Flood of insurance questions

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The Queensland floods of 2011 and 2013 have highlighted the issue of insurance affordability. Photo: GLENN HUNT

Flood insurance has been a vexed issue for the insurance industry and homeowners for at least 40 years. Historically, insurers have excluded flood from homeowners' policies.

They did so by introducing the idea that the source of water damage was relevant to the insurance cover such that riverine flooding, that is water inundation from a rising river, would be excluded but water damage from rain or storm would be covered. For most, this is an arcane definition, especially when in many cases it is a matter of opinion and professional judgment by hydrologists as to the source of the water.

There are about 6 million homes in Australia and about 450,000 are subject to material flood risk. Of these, about 300,000 have low to medium flood risk. The other 150,000 are high risk, that is within the one in 100 year flood zones.

In the Wollongong floods in 1998, community outrage led NRMA Insurance's board at the time to grant cover to its policyholders, even though its policies actually excluded flood. The insurance industry has made subsequent efforts to provide more flood cover and, by 2008, several companies had done so.

The test came, however, with the Brisbane and Ipswich floods in January 2011 when many properties were deemed to have suffered riverine flooding and were not covered.

The subsequent controversy, of which we have all been reminded so vividly in the past week or two as floods have recurred in Queensland and northern NSW, stimulated the commonwealth government to examine disaster insurance in depth, looking for a solution to the availability of flood insurance and its affordability.

The insurance industry also reviewed its position: the availability of flood cover expanded exponentially in 2012 and most homeowners now have flood cover (and in most cases at no cost because there is no material risk). But it has also made the affordability problem highly visible.

The government's Natural Disaster Insurance Review (NDIR) of 2011 concentrated much of its efforts on trying to identify solutions to the affordability problem. Incidentally, affordability in this context should not be thought of as the means to pay because it is not really a social welfare question but a property protection question. Affordability should be approached by considering what is a reasonable price having regard to the price previously paid without flood insurance.

Affordability also should be seen as a legacy problem that does not apply to people who build new homes in flood zones. There are many homes that were built in flood prone areas years ago where local councils opened the land for development but should not have.

The floods of January 2013 have brought the affordability question into sharp relief. With the availability problem now essentially solved, there are many flooded homes where the owners were offered flood insurance but declined to buy it.

It is no surprise that those for whom the price is highest are those who needed it most but did not buy it.

Reducing flood risk and thence insurance premiums has to be a priority. Greater investment in flood risk mitigation clearly is worthwhile but such initiatives take time and do not deal with the affordability problems of today.

If affordability is accepted by the community and by governments as a genuine problem, then someone has to pay something to solve it. How then might it be tackled?

Could we have cross-subsidies by all insured homeowners to those in flood prone areas – an unpopular idea widely seen as inequitable?

Or local councils bearing the cost – they would then have to levy their ratepayers who are the very homeowners who couldn't afford insurance in the first place?

Could we have a US style flood or windstorm scheme – not only do some of them draw heavily on taxpayer funds but they have encouraged more people to build and own homes in flood zones and windstorm areas?

Or could the government pay subsidies to insurance companies – and in most years when there are no major floods, the subsidies would fall to profits for shareholders?

The NDIR panel explored all of these possibilities and more. It concluded the optimal solution is a system where prices for flood risk are discounted, temporarily and in a manner carefully constructed to preserve proper incentives.

Part of the flood risk would then be held by insurers and part accepted by the federal and state governments. Only in years when there are major floods, such as 2011 and 2013, would the governments bear any costs.

This approach is not only the lowest cost way to assist homeowners in higher flood risk areas to gain insurance but because government payments would be made only in major flood years, governments would have the ability to restructure and redirect other forms of disaster relief payments towards those who are insured, thereby mitigating their own costs.

The government is yet to take a position on the affordability question but the recent floods emphasise the community interest in it.

■ *John Trowbridge chaired the 2011 Natural Disaster Insurance Review*