

Draft Report: Productivity Commission's Inquiry into Natural Disaster Funding Arrangements

Submission by the Financial Rights Legal Centre

The Financial Rights Legal Centre (*formerly known as the Consumer Credit Legal Centre (NSW)*) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 22,000 calls for advice or assistance during the 2013/2014 financial year.

Financial Rights also conducts research and collect data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how community legal centres utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether. Federal Government changes to Community Legal Services Program funding agreements in mid 2014 restrict policy and law reform that community legal centres can undertake with Federal Government funds. These restrictions have the potential to deprive Government and others from valuable advice and information and reduce efficiency and other improvements in the legal system. For more information please see <http://www.communitylawaustralia.org.au/law-reform-and-legal-policy-restrictions/>

Thank you for the opportunity to comment on the Draft Report of the Productivity Commission's Inquiry into Natural Disaster Funding Arrangements. This submission has been informed by our extensive experience working with consumers of insurance through the Insurance Law Service, a national legal advice hotline run by the Financial Rights Legal Centre (Financial Rights).

General comments

We would like to make a general comment about climate change. With the instances of natural perils seemingly increasing in numbers and severity, and with current public policy seemingly stymieing climate change action it seems that risk may be increasing without the necessary mitigation strategies being implemented. Although we are glad to see the Commission's macroeconomic look at the cost of natural disasters and the need for greater mitigation strategies, we are concerned that the Commission's Draft Report does not adequately take into account the escalating nature of the problems it discusses.

According to the Intergovernmental Panel on Climate Change (IPCC) human interference with the climate system is occurring, and climate change poses risks for human and natural systems. The IPCC is the leading international body for the assessment of climate change. It was established by the United Nations Environment Programme (UNEP) and the World Meteorological Organization (WMO) in 1988 to provide the world with a clear scientific view on the current state of knowledge in climate change and its potential environmental and socio-economic impacts. In 2013 they released their most recent Assessment (AR5) and a key finding of that Assessment is that, "it is extremely likely that human influence has been the dominant cause of the observed warming since the mid-20th century." [WGI AR5 SPM Section D.3, 2.2, 6.3, 10.3-6, 10.9. Available at: <http://www.ipcc.ch/report/ar5/index.shtml>]

We submit that the impacts of climate change on the frequency and severity of severe weather events must be taken into account when recommending changes to natural disaster funding arrangements. Any budgets recommended by the Commission must forecast increasing costs due to climate change and costs to Government related to increasing lack of insurance and under insurance (due to increasing risk).

Transparency of insurance premiums - mechanism of review for consumer's in relation to insurance premium pricing

Relevant to our specific comments on the recommendations below is the current inadequacy of premium pricing in insurance.

Currently, the only "review" of premiums or insurers' decisions in relation to offering insurance is for a consumer to shop around (see what other insurers are offering). Outside of market forces the only mechanism available is for an insured to make a request in writing under section 75 of the Insurance Contracts Act 1986. An insured can only use section 75 when either their insurance is cancelled or by reason of some special risk relating to the insured or to the subject-matter of the contract, or when the insurer offers insurance cover to the insured on terms that are less advantageous to the insured than the terms that the insurer would otherwise offer.

However, the Act and section 75 provide no guidance as to what information the insurer is obliged to provide in its written reasons, and there is no mechanism for review in the event the decision of the insurer is erroneous or based on incorrect information.

In insurance markets with limited suppliers, competition is not an adequate mechanism for consumers to 'review' insurance premiums. If all insurers are using incorrect data or not taking into account localised factors, then competition fails.

As an alternative, a consumer can make an application to the Financial Ombudsman Service (FOS) who has a very limited decision in reviewing premiums. The FOS Terms of Reference provides:

Clause 5.1 - The service may not consider a dispute:

- b) *about the level of a fee, **premium**, charge or interest rate – unless:*
 - (i) *the Dispute concerns non-disclosure, misrepresentation or incorrect application of the fee, premium, charge or interest rate by the Financial Services Provider having*

regard to any scale or practices generally applied by that Financial Services Provider or agreed with that Applicant; ...

- e) *in the case of a Dispute about a General Insurance Policy – about rating factors and weightings the insurer applies to determine the insured's or proposed insured's base premium which is commercially sensitive information;*
- f) *about a decision to refuse to provide insurance cover except where:*
 - (i) *the Dispute is that the decision was made indiscriminately, maliciously or on the basis of incorrect information; or*
 - (ii) *the Dispute pertains to medical indemnity insurance cover; ...*

In the 2013/14 financial year 38 consumers lodged disputes about insurance cover refusals (under clause 5.1(f)) and were excluded from FOS, and 19 consumers lodged disputes about premiums and weightings and had the dispute refused (see the 2013/14 FOS Annual Report on page 49). The Annual Report does not indicate whether FOS accepted any disputes made by consumers under the above sections.

A review of all of the decisions made by FOS to date shows that 15 determinations have been issued in their jurisdiction about “incorrect premiums”, the majority of decisions relate to consumers being misled.

Significantly, determination number 218234 recognises that an insurer has the commercial decision to increase premiums, but must disclose the basis of the increase beyond providing a general explanation. In our view, this was a good decision of FOS as it enabled a consumer some degree of contestability of an unexplained premium increase when the consumer's personal circumstances (and risk assessment had not changed) and the insurer could not justify the increase in the cost. However, this represents one decision of FOS and has not resulted in any insurers giving reasons on renewals as to increases in insurance costs.

Insurers should not be able to hide behind vague reasons and unsubstantiated assertions about how premiums are priced. They should have to substantiate premium pricing across all forms of insurance. In the home and contents space it is essential.

In our view, the failure of industry to have any mechanism of review of the accuracy of premium calculations is of significant detriment to consumers. This failure also provides no guarantee that any household mitigation strategies or idiosyncratic household conditions are taken into account when determining premiums. Consequently, premium prices cannot be said to be “accurate” signaling of risk as there is no contestability or transparency in their calculation.

A consumer may reject the premium as an inaccurate reflection of their risk, and where there are few insurers in the market place (or they are all relying on the same incorrect information) a consumer may decide to self-insure or be forced to be uninsured not only for the risk of the hazard but for all claims (where they cannot get any level of cover).

If a robust dispute mechanism was in place, creating greater transparency and contestability of premium pricing, the benefits include:

- a) consumers may be persuaded they are at risk, and decide to incur the cost to insure;
- b) consumers may undertake personal mitigation strategies; or
- c) consumers may lobby local government for local mitigation strategies.

In the absence of this information, consumers are in the dark and may be making poor decisions. If they could have a premium pricing decision reviewed by an independent body, consumers may be more likely to believe the risk assessments on their properties.

Specific Comments Relating to Selected Draft Recommendations, findings and information requests

Funding arrangements for mitigation

We strongly support the Commission's comment made on page 22 of the Draft Report Overview that post-mitigation premiums should be subject to some independent review. We support an independent review option for ALL post-mitigation premium changes, in the form of an independent Monitor or an Ombudsman.

Home owners will only be incentivised to undertake mitigation projects on their own properties if there is a corresponding reduction in insurance premiums. Currently there is no independent or regulatory mechanism for private home owners to contest post-mitigation insurance premiums. If an insurer refuses to recognise mitigation strategies undertaken by a homeowner by lowering premiums, or does not lower premiums enough, there must be a way for that homeowner to lodge an independent dispute.

DRAFT RECOMMENDATION 3.2

If the Australian Government reduces the relief and recovery funding it provides to state and territory governments, it should increase annual mitigation expenditure gradually to \$200 million, distributed to the states and territories on a per capita basis. The amount of mitigation spending could be adjusted over time to reflect the imputed 'savings' from reduced relief and recovery funding.

Increased mitigation funding should be conditional on matched funding contributions from the states and territories and best practice institutional and governance arrangements for identifying and selecting mitigation projects. These would include:

- *project proposals that are supported by robust and transparent evaluations (including cost-benefit analysis and assessment of non quantifiable impacts), consistent with National Emergency Risk Assessment Guidelines risk assessments and long term asset management plans, and subject to public consultation and public disclosure of analysis and decisions*
- *considering all alternative or complementary mitigation options (including both structural and non structural measures)*
- *using private funding sources where it is feasible and efficient to do so (including charging beneficiaries)*
- *partnering with insurers to encourage take up of adequate private insurance and private mitigation through measures such as improved information sharing and reduced premiums.*

As stated above in our general observations, we believe there is a direct relationship between consumers taking up adequate insurance and undertaking mitigation strategies that they can identify a correlating reduction in premiums. This can only be done by enabling transparency and contestability.

To date there are no incentives for consumers to undertake any mitigation strategies.

The following case study demonstrates the current lack of any incentives for personal mitigation strategies on a local level. This case study is from our Insurance Law Service email inquiry form in November 2013. Identifying information has been removed for this submission, but the content comes directly from the consumer's email.

Case study

I have a large tree in the backyard which arborists advise will have to be removed soon before it falls down. The cost will be \$6,000-\$7,000. The insurance company has advised that they will cover me if the tree falls on our/our neighbours property and causes damage (very likely) but will not cover me for the preventative work of having the tree removed.

If it were to fall the damage to property would be significant and would far exceed the cost of having the tree removed.

This to me seems totally illogical (sic). Please advise if there are any avenues I can pursue. I was thinking that an official report on the health of the tree might help sway the insurer.

Your advice would be greatly appreciated.

In the above consumer example, the insured had no incentive to carry out the personal mitigation strategy of incurring the cost himself to remove the tree. He was not provided any incentive, such as an assurance of a premium reduction. Insurance policies do not provide any mitigation benefits.

Consumers can recognise some personal risks, but the current premium pricing and competition does not provide any benefits for consumers to take any personal mitigation strategies.

Information

DRAFT FINDING 4.1

The availability of information on natural hazards and exposure has improved significantly in recent years, especially in relation to floods. However, there is scope for greater coordination and prioritisation of natural hazard research activities across governments and research institutions.

We agree with the Finding that greater coordination of research activities related to natural hazards is needed, but we submit that a more pressing concern for consumers is the accessibility of currently available information. It is obvious to consumers that insurance companies make decisions about premium pricing and coverage based on data that they have access to, but that data is rarely made available to customers. Even when customers request reasons why their premiums have increased, it is not common for them to get a complete answer (See above).

The following case study demonstrates the lack of information and explanations that insurance companies and local governments provide to customers about changes to natural hazard risks and insurance premiums. This case study from our Insurance Law Service email inquiry form in early October 2014. Identifying information has been removed for this submission, but the content comes directly from the consumer's email.

Case Study: Failure to share information with homeowners

The Toowoomba Regional council are constructing a 50ML capacity detention basin directly opposite my property. I was advised by my insurer to seek legal advice as to the increased flood risk to my property. The council have assured residents that the basin will not fail or will not flood properties that have never flooded. I am concerned about the future impact on my home and contents premiums. I do not work and would like independent verification that the basin will not result in a reassessment of flood risk in this street.

The council has not released any information about the flooding risk of the detention basin. This is why I contacted my insurer (who recommended I seek legal advice - which I cannot afford). My insurance premium is not due until the middle of next year - but I was concerned about any potential nasty surprises - as in a huge increase - their response was the usual insurance company rubbish about not being able to calculate my premium until it falls due - this detention basin has been in the news for almost a year and construction is ongoing (opposite my house) -so I would be surprised if my insurer knew nothing. This will affect every property in this street.

The consumer in the case study above faces the following dilemma:

- No control over the Local Council's decision;
- Uncertainty as to the impact of the Local Council's decision on her risk;
- Uncertainty as to how the insurer will calculate the risk; and
- There is no way for her to prepare, she is on a low fixed income. Does she need to be saving now for a further premium increase?

INFORMATION REQUEST

If guidelines for the collection and dissemination of hazard mapping and modelling are developed:

- *who would be best placed to develop these guidelines?*
- *what hazards could be covered?*
- *how could guidelines for hazard types be prioritised for development?*

We recommend that a single government clearinghouse website should be developed to collect and disseminate mapping and modelling data. This will ensure data consistency for industry users and a reliable information source for consumers. Consumers do not always trust private insurance companies to provide accurate information about their hazard risks, since it can be seen as a tactic for selling more insurance.

The clearinghouse website ought to have a review mechanism in the event there is any dispute and ought to be funded to ensure it is able to regularly review the information, for example to respond to any emerging local mitigation strategies undertaken in different local areas.

DRAFT RECOMMENDATION 4.1

When collecting new natural hazard data or undertaking modelling, all levels of governments should:

- *make information publicly available where it is used for their own risk management and/or there are significant public benefits from doing so*

- *use private sector providers where cost effective, and use licencing arrangements that allow for public dissemination. Where there are costs involved in obtaining intellectual property rights for existing data, governments should weigh up these costs against the public benefits of making the data freely accessible*
- *apply cost recovery where governments are best placed to collect or analyse specialist data for which the benefits accrue mostly to private sector users.*

We strongly support making all new (and old) natural hazard data available to the public. We recognise that many individual homeowners may not be able to interpret such data, but we do not believe that is a good enough reason to not make this information publicly available.

We also continue to emphasise that currently existing natural hazard data should be made available to consumers when it is relevant to risk levels on their property or on property that they are interested in purchasing. The question becomes who would be obligated to provide this information the vendor or the local council. Currently, providing this information is likely to be outside of a vendor's capability without enough public information available and this is unlikely to be fair onus to place on an individual householder until such time as this risk information is more accessible.

Currently, insurance companies are not required to make this information available to consumers, even when it relates directly to their premium pricing.

As can be seen from the comments above, the information is difficult to contest due to the lack of information available for consumers. In our view, this must have a detrimental impact on competition as insurers accuracy is self ultimately self-regulated.

DRAFT RECOMMENDATION 4.2

State and territory governments, local governments and insurers should explore opportunities for collaboration and partnerships. Partnerships, for example, could be formed through the Insurance Council of Australia and state based local government associations (or regional organisations of councils). Consideration could be given to the Trusted Information Sharing Network model, and involve:

- *governments sharing natural hazard data that they already hold and undertaking land use planning and mitigation to reduce risk exposure and vulnerability*
- *insurers sharing expertise and information (for example, claims data) to inform land use planning and mitigation*
- *collaboration to inform households of the risks that they face and adequacy of their insurance to fully cover rebuilding costs, and to encourage private funding of mitigation through incentives such as reduced premiums.*

We strongly support these Recommendations. Homeowners should be informed of the risks that they face and the adequacy of their insurance to fully cover rebuilding costs. Insurance companies and governments should also collaborate in ways to encourage mitigation through incentives such as reduced premiums.

We additionally recommend that current and future premium pricing must be made more transparent. Homeowners will have no reason to privately fund mitigation strategies if they do not get clear information about what factors have been used to determine their premium pricing. These factors must be transparent, and they must be contestable when a homeowner believes something has been evaluated incorrectly.

DRAFT RECOMMENDATION 4.3

State and territory governments should hasten implementation of the Enhancing Disaster Resilience in the Built Environment Roadmap, including reviewing the regulatory components of vendor disclosure statements. Furthermore, the Land Use Planning and Building Codes Taskforce should consider possibilities for regular, low cost dissemination of hazard information to households by governments and insurers (for example, the work of the Insurance Council of Australia to develop natural hazard ratings at a household level).

We strongly support the Commission's Recommendation to implement low cost dissemination of hazard information to households by governments and insurers such as through council rates notices, rental contracts or insurance renewal statements. We are especially supportive of providing this information through council rates notices since that would help eliminate any suspicion that a homeowners might have regarding hazard information being provided directly through private insurance companies.

We note concern about the Insurance Council of Australia's Building Resilience Rating Tool. If this Tool (once it is made available to the public) does provide accurate and independent information about household vulnerability, it will be a very useful tool for homeowners in assessing their own risk. Unfortunately, there is currently no evidence this tool will eventuate or meet any intended objectives. We are concerned that household data may not be accurate, and will be difficult to contest if it does not take into account individual mitigation and resilience factors of households. We are also concerned that even if the ratings are accurate, that will not ensure that insurance premiums will accurately match the ratings.

Insurance

DRAFT RECOMMENDATION 4.8

State and territory taxes and levies on general insurance should be phased out and replaced with less distortionary taxes.

We strongly agree with this Recommendation.

DRAFT RECOMMENDATION 4.9

Insurers should provide additional information to households regarding their insurance policies, the natural hazards they face and possible costs of rebuilding after a natural disaster. This work could be led by the Insurance Council of Australia to ensure consistency in the provision of information across insurers.

We support this Recommendation with the following conditions:

1. More transparent information needs to be available to consumers about the risk assessment. The information must be:
 - Understandable;
 - Consistent; and
 - Contestable.
2. The information being used by the insurer to make their risk assessment should be available to consumers when their premiums are calculated or changed (at renewal what factor changed from the previous year that resulted in an increase).

For this to be easily understood, insurers should break down the premium price components.

If premium pricing “signals risk”, it is important for consumers to know how much represents their “risk” and how much is the insurer recovering other costs associated with insurance. The insurer needs to understand what their personal risk loading is for their property.

The consumer can then take appropriate mitigation strategies – i.e. if the renovate, rebuild or pressure local government to take local mitigation strategies. Consumers cannot effectively do this if they are not aware as to why they are being priced at a certain level. If a consumer has a high premium due to a high claims history, their premium price will be giving them an unclear messages.

3. There must be a way to dispute or contest in the event a consumer disagrees with the assessment.

Currently Section 75 of the ICA is the only option that consumers have to try to request information about their premiums, but in our experience this option is useless and has not led to FOS having an effective jurisdiction in reviewing the misapplication of premiums. As set out above, there are few decisions and inconsistent decisions.

INFORMATION REQUEST

What is the prevalence of sum insured versus total replacement cost cover in household building and contents insurance policies? Has this changed in recent years? Are there any impediments to insurers disclosing an indicative estimate of the difference between the sum insured and the replacement value of the property?

Are there barriers to insurers recognising property level mitigation through reduced premiums? Where commercial insurers adopt more risk reflective pricing are reinsurers adjusting their prices accordingly?

In our experience engaging with industry and consumers, the prevalence of total replacement cost cover policies is low. This is because it is not being offered.

Almost no consumers in the Australian home insurance market have access to total replacement cost cover, even if they want it and they can afford the premiums.

DRAFT FINDING 4.2

International experience has shown that government intervention in property insurance markets (either through direct provision of insurance or by providing reinsurance) weakens the price signals that insurance premiums send to households and businesses about the level of risk faced. These schemes also create fiscal risks. Governments have had to bear significant costs following large natural disasters because their insurance schemes failed to accumulate adequate reserves.

We are prepared to be bound by the evidentiary findings of the Commission, but we are concerned that there have been no other effective solutions offered in this report to deal with what we consider to be the major problem of non-insurance and underinsurance in certain regions in Australia.

Governments face the financial burden of bearing costs caused by homelessness and increased reliance on social security after disasters if homeowners are unable to afford private insurance. Even if addressing information asymmetries or significant information gaps better aligns insurance prices with underlying risks, this will not fix the problems of non-insurance and underinsurance. There is a looming social problem in

leaving many people with lack of access to insurance with no viable alternatives and the report clearly shows that there is no meaningful public data available on the extent of this problem.

We agree with the Commission that there is an important role for insurers to better target lower-income households through offering a range of insurance products that are better suited to their circumstances, but this will only work if insurance companies take up this role. Historically, there has been very limited engagement of private insurance companies in providing affordable products for lower-income households. Affordable home and contents insurance products has been a key issue for consumer advocates for decades but there is evidence that there is insufficient profit to make product innovation a viable solution.

The Good Shepherd Microfinance report is a good barometer on the issue of low-income insurance. It discusses how the insurance industry has engaged in this area before, but progress has been slow. The disadvantaged and people on low incomes have to some extent been bypassed by a system that concentrates on easier business. The report says that there is still some uncertainty regarding market size and interest for various affordable products.¹

Concluding Remarks

Thank you again for the opportunity to comment on the Draft Report of the Productivity Commission's Inquiry into Natural Disaster Funding Arrangements. If you have any questions or concerns regarding this submission please do not hesitate to contact the Financial Rights Legal Centre on (02) 9212 4216.

Kind Regards,



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¹ The entire report can be accessed here:

http://www.goodshepherdmicrofinance.org.au/sites/default/files/WEB%20VERSION%20Covering%20the%20essential%20-%20Increasing%20access%20to%20insurance%20for%20people%20on%20low%20incomes_0.pdf