National Disaster Insurance Review Submission

Voluntary Insurance – the status quo

From my understanding insurers will soon be able to provide affordable flood cover for the majority of the population (low & medium flood risks), as such this market should be left alone to let market (both consumer & insurer) to decide on the most appropriate cover.

Affordable flood insurance for high flood risk properties is unlikely. Forcing insurers to insure these properties are likely to lead to elimination of insurance competition (insurers exiting the market) and complicated subsidization mechanisms. Instead I would like to propose an alternative non insurance solution:

High flood risk properties – a funding mechanism

I would like to propose a possible mechanism for funding high flood risk properties: individual property flood funds.

Insurance performs two basic functions: pooling of similar risk & long term smoothing of costs. High flood risk property insurance fails on both these functions, similar risks are not pooled (requirement of subsidization) and long term smoothing is not long term (ARI's are below 100 years) hence it is not reasonable to expect the insurance industry to insure these properties.

Due to the frequency of losses any insurance essentially becomes a savings plan. The government could incentivize uninsured/uninsurable to save towards this inevitable risk. The funds would have similar characteristics to superannuation funds:

- funds would be 'preserved' only accessible upon
  - flood/catastrophe event or
  - on sale of property / termination of lease (however the buyer has the option to purchase home + flood fund) or
  - engineer / council / insurer confirmation that a risk mitigation strategy has reduced the flood risk and the fund size can be reduced / homeowner can realize benefit

- funds would receive tax incentives / subsidies from the government to incentivize saving

To assist savers an annual letter to the property owner & occupier could disclose the recommended level of contribution / fund size for the area. This level would represent neither a ceiling nor a floor. How much to be contributed would be at the discretion of the saver. This service could be contracted out by the relevant council.

Under most circumstances this would be an inefficient use of capital however due to the high frequency of events this is no longer the case.

Some benefits of this structure include: -the flood risk is visible as size of the property's existing flood fund would be disclosed during property sale / sales in a similar area would disclose this amount (i.e. no misinformed consumers) -low cost saving schemes (e.g. super) are already available -small business will be more inclined to save as they will get back their money instead of purchasing insurance 'money they will never get back' -the annual letter allows the true living cost to be determined

In the short term the government/insurers could offer limited/ 'funding' insurance. Such insurance programs already exist e.g. insurers offer 'funding' insurance to companies with asbestos exposure where the ultimate cost is borne by the insured.

Low economic consumer & high risk flood property considerations

The low economic demographic cannot afford increases in premiums / would not be able to fund an 'individual flood fund'. Whilst this is true, it is also true that they cannot afford to live in high flood risk areas where they are living beyond their means (the true cost of rents + flood risk is too much for them to bear.)

Any program which allows for individuals to live beyond their means is temporary at best.

The annual letter will make it clear what the recommended level of flood fund contribution is. If this is beyond the owner / occupiers means they should consider selling / exiting their lease. If certain properties are too risky for anyone to afford then no one should live there. If individuals choose to continue to live beyond their means then it is at their own peril.

In addition the effect on the low economic demographic can be mitigated in two ways

- Centrelink can put constraints on beneficiaries moving to high risk areas
  - this is already done in New Zealand (but in the case of beneficiaries moving to low employment areas)
- Any future government bailouts are on the proviso that the uninsured/non saver sells their property / exits the lease and does not return to that area.

Yours Sincerely,
Chris Logan