Key issues and future pathways for home and contents insurance

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Background to the Forum

Climate change is driving a significant increase in environmental disasters and property damage, and the implications for risk and insurance are becoming matters of public debate.

These changes in risk are driving heavy increases in home and contents (H&C) insurance premiums, limiting access to insurance for many. Affordability issues result in non-insurance and underinsurance of households, especially those with lower incomes – yet these are more likely to be the households that can only afford to buy property in higher risk locations. Disasters are crystallising these risks, as increasing numbers of Australians who lack appropriate insurance cover are experiencing traumatic property loss. The operation of the insurance market also poses problems, with complex contracts and information asymmetries between insurers and customers. Apart from those who cannot afford insurance, there are many experiencing the trauma of property loss, only to discover they did not have adequate insurance in the first place.

People living in areas at risk of climate-induced disaster are being forced to play 'climate disaster Russian roulette', unable to afford lower risk housing, but also unable to afford H&C insurance appropriate to their needs.

The Forum was organised recognising the importance of fostering a broad-based, inclusive and open conversation. By bringing together key stakeholders from industry, government, academia and the community sector we aimed to foster new relationships, develop a shared understanding of the issues and bring to light potential solutions.

[1] This paper has been prepared by the event organisers to summarise the issues canvassed at the forum. It should not be read as representing the views of any of the presenters or attendees. The authors are Dr Antonia Settle, McKenzie Postdoctoral Fellow, Melbourne Institute of Applied Economic and Social Research; Dr Emily Porter, Senior Research Fellow, Brotherhood of St. Laurence; and Dr Sandy Ross, Executive Officer, Financial Counselling Victoria.

Forum outcomes

Across the diverse group in attendance, there appeared to be broad agreement around the scale of the problem and the urgent need for solutions. Key insights from the panel discussions are summarised below, including the range of solutions that will need to be explored to ensure insurance can play its part in building a safe and resilient society as the climate crisis intensifies.

This summary aims to broadly reflect the insights shared by expert panellists and guests. However, we do not claim to canvass all issues and perspectives within this complex topic.

The current housing insurance system is not fit for purpose

Insurance is an essential element in preparing for and responding to disasters. It spreads and manages risk and should ensure households have sufficient resources to cover the cost of recovery. It protects people from the impacts of misfortune and accident and underpins resilient responses to disaster.

However, as climate change related disasters devastate multiple locations, our insurance system is being stress-tested beyond its capacity. When entire communities and regions are struck by disaster, and many households turn out to be uninsured or underinsured, it is the wider community, largely through government, that is called on to assist. Thus, these issues of inadequate or unaffordable insurance, if not addressed, will result in increased costs to government, and ultimately to all Australians, while slowing recovery and rebuilding efforts. Finding a way to address these issues concerns us all.

1. Building and development decisions

H&C insurance is the last step in the risk management process, preceded by decisions made by governments (federal, state and local), planners, developers and the building industry, banks and consumers. As hazards from floods, storms/cyclones, bushfires and coastal surges/beach erosion increase in geographic scale and intensity, more and more houses are shown to be in hazardous areas; yet building developments are continuing unabated in many such areas.

Informed decision making on development, building and purchase of property

There seems to be general agreement that government leadership is needed to coordinate, establish and enforce requirements for transparent sharing of information on current and emerging climate risks and what they mean for specific locations. This information needs to flow to all key stakeholders: insurers, developers and local councils, as well as consumers and banks and lending institutions. It also needs to be incorporated into improved building standards for more resilient housing stock.

At present planners often don’t consider climate risks in approving new developments, in part due to limited government guidance on accepted risk levels and agreed climate scenarios. Some councils even bury risk information out of fear of its impacts on property prices. Open sharing of information about risk and taking account of that risk in decision making at every step in the property chain is required to protect households from exposure to significant disaster risks. It will also give insurance price signals a chance of working as a risk management mechanism.

Mitigating risks for existing communities

The Productivity Commission found that for every 97 cents spent on clean-up and recovery after a disaster in Australia, only 3 cents is spent on prevention, indicating there is considerable scope to increase prevention and mitigation efforts, with the prospect of reducing overall costs of disasters.

Reducing household and community risk through adaptation and mitigation will be important for protecting existing communities, particularly where focused on the highest risk homes. Improved data access, quality and use could inform where the following types of interventions would be appropriate:

- Retrofitting homes where possible to make them more resilient in the event of disasters. Retrofitting was used successfully in WA to protect homes against cyclones. Its effectiveness in managing other perils requires more research and piloting.
- Mitigations with infrastructure (e.g. levees and seawalls) or natural assets (e.g. mangroves to limit storm swells). In Roma, lifting the levee substantially reduced premiums: high-risk households saw their premiums fall by up to 95%. However, these measures can shift rather than remove risk, as observed in Lismore, especially where there is limited data about potential risk scenarios.
- Managed retreat and buy-backs in areas that are too risky for inhabitants, as being trialled in parts of flood-impacted Queensland.

2. Insurance premiums

Four perils are responsible for the majority of insurance risk in Australia – flood, storm, bushfire and coastal strip risk. Of these, flood is the most significant, followed by storm/cyclone, bushfire and coastal strip risks (including beach erosion and storm surge). Such events are likely to create risks to life, and destroy whole homes or force long displacements, leading to very large insurance claims. Climate change is making these events more likely and more costly, reflected in sharply rising insurance premiums and increasing insurance affordability problems, particularly for low-income households or those in, or at risk of, financial stress.

Previous efforts to improve insurance access for consumers have focused on availability (e.g. access to flood insurance), but affordability and adequacy are now the greatest challenges. Many households, especially vulnerable households, are now opting out of insurance altogether, cutting essential cover like flood insurance or reducing the amount of cover.

Where a home is uninsured or underinsured, the risk of weather-related disaster is transferred from insurers to the households, with implications for property values. Steeply rising premiums similarly may impact negatively on the value of homes in some locations. Homes that become effectively uninsurable are at risk of becoming stranded assets, which homeowners cannot sell without realising significant financial loss.

Rising premiums can also impact house values, which may make finance difficult to secure in some regions (as already seen in northern Australia). This imposes risk on individual homeowners as well as the financial system as a whole, given that homes supply the underlying collateral for mortgage debt and hold around half of Australia's wealth. Some of these risks also flow through to the mortgage lenders, mainly the banks.

Poor data makes it hard to understand the scale of these challenges. However, it is clear that risk is highly skewed. Currently, a relatively small proportion (one estimate is 2–4%) of the total housing stock is driving the growing cost of payouts, pushing up premiums for the market as a whole through the high costs incurred for total loss. At the same time, a much larger percentage of homes are at significant risk of fire and flood damage. Without interventions to reduce risk, these proportions (both homes at risk and insured homes lost) could double by 2050 as the impacts of climate change intensify. Although there is variation between states, taxes on insurance products tend to be scaled with underlying premiums, further increasing insurance costs for high-risk homes.

Premium costs and uneven spread of risks
Uneven risks across different regions and homes, along with uneven incomes, create a situation where premium costs have uneven impacts. Many higher risk homes are older housing stock that poses a legacy issue. Households that have long been established in now at-risk locations may be hesitant to move, due to social and economic ties. For vulnerable community members, including frail older people or people with disability who may rely on local networks, relocating could mean loss of care and support. For others, economic constraints may limit access to affordable housing in less risky locations.

3. Vulnerability of low-income households

As increasing numbers of people on incomes below the median are priced out of 'safer', more expensive locations and have to buy less robust housing in new, cheaper developments in risky areas, we are seeing an intensification of property and life risks for those least able to afford high insurance costs. Households may be unaware of the risks in certain locations, or simply unable to avoid them. Mortgage approvals exacerbate this, as banks commonly base lending approvals on the asset price without consideration of the disaster risks or the impact of insurance costs on the borrower.

Many households (WEstjustice estimates up to 45% of Victorian households) are experiencing mortgage stress, in the context of high household debt, interest rate increases, falling real wages and a steep rise in the cost of living. In households going without essentials such as food or medicines to keep paying the mortgage, insurance quickly becomes a low budget priority.

Anglicare polled 600 households in Bega, NSW, affected by the bushfires, which showed only half had adequate insurance, with 25% having no insurance at all. Many of those under- and uninsured households have low incomes. However, data gaps make it hard to assess the overall scale of under- and non-insurance.

4. Consumer protection failures in the insurance market

Consumers are forced to bear the risk of accurately estimating the replacement value of their home and contents, despite having little access to relevant knowledge or expertise. At the same time, the insurance companies have considerable knowledge of complex issues such as building materials and labour costs, planning overlays and the implications of Bushfire Attack Level (BAL) ratings for rebuild costs. Despite this, almost all insurers decline to offer total replacement cover[2] insurance options. These challenges reflect the power imbalance between insurers and consumers, which is a major concern for consumer groups and financial counsellors. The *Insurance Contracts Act 1984* (Cwlth) has not been substantially reviewed since the 1980s; and its standard contract provisions are outdated and not regularly used by industry. A robust review of the Act could explore reinvigorated standard contract provisions to require a total replacement cost cover option at an affordable cost.

Another consumer rights issue linked to underinsurance, information asymmetry and risk transfer is the excessive use of rapid cash settlement offers by insurers in dealing with customers affected by disasters. For example, rebuilding costs often shift around and only become clear some time after a disaster, as residential building standards are made more stringent, and rebuilding efforts push up demand for material and labour. Many consumers are shocked to find a significant gap between their rebuild costs and the amount they settled for in cash from their insurer shortly after the disaster. Financial counsellors dealing with Gippsland bushfire survivors estimated that 90% had no

[2] Most housing insurance policies provide cover to a fixed sum specified by the customer, rather than total replacement cover.

idea about BAL ratings, raising questions about how informed they were in making decisions on insurers' cash offers (or how much to insure for). Research has shown many people lodging an insurance claim are in a state of trauma due to the loss of their home. They are seldom in an appropriate state of mind to assess and properly understand the implications of a cash settlement of their claim. Yet there are pressures on those impacted by disaster to go for the certainty and sense of progress created by acceptance of cash offers. More information on the proportion of homeowners accepting cash settlements and their reasons for doing so is required.

One barrier identified in relation to insurers providing clearer information to customers was the regulation preventing insurers from providing individualised financial advice. However, the implications of removing that regulation were not explored in the discussion.

Consumers lacking trust in insurers

These practices have eroded trust in insurers. Financial counsellors report many claimants feel betrayed by their insurers once they discover that, despite acting in good faith as longstanding customers, they do not have adequate cover for a crisis. Some find out they have not been covered due to technicalities in the contract (e.g. unclear property maintenance requirements, or prohibitions on running a business from a property) or having relied on insurance company tools that did not provide an accurate estimate of rebuild costs.

There are also problems being reported with how insurance companies deal with claimants. Suncorp reported implementing dedicated training and work with staff to increase sensitivity in responding to vulnerable customers to address these concerns, but this approach does not appear to be widespread. The high level of stress and mental health impacts for families making a claim in the aftermath of a disaster highlights the need to include consumer advocates in policy discussions.

Increasing number of renters left out of insurance conversation

Housing affordability and poor information pose a distinct set of issues for renters. Renters may have contents insurance but often have limited information on the location risks or whether the house they are renting is insured. Renters make up around 50% of households in the high-risk NSW Northern Rivers region and need to be included in development of solutions. Improving minimum building standards for rental properties would improve the resilience of some rental properties to climate change and would decrease the risk borne by renters.

Pathways to a protected and resilient society

The forum in its latter stages moved to discuss solutions. Panellists and audience members identified a broad range of potential actions to improve access to insurance, reduce underinsurance and minimise risk to families, communities and the broader economy, though many of these are subject to debate. Possible actions are outlined below.

More coordination and leadership to reduce new risks

- Ensure that new developments in high-risk areas are avoided and that new housing stock will withstand climate-related risk, by increasing coordination between all levels of government, developers, insurers and banks. Including consumers and consumer advocates in these discussions is important.

Improved data availability, sharing and usage

- Collect and share more data on risks and existing assets to inform policy, and develop clearer policy guidance for planners and local government. This includes state and federal

government setting agreed climate change scenarios and acceptable risk levels to guide local planners.
- Harmonise acceptable risk levels and assessment standards across states and improve availability of data for all stakeholders. This would address hesitation from some councils in sharing data on risk due to backlash from homeowners.
- Consider the potential for an asset register or database drawing on existing local government and industry data to better understand existing risks and the opportunities for mitigation, particularly in high-risk areas. This would need to be actively managed to ensure consistency and update records when assets are retrofitted or ratings change.

Improving the functioning and fairness of the insurance market

- Make regulatory changes to expand offer of 'standard cover' and 'replacement value' products to shift the risk of underinsurance away from customers; and improve consumer information to make the operation of insurance contracts fairer.
- Encourage insurers to work with consumer advocates to develop innovative products (e.g. products that recognise and reward customers who make their homes more resilient).
- Consider regulatory changes that would allow insurers to provide certain types of financial advice to consumers.
- Increase investment in identifying and supporting vulnerable customers and settling claims fairly and without undue delay.
- Improve data collection and reporting of cash settlements.

A bigger role for banks

- Urge banks to consider the cost of insurance when approving future finance, to limit mortgage exposure in high-risk areas; and to consider support options for legacy households unable to afford insurance costs.
- Consider options to enable mortgage lenders to consistently check that H&C insurance is obtained and maintained by mortgage holders.

Better land use planning, mitigation and adaptation to reduce risk

- Close the current gap between land use planning and insurance decisions, which leaves insurance as a bandaid solution after risky developments have been built.
- Improve building standards, including those for existing rental properties, so that homes can better withstand weather events, reducing the overall impact of climate risk.

Other government action options

As the impacts of climate change, cost of living pressures and high housing prices combine, it is clear that appropriate insurance is likely to remain unaffordable for many households. Various potential government interventions were raised, including:

- Develop options for managed retreat, buybacks and mitigation infrastructure in high-risk areas, funded by taxpayers.
- Expand the Northern Australia re-insurance pool to other locations and perils and build on the re-insurance pool framework to incorporate improved incentives for mitigation and adaptation activities and better address the needs of vulnerable households. Many panellists thought that any reinsurance pool should have a limited life span, recognising it is most appropriate to use as a tool to support resolution of legacy issues, in conjunction with other reforms being discussed regarding mitigation and prevention.
- Explore options for direct subsidies, with limits based on targeting, or use of a grandfather clause to focus on legacy homes.

Insurance as an essential service?

As the forum drew to a close, various participants raised the social role insurance plays in protecting communities and sharing risk-related cost burdens. Is it, or should it be treated as, an essential service? If it is, then what implications does that have for addressing access and affordability?

Insurance comes in many forms; and leaving insurance to the market does not always deliver the social and economic benefits sought by the community (or policy makers). There are many examples of compulsory government provision, public options and complex cross subsidisation, such as in compulsory third-party accident cover, health insurance and work cover. Subsidies are one way of adapting market-based insurance provision to protect vulnerable households. However, designing subsidies also needs to limit perverse outcomes such as exacerbating the concentration of low-income households in the most at-risk locations.

There are many unresolved questions about how policies such as subsidies and risk reduction through mitigation, adaptation and buy-backs should be funded. Answering these questions will be challenging. However, the costs of managing the impacts of climate change should not be borne by those with the least resources; the needs of vulnerable households should remain a key consideration. Moreover, policy to reduce insurance costs must not be separated from the broader need to limit the risks of climate change by working to keep average temperature rises to 1.5 °C. This will require sharply reducing carbon emissions by 2030, including a fast withdrawal from fossil fuel use.

Next steps

The forum highlighted the need for coordinated and fast action on H&C insurance issues and the value in bringing together diverse stakeholders to find solutions.

To this end, we are inviting interested attendees/stakeholders to indicate their interest in helping to organise/attend/support a follow-up forum in the first half of 2023.

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