



Association of Building Societies and Credit Unions

22 July 2011

Mr John Trowbridge  
Review Panel Chair  
Natural Disaster Insurance Review  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Sent via: [NDIR@treasury.gov.au](mailto:NDIR@treasury.gov.au)

Dear Mr Trowbridge

### **Natural Disaster Insurance Review**

Thank you for the opportunity to comment on the Natural Disaster Insurance Review – inquiry into flood insurance and related matters.

Abacus – Australian Mutuals is the industry association for Australia’s mutual banking institutions: credit unions and mutual building societies. Abacus represents 101 credit unions and 8 mutual building societies. Some 4.5 million Australians are members of a mutual banking institution

Credit unions and mutual building societies provide a full range of retail banking services, including home loans, personal loans and credit cards. All credit unions and mutual building societies are Authorised Deposit-taking Institutions regulated by the Australian Prudential Regulation Authority and are licensed and subject to the requirements of the National Consumer Credit Protection Act, including the responsible lending requirements.

### **General comments**

The scope of this submission is limited to the issues raised in chapter 14 of the issues paper however we provide the following general comments.

Abacus supports efforts that improve availability and affordability of householder insurance cover for floods and other natural disasters.

According to the issues paper, some 15 per cent of home and contents insurance claims relating to the Brisbane flood were denied and that the majority of these related to flood exclusions in home insurance policies. This does suggest improved consumer awareness is warranted in relation to insurance matters.

While this is an issue for the insurance industry to respond to, Abacus sees merit in developing a consistent, plain English definition of the term ‘flood’, and improving the disclosure of insurance policy limitations.

By addressing these issues, Abacus believes consumers can make more informed decisions about their insurance needs.

In the recent aftermath of the Queensland floods and Cyclone Yasi, Abacus members were quick to respond by offering those hardest hit with 'repayment holidays' and other concessions while people recovered from these events.

In line with our sector's consistent market-leading performance in customer satisfaction ratings, mutual banking institutions continue to respond quickly and compassionately in times of natural disasters.

*What level of responsibility do lending institutions have toward themselves and toward their home mortgage customers for the purchase of insurance?*

Abacus contends that lenders should remain free to determine, on a commercial basis, how best to manage their home loan risks.

As such, Abacus would not support additional prescriptive measures in terms of compulsory flood cover for home lending.

Abacus believes that customers are solely responsible for ensuring that they acquire and maintain appropriate insurance coverage that meets their contractual loan obligations.

Given the issues paper advises some 94 per cent of Australian homes are not exposed to flood risk, Abacus cautions the Review Panel against recommending compulsory flood insurance coverage for all Australian homes.

Such a move would be a disproportionate policy response to an issue that affects about six per cent of Australian homes, in varying degrees, from very high risk of flood to a minimal flood risk.

Further, according to the issues paper, 2.2 per cent of mortgaged properties were uninsured in May 2007. The impact on lenders could be significant if they were compelled by law to enforce their contractual right to demand insurance cover from these customers who are otherwise meeting their obligations to the lender.

*What level of responsibility do lending institutions have toward themselves and toward their home mortgage customers for the scope of insurance cover, and in particular whether it includes flood cover?*

As a standard condition of their home loan contracts, Abacus members require insurance cover be taken over the secured property, by the customer.

Abacus members rely on property valuers to provide an assessment of environmental issues, including flooding, that might pose a risk to a secured property at the time of settlement.

If an Abacus member becomes aware that flood poses a risk to a secured property, the member would insist on specific flood cover being taken out by the customer.

To promote better awareness among lenders and customers of flood risks, Abacus supports measures that deliver improved, publicly available flood risk data.

We believe the customer is responsible for understanding all inclusions and exclusions contained in their insurance policy, particularly with respect to flood and other disaster events.

As such, members do not review the contract of insurance taken out by their customers, other than to confirm the replacement value of the property is included in the policy and that the member's interest in the property is noted on the policy.

Generally, if Abacus members become aware of specific exclusions in a particular home insurance policy, they advise their mortgage customers accordingly at the time the loan is being taken out.

*What level of responsibility do lending institutions have toward themselves and toward their home mortgage customers for the quantum of insurance?*

Customers must adequately insure their property for an amount at least equal to the replacement cost provided on the valuation report at the time of settlement.

As noted previously, customers are solely responsible for ensuring that they acquire and maintain appropriate insurance coverage that meets their contractual loan obligations.

*What level of responsibility do lending institutions have toward themselves and toward their home mortgage customers for the continuity of insurance during the life of the mortgage?*

Adequate insurance coverage over the secured property must be taken out at the time of settlement, and be maintained for the life of the loan.

Given the Abacus membership ranges from small institutions with \$10 million in assets, to individual members with some \$8.5 billion in assets, the mutual sector manages the issue of insurance continuity in two distinct ways.

Smaller members undertake an annual review of their home loans to ensure insurance continuity. As part of this process, customers are requested to provide the lender with a certificate of currency of their insurance contract. This internal review process is relatively straight forward, and generally does not require significant resources for a small lender with only a few hundred loans on its books.

At the other end of the membership spectrum, some Abacus members manage tens of thousands of home loans. These members have made the commercial decision not to review their loans with respect to insurance currency. Larger mutual limit their annual insurance review to commercial loans, and other loans that exceed a certain value threshold.

These members manage risk to secured property by taking out 'Innocent Mortgage' insurance policies to cover losses, such as from fire, where the mortgagor does not have insurance cover.

This risk mitigation strategy is limited in that losses arising from floods are not covered, however this strategy remains more commercially attractive than undertaking annual reviews.

We believe compulsory insurance reviews by lenders would be time consuming, costly and incomplete given some customers refuse repeated requests to provide evidence of insurance coverage.

Should compulsory insurance reviews be imposed on lenders, one Abacus member estimates the systems changes needed to review of 40,000 home loans and 16,000 motor vehicle loans would be in excess of \$3 million.

In addition to increased compliance costs for some members with compulsory insurance reviews were introduced, a challenge for all lenders is how to manage customers that ignore requests to provide evidence of insurance?

This issue becomes particularly where loan payments are up to date but the loan contract has been breached by not providing the lender with evidence of insurance.

Generally, most mutual loan contracts have provisions that enable the lender to take out insurance of the secured property, at the cost of the customer.

Abacus would seek to ensure this option not be mandated by new regulations. We submit that lenders maintain the discretion to compulsorily take out insurance at the cost of the customer, as an option of last resort.

Another challenge arising from an annual insurance review is to determine whether a policy remains current, and has not been cancelled, from one annual review to the next. We contend that it is reasonable to expect some customers could provide a certificate of currency for flood insurance to meet their obligations to the lender, then cancel the policy soon after. An insurance policy may be cancelled, for example, because of the general cost of living pressures on a family, or the perceived expense of taking out flood cover.

#### *Third party insurance reviews*

The issues paper notes that in the United States, private sector firms are engaged by lending institutions to confirm whether home loan customers have taken out flood insurance. If a customer does not have current flood insurance, the lender takes out cover on behalf of the customer and charges the cost of the insurance back to the customer.

The model used in the United States will increase costs for lenders and customers, it denies the customer choice of coverage (or self insurance) and introduces an added layer of red tape.

It is for these reasons we believe such arrangements are not suitable for the Australian context, and we oppose a similar scheme being forced on Australian lenders.

Please contact Jim Aliferis on 02 8299 9033 or [jaliferis@abacus.org.au](mailto:jaliferis@abacus.org.au) to discuss any aspect of this submission.

Yours sincerely



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