] Problematically, these are not the only serious weather related catastrophes which Australia has endured recently. Ironically whilst the East Coast of Australia was flooding the West Coast of Australia in areas around Roleystone, Armadle, Kelmscott and Redhill (outer suburbs of Perth)[7] were subjected to serious bushfires. Furthermore in 2009 Black Saturday saw one

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[3] Institute of Insurance Actuaries, 'Submission to the Garnaut Climate Change Review – Update 2011' (March 2011) 1, 13 at <www.actuaries.asn.au>

[4] The Insurance Council of Australia as of 25 March 2011 has the figures for the insurable losses resulting from the flooding in Queensland amounting to $2.31 Billion which is based upon claims from 49,400 properties. See: Insurance Council of Australia, 'Insurance Council of Australia Historical and Current Data Statistics at 25 March 2011' at <http://www.insurancecouncil.com.au/IndustryStatisticsData/CatastropheDisasterStatistics/tabid/1572/Default.aspx

[5] Ibid.

It has been suggested that the losses resulting in Victoria from the flooding has amounted to $86 Million in damages derived from claims for damages to 6,609 properties.

[6] Ibid.

The current estimate of the damages from insured losses arising out of Cyclone Yasi is $868 Million which has arisen from 59,990 claims.

[7] Ibid.

of the nation's worst catastrophic bushfires in history with over 173 dead and losses exceeding $4 Billion.[8]

Clearly the increase in these weather related catastrophes should raise alarm bells and prompt action with a matter of urgency. Action is needed to mitigate the potential future losses caused by catastrophes. However as the starting point we should not simply look at the recovery process for the current disasters but rather the failures which are currently in existence which can be remedied to mitigate the economic implications for future disasters. Essentially one of the biggest failures which continues, to stem from the disproportionate amount of funding that is spent in the recovery phase without adequate consideration about creating greater resilience which will have the effect of mitigating future losses. Politically speaking, no government would be in a position to abandon the victims of a disaster in the aftermath. Problematically though the current trend has been to look at the recovery phase, this is not the best mechanism as an overall long term natural disaster blue print. Rather the way that government funding is provided requires the current policy makers to explore funding mechanisms for which the only benefit derived may not come instantly but rather may be seen after the next major disaster where through the spending on preparedness and resilience the overall losses are likely to be lowered. In the future the basis of funding for any regime must not only look at the implications of spending now but examine longer term benefits from more resilient communities.[9] Properties will need to be built to better withstand natural disasters. This can be achieved through a change in planning and building regulations to ensure that any new premises being built recognize the potential for Australia to be subjected to increasingly severe and increasingly frequent weather related disasters. Essentially such changes to building regulations and ensuring greater resilience to properties can be achieved through cooperation with the insurance industry. If properties were better able to withstand potential damage from natural disaster and there was an increase in the number of adequately insured individuals then this will take a huge strain off the government in having to provide assistance and relief in the aftermath. The clearest example of the need for change may be seen in the aftermath of the Queensland flooding in 2011, whereby the shortfalls have promulgated the introduction of a temporary flood and cyclone levy. Although the idea of having a disaster based levy is not problematic, the currently proposed scheme falls short of serving longer term objectives rather creating a temporary 'band aid' approach.

The current inquiry should be expanded beyond the strict confines of the catastrophe occurring with the flooding in Queensland and Victoria and the cumulative implications of the damage sustained by Cyclone Yasi. The inquiry rather should be broadened so that there is an exploration of better equipping the nation with the ability to financially cope with the increase in weather related events reaping havoc. In particular it would be

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The current losses from damaged property arising out of the catastrophic fires which occurred in February 2011 in the areas surrounding Roleystone, Armadale, Kelmscott and Redhill just outside of Perth has amounted to damages of $35 Million from 35 insured properties.

[8] Commonwealth, 2009 Victorian Bushfires Royal Commission, *Final Report (Summary)* (2010) 1.

[9] Edward Mortimer, Anthony Bergin and Rachel Carter, 'Sharing the Risk: Financing Australia's Disaster Resilience', *Australasian Strategic Policy Institute* (February 2001), 1, 1 – 24.

irrational for an inquiry not to encompass an examination of the implication of property losses endured from bushfires. Bushfires often occur simultaneously with flooding within the Australian nation although they will occur in different geographical positions often different states. An example of this may be seen in that whilst Victoria endured the horrendous fires of Black Saturday, much of Queensland and Northern New South Wales was flooding. Similarly during the recent flooding in Queensland and Victoria, there were bushfires in some of the suburbs on the outskirts of Perth. The terms of reference of the inquiry refers to the need for an adequate analysis of the insurance system which should be explored for all types of disasters across the different states and territories in Australia. In particular an exploration must be made about implementing financially sustainable longer term options which promote there being a higher level of people who are adequately insured. There is a need to keep the number of uninsured people to a minimum and to help people understand the realistic levels of insurance which are needed to ensure adequacy of coverage. If levels of insurance were increased then this would benefit the public generally as more people would have their financial interests protected against loss from a natural disaster. An increase in the levels of insurance would also benefit the insurance industry which may lead to an overall reduction in the cost or premiums through an enlarged class of policy holders for who to spread the risk. Furthermore the government would be able to allocate the funding currently spent on the recovery phase of natural disasters on providing other infrastructure and benefits which will help society generally. Planning and creating greater resilience against future disasters needs to be a crucial ingredient in the creation of a solution which will eradicate the need for a future temporary disaster levy.[10] Part of the solution will simply require greater public awareness of the issues.

Promoting resilience rather than recovery for natural disasters

The main objective for this current inquiry should not be solely on helping the victims of the flooding and Cyclone Yasi in the recovery phase but also clearly defining this as a turning point towards positive change. Essentially part of the solutions should involve exploring different options available which the government could adopt as a means of mitigating the harsh consequences of a natural disaster and also for assessing the adequacy of our current insurance regime.

Looking at improving the levels of insurance in Australia is an obvious starting point in equipping the nation to withstand property losses resulting from a natural disaster. Currently there are high levels of uninsured and inadequately insured individuals. The statistics do vary from state to state but have been known to be as high as 30%[11] and it

[10] Anthony Bergin, Edward Mortimer and Rachel Carter, 'Deciding Just Who Picks Up the Tab After a Catastrophe', *The Australian* (Australia) 12 February 2011.

[11] It is important to note that statistics on the precise level of those who are uninsured varies. After the Black Saturday fires in Victoria it was suggested that the levels of people without adequate insurance was in excess of 20% of those who lived in the affected areas. Furthermore it was said that only approximately 86% of people living in the bushfire affected areas had both home and contents insurance. See: Joshua Whittaker, Katharine Haynes, Jim McLennan, John Handmer and Briony Towers, 'Victorian 2009 Bushfire Research Response Household Mail Survey' (Bushfire CRC, Report, January 2010) 2, 43.

has been suggested 'that between 27% and 81% of consumers were underinsured by 10% or more against current rebuilding costs'[12] Anecdotal accounts tend to suggest that in many of the highly affected areas in Queensland these figure were fairly accurate to determine the number of inadequately insured individuals. There are a number of reasons why people are inadequately insured in Australia[13] which are:

- Cost;[14]
- Taxes on insurance particularly state taxes (fire services levy in Victoria and New South Wales and stamp duty in all of the Australian states)[15]
- Inability to properly calculate what their property is worth;[16]
- Exclusions preventing them obtaining cover for certain risks such as flooding;
- Lack of understanding about what their policy covers and the amount they are covered for;
- Failure to take into account the total cost of a property being demolished and the auxiliary costs which go with this (such as site clearance, site leveling, landscaping etc);[17]
- Lack of awareness of need and naivety in individuals thinking that a weather related disaster could not affect them;
- Tendency to focus upon recovery after disasters rather than actively promoting resilience which can lead to fewer future losses from natural disasters.[18]

After the recent events and the exposure of the problems with insurance unfortunately there has been much of a blame game with the insurers often being blamed for moderate levels of underinsurance in Australia. Insurers charging high prices for insurance

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It has been suggested that in Queensland after Cyclone Larry that only approximately 36% of people in the area affected were insured and after the Black Saturday bushfires that only 74% of people had insurance to cover losses. See: John Newman (Vice President of Institute of Insurance Actuaries of Australia), Submission to Garnaut Climate Review, *Garnaut Climate Change Review*, 3 March 2011, 6.

[12] Australian Securities and Investments Commission, 'Getting Home Insurance Right- A Report on Home Building Underinsurance' (Report No 54, Australian Securities and Investment Commission (ASIC), September 2005) 5.

[13] Rachel Anne Carter, 'Risk and the Decision to Insure in Australia: The Black Saturday Fires' to be presented in July 2010 at Disasters and Sociolegal Studies Workshop, Onati, Spain; Rachel Anne Carter, 'Analysis of Australian Insurance Law and Regulatory Systems Covering Property Damage Caused by Fire' paper presented at the Bushfire Cooperative Research Centre Research Advisory Forum, Brisbane, May 2011.

[14] Rachel Carter, 'Flood Insurance Must be Made Accessible to All', *The Australian* (Australia) 13 January 2011, 14.

[15] Rachel Anne Carter, 'Taxing the Taxed- Duplication of Taxation in Property Insurance and Social Implications' paper presented at the University of Melbourne, Australasian Tax Teachers Association Conference, January 2011; Rachel Anne Carter, 'Wild Fires- The Legal Regulatory System of Insurance and Emergency Services Funding' (2011) *Southern Cross University Law Review* (Forthcoming 2011).

[16] Australian Securities and Investments Commission, 'Getting Home Insurance Right- A Report on Home Building Underinsurance' (Report No 54, Australian Securities and Investment Commission (ASIC), September 2005).

[17] Australian Securities and Investments Commission, 'Getting Home Insurance Right- A Report on Home Building Underinsurance' (Report No 54, Australian Securities and Investment Commission (ASIC), September 2005) 5

[18] Edward Mortimer, Anthony Bergin and Rachel Carter, 'Sharing the Risk: Financing Australia's Disaster Resilience', *Australasian Strategic Policy Institute* (February 2001), 1, 1 – 24.

products are claimed to be the predominant reason for high levels of uninsured and inadequately insured individuals within Australian society. It is important that insurers are not unfairly blamed for systematic or institutionalized failures which are keeping people out of the insurance market.[19] The first thing which must be kept in mind is that currently the way the insurance market is set up is that insurers are commercial entities and are therefore carrying out the provision of insurance as a business mechanism ultimately to improve the returns for their investors after they have adequately satisfied their obligation of insuring against losses which their policyholders may endure. It is due to this commercial nature of an insurance enterprise that access to insurance may be difficult. However, provided that the risk could be appropriately priced it would be in the interest of the insurance industry to have as many people insured as possible therefore enlarging the amount of income they receive from the provision of insurance products and services.[20]

The provision of insurance services requires insurance to be commercially priced by insurance actuaries who require statistical data to assess the risk and to ensure that a risk remains commercially viable. Due to this process there are exclusions for certain risks where the risk of creating an insurable loss is simply too high. One common example is that in areas which are prone to particularly high levels of flooding, flood insurance is sometimes unavailable or the cost of attaining it effectively renders it prohibitive for many. In those high risk areas, even if insurance is available it will only become available after paying a substantial additional premium to represent the extra risk which an insurer takes on. In some instances the additional amount which is charged to represent the risk is such that the cost of insurance is simply prohibitive for those who may already be struggling to put food on the table. The current legislative regime is premised in a manner in which an insurer is able to decline a risk if they feel that taking on such a risk would not be commercially viable.[21] The ability for an insurer to decline a risk freely has exacerbated the problem of uninsured and inadequately insured individuals in Australia. However it is unfair for the insurer to be blamed for this when the system is premised upon insurance companies operating as commercial entities and the legal regulatory regime is supporting this premise.

Essentially if the problem of access is to be rectified there needs to be at least some government intervention whereby insurance would be transformed even partially to providing a more welfare based position of accepting risk and providing full access to insurance even if this contradicts the actuarial data which suggests the inappropriateness of doing this from a purely commercial standpoint. Ultimately if the correct equilibrium can be reached between costing and access to insurance then the increase in access would benefit a number of stakeholders including the governments at both State and Commonwealth level, the public generally and the insurance industry.

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[19] Rachel Carter, ‘Don’t Blame the Insurers- Blame the System’, *The Punch* (www.thepunch.com.au), 20 January 2011.
[20] Ibid.
[21] Rachel Anne Carter, ‘Mitigating Future Disasters in Australia- The Role of Government, Insurers and the People’ (Paper presented at 9th Conference on Catastrophe Insurance in Asia, Beijing, China, 8 – 9 June 2011).

After the insurance losses which were sustained in the aftermath of the 1974 Brisbane floods, there was a ban on accessing flood insurance in many parts of Queensland (other types of insurance for non-flood related losses were still readily available). The previous flooding and the data suggesting the likelihood of future flooding in certain areas means that the risk may become more of a certainty. In some areas it became a matter of questioning when an event will occur rather than speculating as to the likelihood of a risk ever materializing. Thus if it is inevitable that a risk will eventuate and losses will result then this will prevent a number of insurers from accepting the risk. One of the problems with such a situation is firstly planning permission has been provided to enable people to build property in areas which are flood plains (and other equally high risk areas). Therefore problematically the new disaster information is going to impact upon pricing and thus it would only be fair that potential insured's were informed prior to building on land or prior to purchasing property on high risk land that the cost of protecting this asset will be particularly high due to its location and the consequent risk factor. The second problem is that for a number of people living in these areas they are forced into such areas due to their socioeconomic position and thus cannot afford to recover from a disaster without adequate insurance. These people may be pushed out of the insurance market as it may be too prohibitively expensive or they simply may not be able to get access to cover against the risk of flood. A number of members of the general public were upset in the aftermath of the current flooding in Queensland and Victoria that they could not get insurance to protect their property against losses caused by flooding. For some this may mean that they are seriously looking at the possibility of living in poverty; for others who have greater financial means the losses caused will still have huge repercussions on lifestyle and future economic stability.[22]

Ultimately due to the reality of insurers being commercial entities and the system being premised upon this basis it is necessary that the government provide some assistance to eradicate the issue of access to insurance. If there had been a greater ability for people to access insurance in the areas which were subject to the flooding in January and to Cyclone Yasi in February 2011 then the economic implications for many individuals would not be so grave.

There are a variety of different options available which could be used to increase access to insurance. Some of the options which need to be researched more to discern their inherent appropriateness for a particular state or for Australia as a whole include:

- Subsidies for the provision of insurance;
- Rebates available when creating more resilient properties;
- Ensuring that consumers undertake certain preventative measures and ensure that if these are taken that insurance cannot be denied;
- Providing more flexible mechanisms to pay for insurance and for individuals who may not otherwise be able to afford insurance to budget for this.

[22] Stephane Hallegatte and Valentin Przyluski, 'The Economics of Natural Disasters: Concepts and Methods' (Policy Research Working Paper No 5507, The World Bank, December 2010) 15.

Problematically the denial of access to insurance or the failure to provide affordable access to adequate levels of insurance may breed poverty after a loss bearing event.[23] For many the failure to have economic security after a disaster through insurance would render them unable to properly recover and replace property even with a more modest version of the property which they previously had. This in turn has implications on the public generally whereby for those who are unable to support themselves financially they are left to rely upon welfare through governmental assistance or public benevolence. Although there has been overwhelming public generosity towards providing monetary donations to assist the victims of natural disasters there is only so much the public can give before the saturation point has been reached and no matter what the desire of individuals is, would leave a situation where people simply cannot afford to provide further funds. It is at this point where the ultimate insurer of necessity becomes the public purse and ultimately this will need to be collected through increased levels of taxation to cope with the additional financial burden which is thrust upon the government. If there was adequate levels of insurance both to protect the private economic interests as well as public economic interests the outcome at least from a monetary and property perspective is likely to be lessened.

Cost of Insurance- Is Cost a Prohibitive Factor?

Cost is one of the greatest factors which influence the decision for a potential insured to undertake insurance, which company they wish to undertake coverage with and the value in which they have coverage for. For some people the cost of insurance is simply too prohibitive. The cost is therefore essentially excluding these people from the insurance market and potentially placing them in a precarious position whereby they may end up financially desolate if a natural disaster occurs which creates extensive losses.

Ultimately any resolution must be premised on the facilitation of vertical and horizontal equity in the fiscal affairs affecting the taxation, both of individuals and the implications this has upon providing a geographical fiscal equilibrium between the states in terms of risk, finances and ability to pay. Ensuring that there is a correct fiscal balance which considers vertical and horizontal equitable principles[24] is likely to ensure that cost is reassessed and that cost no longer acts as a preventative mechanism effectively entrenching the status quo of relatively high levels of uninsured and inadequately insured individuals. The issue of costing needs to be determined both in terms of the access of individuals to insurance but also the decisions of a state as to whether they are going to self insure or buy commercial insurance to protect public assets.

One of the current problems with access to insurance for individuals and small businesses in Victoria (and also New South Wales) is the existence of the Fire Services Levy which

[23] Stephane Hallegatte and Valentin Przyluski, 'The Economics of Natural Disasters: Concepts and Methods' (Policy Research Working Paper No 5507, The World Bank, December 2010) 15.

[24] JRG Butler and DP Doessel, 'Natural Disaster Relief and Horizontal Equalization in Australia' (1983) 13 *Journal of Federalism* 55, 55 – 72; JM Buchanan, 'Federalism and Fiscal Equity' (1950) 40 *American Economic Review* 583 - 599.

is imposed upon insurance policies.[25] The insurance policy is also subjected to Goods and Services Tax in all states and also a final layer of Stamp Duty which applies to policies in all of the states. Problematically the cumulative effect of all of these taxes significantly increases the cost of attaining insurance and in fact can lead to increases of up to 123% of the cost of attaining insurance. For many the implication of taxes therefore acts as a disincentive to insure or creates a barrier to the attainment of adequate levels of insurance amongst the community.

In relation to the current problems with flooding and cyclone damage in Queensland the implication of the taxes on insurance were lessened in comparison to the effect on Victoria. In Queensland due to there being a property based levy for the provision of fire and emergency services this means that the tax ramifications are such that there are only two layers of taxation being the GST and Stamp Duty to increase the cost of insurance. In Victoria however some of those who suffered flood damage did not have adequate coverage and some failed to have coverage at all due to the costs which were a preventative barrier. For those Victorian residents who want to insure their properties they are subjected to three layers of taxation which operate in a cumulative manner being the Fire Services Levy, the GST and Stamp Duty. Although currently there is a proposal for disbanding the system of charging a Fire Services Levy on insurance in Victoria at the present this has not materialized in terms of any possible and realistic alternative mechanisms. One of the easiest ways to alleviate the problem of cost of insurance in Victoria is to abandon the Fire Services Levy as currently imposed upon insurance premiums.[26] Although this has been suggested the speed for which suggesting, imposing and implementing alternatives needs to be increased. Unfortunately as long as the status quo remains the less likely it will be to solve the problem of under insurance and inadequate insurance amongst the Australian public.

Secondly when devising the costing of insurance policies it is necessary that in the future there is an equal contribution of both horizontal and vertical fiscal equity imputed into the mechanism for pricing.[27] Furthermore in terms of pricing consumers should be informed about how their policy is calculated and there should be a clear break-up of the different cost components of an insurance premium upon the policy notice. Rather than focusing upon the recovery phase from a disaster ensuring that insurance is affordable and accessible to all should be a better objective of equipping Australia to absorb and mitigate losses resulting from natural disasters. Greater research must be undertaken into providing affordable insurance to all people particularly those for whom currently cost is a prohibitive factor forcing them out of the insurance market and thus potentially placing them in the precarious position of financial ruin if a natural disaster occurs. Methods

[25] The 2009 Victorian Bushfires Royal Commission recommended that it was necessary to remove the fire services levy being imposed upon insurance premiums due to the implication this was having upon the uptake of adequate levels of insurance. See: Commonwealth, 2009 Victorian Bushfire Royal Commission, *Final Report* (2010) 381 – 384.

[26] Rachel Anne Carter, 'Taxing the Taxed- Duplication of Taxation in Property Insurance and Social Implications' paper presented at the University of Melbourne, Australasian Tax Teachers Association Conference, January 2011; Rachel Anne Carter, 'Wild Fires- The Legal Regulatory System of Insurance and Emergency Services Funding' (Southern Cross University Law Review, Forthcoming 2011).

[27] Ibid.

under which the cost of insurance is easier to absorb must also be researched and different proposals suggested to better facilitate the uptake of insurance.

Awareness of the Risk of Property Damage

A secondary problem which needs to be assessed which can contribute towards the problem with uninsured and inadequately insured individuals is the lack of awareness of risks of possible damage to a property. Members of the public have reported that they were not aware of the risk that their property could be potentially annihilated by fire or destroyed in totality by flood or cyclone. There is also a common tendency for people to be risk adverse and to feel like the risk would not happen to them. There are also some people who were living in Queensland at the time of the flooding who had no idea of the particular susceptibility of their property to flooding. Although there was widespread knowledge of the 1974 floods, some did not feel that the floods would affect them in the same way as some felt that with the passage of time they would be immune from a similar incident occurring in the future. Some of this lack of knowledge can be attributed to the fact that for some when properties were purchased initially they were not notified as being in a high risk area. Flood maps were available and could be requested, however many of the flood maps were outdated and they were not provided as a matter of course to those who were considering buying a property which was within a flood prone area. Furthermore amongst some properties there was deceit involved whereby some people were allegedly told by developers that there was not a risk to their property but after the recent floods have found out the hard way that such advice was incorrect. Although some did not know about the risk there were a number of people who were aware of the risk particularly given that the last substantial flood was in 1974 which for a number of people was still within living memory. Furthermore there were a number of houses in the most at risk areas that were built on stilts to be able to withstand a future flood and with this knowledge and forward thinking many of these properties suffered no damage or only minimal damage from the flooding in December 2010 – February 2011.

The awareness or lack thereof was not simply of the risk of a property having the potential to be damaged by a disaster such as through flooding or as a result of a cyclone. Rather, for many the problem was a lack of awareness of what their policy actually covered and what exclusions precluded insurance cover. One of the biggest problems which was revealed in the aftermath of the flooding was that many insurance policies did not automatically cover the risk of flooding. Problematically, if there had been a greater level of individuals who had read and understood the ambit of their coverage prior to the flooding they would not have suffered the same financial hardship in realizing after the loss had been endured that they were not covered for certain losses. Although there were many insurers who excluded coverage for flooding or only provided coverage for such a contingency on the payment of an additional premium amount there were insurers which did cover losses resulting from flooding. Suncorp and Westpac were two insurers who automatically had covered flood borne losses for all types of flooding. Many of the other insurers excluded damages caused by riverine flooding although most insurers covered flash flooding. Unfortunately a huge number of people who did have insurance were caught unaware of exclusions under their policy whereby such damage from riverine flooding was excluded and thus no financial assistance would be provided.

A serious problem which was disclosed after the recent flooding was that people were not aware of the exact ambit of their coverage in terms of the particular wording which was used. The use of insurance jargon and the differences in the terminology flooding between different insurers had created confusion amongst insured's. Furthermore some people who saw the term flood and saw that their policy covered flood were lured into a false sense of security thinking that such coverage encompassed all types of flooding when in reality flash flooding was covered in most policies but riverine flooding was commonly excluded. The flooding in Queensland was the result of riverine flooding whereby it was the rivers which had broken their banks which had created the flooding. This is in contrast to transitory nature in which flash flooding very quickly surges and equally as quickly resides. Many consumers could not comprehend the difference between these different types of flooding. Thus now in the aftermath when they are not being paid for something they felt they were covered for but really were not covered for under their insurance policy, many of these consumers have adopted a stance of blaming the insurers. The insurers are therefore also in a difficult predicament whereby they cannot pay for all of the claims for damage for which they did not cover because in doing so this would lead the companies to become insolvent. Ultimately therefore many individuals and small businesses will be left with the damage bill from the flood or cyclone related losses. Therefore the onus needs to be on ensuring that there is greater awareness of what a policy covers and what exclusions exist. A potential insured should be able to discern their exact coverage before they enter into the contract for insurance.

The lack of awareness had also extended to the amount of coverage which was needed in order for an individual to be adequately insured. A number of insured people did not know what the best mechanism for determining the adequate value to insure their property. Firstly there were huge variances between the different insurance companies in terms of what an identical property would be worth. ASIC have said that the 'largest gap between the lowest and highest estimates was 169% [for the value of a property]. In other words the highest estimate was more than two and a half times the lowest estimate for the same house in the same location'[28] Therefore it is 'hardly surprising that between 27% and 81% of consumers were underinsured by 10% or more against current rebuilding costs.'[29] Furthermore the problem with the two main mechanisms for calculating the value of property insurance wield totally different values and thus contribute to confusion over what a property is worth. One of the mechanisms being the cost per square metre merely takes into account the absolute minimum costs for rebuilding a property of the same type. This mechanism does not take into account the type of furnishings of a property, the type of floor coverings and additional luxuries which may be in a property such as a deluxe rather than just a basic kitchen. On the other hand the second method looks at individual characteristics of a particular property which the insured owns and thus recognises that to rebuild a property with similar features will be much more expensive than a basic property with the cheapest finishes. Although both of these

[28] Australian Securities and Investments Commission, 'Getting Home Insurance Right- A Report on Home Building Underinsurance' (Report No 54, Australian Securities and Investment Commission (ASIC), September 2005) 7.
[29] Ibid 5.

mechanisms can be used towards assisting an insured in determining the value of their property they are still problematic. Generally an insurance policy is renewed annually thus there can be a significant increase in the cost of skills and labour between the time that the policy is taken out and the time that the disaster occurs rendering what would have been an adequate level of insurance at the time it was taken out as being inadequate at the time of loss.[30]

One other unique feature which is particularly relevant in relation to insurance based losses arising after a natural disaster is that if there is a disaster which causes a significantly widespread number of losses this will disproportionately increase the demand for labour and materials in a certain area. The cost of rebuilding when taken out will be based upon labour and building material costs at the time and generally will not be based upon an estimate for inflated costs. Furthermore after a disaster there is often a change in the building laws which make rebuilding more expensive. Although it is important that changes are made to ensure that properties which are being rebuilt will better withstand natural disasters there is a question on who should endure this additional financial burden of ensuring that properties are resilient against future disasters. Given the increase in the costs resulting from an influx of properties that are likely to be destroyed during a natural disaster coupled with probable legislative changes to ensure greater resilience the government should provide some assistance with these additional costs.

Research needs to be undertaken into resolving the problem of the change in legislation and building regulations after a disaster which substantially increases the cost of rebuilding such that even if an insured had adequate insurance before, they were left with a huge outstanding bill for the additional expenses. Perhaps the government could assist in subsidising such materials. There should also be the provision of incentives to those who create more resilient properties prior to a disaster occurring. The importance in looking at the pre disaster period and creating a greater level of preparedness and resilience is likely to have a great impact in the sense that it is very likely to reduce the overall economic losses when a natural disaster does occur. If there are fewer losses and people had adequate economic protection against their losses then this is likely to eliminate the need for any future disaster responses such as the currently proposed temporary flood and cyclone levy.

Solutions for the Insurance Industry

One recommendation therefore is to embark upon an educational campaign whereby the general public need to be made more financially literate. Part of the process of ensuring this should address the need for insurance and should educate the general public about the economic repercussions of not having adequate levels of insurance particularly in light of a current climate of increasingly frequent and increasingly severe natural disasters including bushfire, flood, cyclone, tsunami and serious storms.

[30] Ibid.

A second recommendation is that there should be an extension to the coverage which is offered. Due to the commercial basis upon which the insurance regime is premised perhaps the government may need to provide assistance in ensuring that there is greater access to insurance for all. The government needs to be more proactive in terms of future planning laws whereby they should look at the potential risks of damage from disasters prior to giving planning permission. However for those areas where buildings are presently allowed there should be a move towards ensuring that affordable insurance is available. There are many different options for this and part of this may require a potential insured doing certain things which are not cost prohibitive to ensure that their property will withstand potential natural disasters. For those preventative measures which are more costly; government subsidies should be available. Although in the short term this may create a cost for the government in the longer term the implications of having resilient properties will mean that there are fewer losses, fewer properties which are annihilated or which will be rendered as uninhabitable therefore ultimately saving the government welfare payments for those who are forced to rely upon the government as the insurer of last resort.

Recommendations and Concluding Remarks

The key argument from this submission is that the department of Treasury should consider and engage in further research in relation to the following issues which are currently impinging upon the widespread availability of adequate levels of insurance.

- Resilient Communities;
    - The government should adopt a different strategy whereby their fiscal schedule should not be dominated by post disaster recovery. More money needs to be allocated to prevent natural disasters from occurring and to alleviate the economic and property losses which are sustained as a result. The marked increase in a variety of different natural disasters has shown that preparedness will be more important in creating a long term sustainable mechanism for dealing with property losses caused by natural disasters particularly flood, cyclone and bushfire.
- Ensuring the barriers preventing access to insurance are removed;
    - The recent flooding in Queensland and Victoria and the loss sustained in Northern Queensland due to Cyclone Yasi show that the government needs to ensure that those areas which have already been provided with building and planning approval are such that individuals living within these areas can access insurance to protect their financial interests. Due to the current legislative and regulatory regime enabling insurers to operate as commercial entities, the government may need to provide incentives to ensure that risks that may not be actuarially sound (and thus otherwise denied) are still taken on. The government should also be careful in the future in relation to providing permission to live in an area whereby, all potential residential areas should in the future first be assessed against the likelihood that a natural disaster may occur in such an area and what the probable outcome of this would be.

- Looking at pricing insurance so that it is more affordable particularly for those who are within a lower socioeconomic position;
    - Due to the increasing cost of living some people are forced out of the insurance market as it is simply prohibitively expensive. For these people there should be options available to ensure that insurance is made more affordable such as through creating more flexible payment arrangements or subsidizing insurance so that both vertical and horizontal fiscal considerations are used in the pricing of policies.
- Embrace both vertical and horizontal fiscal equalization in relation to costing insurance and imposing taxation burdens on insurance policies;
    - The taxation implications on insurance currently increases the cost of insurance substantially. In order to assist with the pricing of insurance and ensuring that insurance is more affordable, inefficient state taxes should be disbanded and removed from insurance policies.[31]
- Greater financial literacy amongst the general public about the real rather than perceived need for insurance as a means of preventing poverty;
    - Part of the current problem which has lead to a situation of a reasonably high level of uninsured and inadequately insured individuals is that many do not understand the need for insurance. Further, there are a number of people who feel they cannot afford insurance yet do not fully appreciate that by virtue of them not having insurance this could create a situation of poverty if these people endure losses as a result of a natural disaster.
- Government having greater involvement with the insurance industry, perhaps through the creation and development of public private partnerships;
    - The way that the current insurance regulatory regime is premised is such that insurers are ultimately commercial entities who are to be held accountable both to their policy holders and secondly their shareholders. Furthermore due to this system insurers have great autonomy in determining which risks are commercially viable for them to embrace and which risks they can decline.

[31] Rachel Anne Carter, 'Taxing the Taxed- Duplication of Taxation in Property Insurance and Social Implications' paper presented at the University of Melbourne, Australasian Tax Teachers Association Conference, January 2011.