Addressing non-insurance and underinsurance for emergencies in Victoria

Discussion Paper
April 2017

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This document was drafted by the Department of Health and Human Services in partnership with the Victorian Council of Social Service and was released on 13 April 2017.

Contents

Foreword

This discussion paper is part of a joint project of the Department of Health and Human Services and the Victorian Council of Social Service. Both organisations, and their many partners, are involved with the recovery of individuals and communities after emergencies such as fires and floods, whether large or small, affecting one or many households.

The vision for emergency management in Victoria is "safer and more resilient communities". In relation to recovery, the primary responsibility for replacement or reinstatement of damaged or destroyed lifestyle assets such as homes and contents lies with the individual.

One of the key aspects of resilient communities and households is the capacity to restore their lives after significant loss, which for most people means holding insurance, which can reduce the financial and emotional burden.

There is some post-emergency government financial assistance routinely provided for people by the State and Commonwealth under the Natural Disaster Relief and Recovery Arrangements. However, this re-establishment assistance is unlikely to be sufficient to replace a significantly damaged home and/or contents, and may only be available to people on low-incomes.

It is evident that many people, in particular low-income households, and many in high-risk areas, do not carry any or sufficient insurance to support their recovery. After an emergency they may be unable to restore their previous lifestyle, and can descend into poverty.

While on occasion charitable fundraising does provide financial assistance, this tends to occur only after the biggest high-profile emergencies where large funds are distributed.

Recent changes to the eligibility requirements for personal hardship assistance payments emphasise the need for people to hold appropriate insurances.

This discussion paper is a step towards the development of a cross-sector strategy for presentation to the Victorian Government with recommended actions to address the problem of property loss – home and/or contents – following emergencies. The paper looks at uninsured and underinsured households.

I also acknowledge the recent release of *Uninsured Australia – The case for not-for-profit insurance* report from the Brotherhood of St Laurence's Financial Inclusion Program. It is encouraging to see the active engagement of the not for profit sector with these important issues.

On behalf of the department and the Victorian Council of Social Service, I invite you to read and reflect on the issues explored in the paper and provide your thoughts and feedback on them or on other ways you consider the problem can be tackled.

Melissa Skilbeck
Deputy Secretary, Regulation, Health Protection and Emergency Management
Department of Health and Human Services

1. What is this discussion paper about?

The Department of Health and Human Services has committed to leading the development of a Victorian Government strategy to address non-insurance and underinsurance among Victorians most at risk of unrecoverable financial loss following an emergency.

Responses to this discussion paper will contribute towards a cross-sector strategy for presentation to the Victorian Government with recommended actions to address the problem of property loss in emergencies.

In particular, the Victorian Government is interested in **the most disadvantaged, low-income members of the community that can least weather the cost of emergencies**. This strategy will contribute to the desired outcome for Victorians to have suitable and stable housing, as well as financial security.

The Department of Health and Human Services (the department) will develop the strategy jointly with the Victorian Council of Social Service (VCOSS), in recognition that the issue of insurance is broader than emergency management, that the community sector has significant knowledge of financial issues affecting low-income people, and that community-sector organisations have a history of engagement with finance and insurance providers.

While the strategy is expected to include options for government action, it is clear that likely action by a state government alone will not resolve the problem. As a cross-sectoral issue, the solutions sought will require involvement from the key sectors involved – the insurance, finance, consumer advisory and community sectors and government at all levels.

Through this discussion paper, we are seeking your views on non-insurance and underinsurance within at-risk groups most vulnerable to financial shocks, the different barriers to insurance within these different groups and the opportunities to improve coverage and reduce the risk of unrecoverable losses from an emergency.

Insurance

In this paper, ‘insurance’ refers to cover for the structure of a dwelling (**building insurance**) and for the contents of the dwelling **(contents insurance**). While these policies are often purchased together, they are distinct and can be considered separately. In general, renters do not need building insurance, as the building is the owner’s responsibility. Likewise, owners corporations usually insure the structure in strata titled buildings or developments, and specific policies exist for that market. Building insurance policies also vary in their details. They may or may not cover outbuildings and fences, clean up and the costs of emergency accommodation.

Expert Workshop

As part of the project to develop the strategy, the department and VCOSS held an expert workshop in late 2016 involving the insurance industry, community sector organisations, academics, state and local government to:

- understand the existing work and programs underway that helps to reduce the exposure of at-risk groups to loss
- identify drivers of people who are uninsured and underinsured and opportunities to improve insurance coverage

As an outcome of the workshop, several **key themes have emerged that form the structure of this discussion paper**:

1. The problem: financial loss and emergency recovery
2. Financial resilience and inclusion
3. Risk awareness
4. Cost and affordability
5. Consumer trust of insurance products and industry
6. Consumer financial literacy, and understanding of the role that insurance plays
7. Market failure

Although not their own themes, ideas around collaboration and the consideration of insurance coverage across different demographics should form part of the discussion around each of the six themes.

Ideally, collaboration between government and other stakeholders including the insurance, finance, consumer advisory and community sectors will underpin any strategy to improve insurance coverage. This is also true in relation to considering rates of uninsured and underinsured within at-risk groups, the different barriers to insurance within these different groups and the opportunities to improve coverage and reduce the risk of unrecoverable losses from an emergency.

Following a discussion of each theme, the paper poses a number of questions to elicit the views, ideas and potential opportunities that you are invited to propose through the consultation process.

2. The problem: financial loss and emergency recovery

Following an emergency, material and financial loss is a significant issue. Homes and contents can be fully or partially destroyed or damaged. Affected households may need to pay rent on top of the cost of rebuilding, and household savings and government grants may be insufficient to cover the cost of rebuilding and replacing contents.

This is especially the case for those more vulnerable to financial shocks. For example, those on low incomes, who are also less likely to be adequately insured. Although other measures such as risk reduction are vital, the uptake and adequacy of **insurance coverage among low-income Victorians** is the central problem this discussion paper is seeking to explore, noting that some themes relate to insurance in general where change could benefit all Victorians.

What is insurance and what are its benefits?

Buying insurance allows people to pay an annual premium to avoid the possibility of paying a much larger amount later should the potential loss they are insuring against be realised. The cost of the annual premium is usually a small fraction of the cost to replace the asset. Policyholders pay their premiums into insurance pools, managed by professional insurance managers, in order to spread the total risk of loss across all the policyholders, most of whom will not suffer loss and make a claim in the relevant year.

The level of the premium is related to both the amount insured and the likelihood of damage in that year to the insured assets from specified causes. In areas where premiums are relatively high due to elevated risk levels, they can operate as a price signal potentially encouraging individuals, communities and even governments to reduce risks through such activities as floodplain management.

The availability and penetration of insurance is thus a key aspect in fostering resilient communities; without insurance, householders must bear the costs of recovery themselves, or rely on government assistance and public benevolence.[1]

Level of insurance coverage

There have been a number of reports in Australia that provide some data on the extent of uninsured and underinsured in Australia, including among low-income groups.

In 2014, the Productivity Commission published key results of various studies into the extent of uninsured and underinsured in Australia. These are shown below.

Evidence of uninsured and underinsured among householders

- The Australian Securities and Investments Commission (ASIC 2005) reported that recent surveys suggested that between 27 per cent and 81 per cent of consumers were underinsured by 10 per cent or more against current rebuilding costs. In addition, it reported that 40 per cent of houses destroyed in the 2003 Canberra bushfires were underinsured relative to the replacement cost.
- Tooth (2012) surveyed 1200 households and found that about 9 per cent did not have building and contents insurance and about 39 per cent did not have contents insurance.
- Tooth and Barker (2007) estimated that 4 per cent of owner-occupied households in Australia lacked building insurance and 12 per cent of owner-occupied and 67 per cent of rental households lacked contents insurance.

[1] Mortimer, E, Bergin, A & Carter, R 2011, *Sharing risk – Financing Australia's disaster resilience*, Australian Strategic Policy Institute Special Report, February, Issue 37, pp. 3-4.

- Insurance Australia Group, using NRMA claims data, found that 35 per cent of residents affected by the 2013 Blue Mountains bushfires were underinsured.
- Collins (2011) studied building, contents and vehicle insurance for people on low incomes and found that 32 per cent did not have building and contents insurance.
- The Bushfire and Natural Hazards Cooperative Research Centre and Bushfire Cooperative Research Centre conducted surveys following fire events in New South Wales, Victoria and Western Australia. Across the surveys, they found that about 13 per cent of households were not insured (BNHCRC, sub. 41).
- A study of Charleville and Mackay (Queensland) after the 2008 floods found that 32 per cent of residents and 57 per cent of businesses had flood cover (Apan et al. 2010).
- Quantum Market Research (2013) conducted a household survey and found that 83 per cent were underinsured for their building and contents based on the definition of underinsurance as 'any person who cannot resume their same standard of living in the event of a crisis'. About 4 per cent of home owners did not have building insurance and 7 per cent did not have contents insurance. [2]

In 2016, the National Australia Bank (NAB) and the Centre for Social Impact in *Financial Resilience in Australia* noted that 8.7 per cent of Australians have no access to any type of insurance, and 9.7 per cent express having an unmet need for insurance.[3]

A snapshot of the uninsured and underinsured

As part of this project, the department also engaged the market research company Essence to provide a market snapshot of insurance levels in certain high risk areas in Victoria, and derived the following results based on a survey of 907 Victorians aged 18+ (October 2016) interviews and focus groups:

- 46 per cent were fully covered and insured to the right value (as determined by the respondent)
- 28 per cent were underinsured (in terms of value or appropriate coverage or both)
- 26 per cent were not insured. Of that 26 per cent, 72 per cent met the department's definition of low-income
- Beyond this, the uninsured:
  - are often renters (52 per cent of renters have no contents insurance)
  - frequently move house (in 49 per cent of cases the uninsured had lived in the house less than 3 years and in 66 per cent of cases they had moved twice in the past 10 years)
  - aged between 18-34 (63 per cent of uninsured), receive benefit payments or government income support (27 per cent)
  - Recent migrants where English is not a first language are also likely to be less insured.[4]

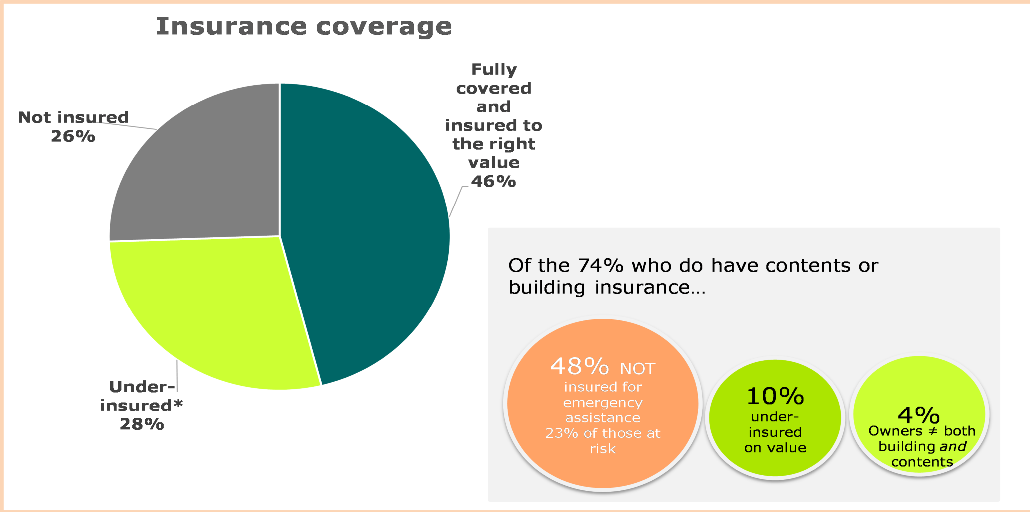
[2] Productivity Commission 2014, *Natural Disaster Funding Arrangements*, Inquiry Report no. 74, Canberra. Vol 1, p. 448.

[3] Muir, K, Reeve, R, Connolly C, Marjolin, A, Salignac, F & Ho, K 2016, *Financial Resilience in Australia* 2015, Centre for Social Impact (CSI), University of New South Wales for National Australia Bank. p. 4.

[4] Essence Communications 2016, *DHHS Underinsurance Research – Topline Findings,* October.

These results are illustrated on the following chart.

Insurance Coverage



Source: Essence Communications, *DHHS Underinsurance Research*: *Topline Findings* October 2016

It is quite evident that levels of underinsurance and especially non-insurance are higher among those Victorians who have the fewest personal resources available to recover following an emergency.

Low levels of adequate insurance coverage among low-income Victorians affects a range of stakeholders, not least of all the low-income uninsured.

Communities affected by emergencies, all levels of government, the community sector and the insurance industry (not least from an underinsurance perspective) also have an interest in addressing the issue.

Effects of the problem

Good Shepherd Microfinance, in its 2013 report *Covering the essentials* noted that a lack of adequate insurance leaves those most vulnerable at risk of losing assets that they might not be able to replace. This is particularly concerning given that natural disasters (as well as other risks like unemployment, the death of a breadwinner, permanent disability, business failure, and theft) were the main events that could tip people into poverty.[5]

Furthermore, the 2010 Victorian Bushfires Royal Commission reported as follows:

> *Community recovery after a disaster is impacted by the adequacy of insurance cover taken by individuals and businesses. When insurance cover is insufficient to allow for rebuilding, the recovery process will be stifled*.[6]

Given that underinsurance is widespread, the ability of even the well-insured to rebuild on their properties can be impaired due to the increased costs of replacing houses, where new regulations have led to significant cost increases in bushfire prone areas, as well as replacing more expensive contents.

Aside from ensuring that community recovery following an emergency is not stifled, both government and the community sector also have an interest in making sure that Victorian communities are more resilient to emergencies, and members of the community are not pushed into poverty due to unrecoverable losses caused by an emergency.

[5] Collins, D 2103, *Covering the Essentials: Increasing access and affordability of insurance for people on low incomes*, Good Shepherd Microfinance, pp. 7-8.

[6] Victorian Bushfires Royal Commission Report 2010, Volume 2, Chapter 8 Relief and Recovery, p. 339.

Discussion questions

2.1 To what extent is there an issue among low-income Victorians with unrecovered/unrecoverable financial losses following emergencies? How serious is any such issue?

2.2 To what extent is improving either or both the uptake and/or adequacy of insurance coverage an answer to the issue of exposure to such losses? What are some other options?

2.3 What would be appropriate levels and types of community, finance sector and/or government actions to improve insurance coverage among low-income and vulnerable Victorians?

2.4 In relation to this project, what would success look like? For example, greater resilience among low-income Victorians.

3. Taking out insurance: financial resilience and inclusion

Financial resilience and inclusion

There are many people who lack the financial means to take out insurance.

Financial inclusion is often defined as a person's access to and use of basic financial services: bank account, low rate credit card and basic insurance. There is a significant extent of financial exclusion in Australia.

More than three million people **(18.3 per cent of the adult population in Australia) were either fully excluded or severely excluded from financial services** in 2014. This figure includes 1.3 per cent of adults who are fully excluded (they had no financial services products) and 17.0 per cent of adults who are severely excluded (they had only one financial services product). [7]

Beyond the basic concept of financial inclusion, National Australia Bank and the Centre for Social Impact, define the concept of financial resilience in *Financial Resilience in Australia 2015,* as "the ability to access and draw on internal capabilities and appropriate, acceptable and accessible external resources and supports in times of financial adversity." [8]

Financial Resilience

Financial resilience is about access to four groups of resources:

1. Economic resources (savings, debt management, meeting costs of living, raising funds in an emergency, income level);
2. Financial products and services (access to and demand for financial products and services);
3. Financial knowledge and behaviour (knowledge and understanding of financial products and services and ability/willingness to apply that knowledge); and
4. Social capital (family, friend, community, and government networks and supports).

Source: *Financial Resilience in Australia 2015*

While theoretically the components of financial resilience can be classified as separate internal and external resources, in practice, the relationship between the four groups is dynamic. For example, an individual's ability to raise emergency funds might depend on either their access to support networks or relevant financial products and services.[9] Financial resilience can be improved by making improvements across these components.

Although a range of financial inclusion initiatives are currently available in Australia, they are unlikely to be able to respond to the scale of the group identified in the severe and high financial stress and vulnerability categories. This raises very real concerns about the financial wellbeing of 11.1 per cent of the adult population (2.02m people) in severe or high financial stress/vulnerability.[10]

Without access to financial services, people may be unable to borrow at a fair rate, save for necessities or make provision for their future. In addition they may face significant disadvantages such as being

[7] Muir, K, Reeve, R, Connolly, C, Marjolin, A, Salignac, F & Ho, K 2016, *Financial Resilience in Australia* 2015, Centre for Social Impact – University of New South Wales for National Australia Bank, 2016, p. 85.

[8] Ibid, p. 5.

[9] Ibid, p. 17.

[10] Ibid, p. 85.

unable to start a job or set up home. In Australia, **10 per cent of households have no savings** and, for many, credit is the only way that they can budget for larger purchases, and many people resort to using high interest lenders.

The report also found that **48 per cent of people have only a "basic understanding" of financial products and services** and more than 9 per cent report that they have "no understanding".[11]

In 2013, the average annual cost of basic financial services in Australia (a basic transaction account, a low rate credit card and some basic general insurance) was $1801 – just to maintain a very simple level of service, with no additional features or benefits. For 8.1 per cent of the adult population (1.45m people) this would represent over 15 per cent of their annual income. For another 10 per cent of the population this would represent between 10 and 15 per cent of their annual income. These costs severely limit the ability of a large proportion of the Australian population to gain access to mainstream financial services. [12]

In 2015 Australia committed to financial inclusion by agreeing to international obligations including the G20 Financial Inclusion Action Plan and the United Nation's Sustainable Development Goals.

Good Shepherd Microfinance was subsequently appointed by the Australian Government to develop a **Financial Inclusion Action Plan** (FIAP) program. The FIAP program provides an opportunity for organisations to consider and take real action to realise financial inclusion and thereby enable economic mobility and resilience – especially for women. The program has been developed in partnership with the Australian Government, Ernst & Young and the Centre for Social Impact and is also supported by an advisory group of experienced professionals from across the government, corporate and community sectors.

A FIAP is an agreed strategy of practical actions that an organisation will undertake to improve financial inclusion in Australia. By way of example, in 2016, the Queensland Government issued a *Financial Inclusion and Resilience Plan* backed by a four-year budget allocation. **It includes addressing the need for more accessible insurance, and supporting individuals and families to "better prepare for and recover from financially stressful disaster events and emergency incidents."**[13] One of the key actions under this plan was the development of the Money Ready Toolkit in partnership with Good Shepherd Microfinance. The toolkit provides tips and information to help Queenslanders better prepare and protect themselves and their families by making good money choices, and one of the key topics covered is insurance.

Discussion questions

3.1	How can the adoption of financial inclusion policies and practices help improve the affordability and accessibility of insurance products for low-income Victorians?
3.2	What are the opportunities for collaboration between government, the community sector and the insurance industry to improve financial inclusion and resilience among low-income Victorians?

[11] Ibid, p. 6.

[12] Connolly, C 2014, *Measuring Financial Exclusion in Australia*, Centre for Social Impact – University of New South Wales for National Australia Bank, p. 6.

[13] State of Queensland, Department of Communities, Child Safety and Disability Services 2016, *Queensland Financial Inclusion Plan*, p. 24.

4. Taking out insurance: risk awareness

Risk awareness and the decision to insure

In this discussion, two distinct risks are relevant. The first is the risk of loss or damage to insured assets from a hazard such as bushfire, flood or other damage to home and contents caused by emergencies. Management of this risk relates to the attributes of the assets, such as location, defences, vulnerability and the proximity, intensity and likelihood of the hazard agent. This risk can be characterised as **hazard risk**.

The second is **financial risk** to the owner of the assets lost and the need to fund their replacement in order to maintain their previous lifestyle. Management of financial risk involves financial strategies such as savings, borrowing or insurance.

In relation to financial risk, the Essence research commissioned by the department found that many **people underestimate their risk and overestimate their resilience**. "When presented with the scenario of losing their home, they realise the enormity and devastation, however few really think about this happening." Furthermore, Essence found that **36 per cent of those who are do not have insurance claim that they will not consider getting it in the future**.[14] There could be any number of explanations for this statistic, however, one could be that some of the respondents do not understand the possible consequences of the threats they face, or of failing to insure. Interestingly, the research also found that government emergency contributions after emergencies were not seen as a reason not to insure: "It was considered that any contribution would not cover sufficiently, and was just a 'hand-out'".

The Essence research found lack of perceived need as the second most important reason for not taking out insurance, affordability being the primary reason, and forgetting to renew the policy being the third (**44 per cent of uninsured did not perceive the need for insurance**).

Consciousness of a need to insure

Essence also reported that:

> *Sometimes there is an assumption that low income earners actively consider the concept of insurance and then reject it. However, it is one thing to be considered and rejected – it is quite another never to be considered at all. This, together with widespread lack of financial literacy, leads some stakeholders to believe this lack of affinity is far more the issue with insurance – it is significantly divorced from their consideration of household responsibilities, never having entered their consciousness.*[15]

These results are similar to findings in a study carried out in the United Kingdom that identified sub-groups among the uninsured, as set out in the chart below.[16] Broadly speaking, they fell into four groups according to how they assessed financial risk and made decisions about insurance. Most were fairly aware of the hazard risks they faced – burglary in the main.

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[14] Essence Communications 2016, *DHHS Underinsurance - Creative Evaluation Report Findings*, December, pp 12-13.

[15] Essence Communications 2016, *Stakeholder interviews on the issue of Non insurance'* November, p 2.

[16] Whyley, C, & Kempson, E 1998, 'Access to home contents insurance for low-income households' *Findings,* Joseph Rowntree Foundation, March.

Attitudinal groupings of uninsured people in the UK

Risk averse This group was acutely aware of risk and very anxious to mitigate its effects. On the whole, uninsured risk averse households had tried to get insurance but were prevented by problems of access and price.	Risk calculators "Risk calculators" made a detailed assessment of their personal risks and weighed these up against the cost of insurance. Many of those who subsequently decided not to insure felt that they faced low risks, or had few possessions to protect. They often had other strategies for replacing stolen or damaged goods.
Risk resigned This group was broadly aware of the risks and possible consequences of being uninsured but had not seriously applied them to their own circumstances. Many had very tight finances, were marginalised from financial services and were rather fatalistic about their circumstances.	Risk unaware Those who were "risk unaware" tended to have a relatively relaxed view of life. They also tended to be better-off than most uninsured households and less likely to have recent experience of a fire, flood or burglary.

Source: Whyley & Kempson, 1998

Hazard risk awareness

In relation to hazard risk, most government reports about insurance in recent years have recommended **better hazard risk information be available to householders**, in order to inform their decisions about the type and level of insurance they may need, and to assist them in comparing different insurers' offerings.

This issue is one that affects all consumers and potential consumers of insurance, not merely those on low incomes. Householders require clear and simple information that informs appropriate levels of protection through household insurance. This includes clear and consistent information about the hazard risks that householders face, as well as the costs of repairing or rebuilding and the costs of replacing household contents.

The Productivity Commission in its 2014 report on *Natural Disaster Funding Arrangements* recommended that insurers (Rec 4.9) and governments (Rec 4.1) disclose natural hazard information to policyholders.[17] In response, the insurance industry has noted that this a very complex issue.

"While this information is likely to be beneficial to consumers, its disclosure by insurers may lead to consumers receiving inconsistent and conflicting information from different insurers due to the existence of various data sources."[18]

The insurance industry has traditionally taken the position that the insurer's view of risk is communicated through the price signal, and that it is primarily a government responsibility to make natural hazard risk information broadly available.[19]

Nonetheless, the Insurance Council of Australia has been experimenting with approaches to hazard risk disclosure, using its Resilient Property website, [20] to elicit opinions as to whether a resilience rating report such as is shown below would be feasible and beneficial. It combines information about the house, its

[17] Productivity Commission Inquiry Report 2014, No 74, *Natural Disaster Funding Arrangements*. Volume 1, 17 December.

[18] Insurance Council of Australia 2015, *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, Report of the Effective Disclosure Taskforce to Insurance Council Board, p. 35.

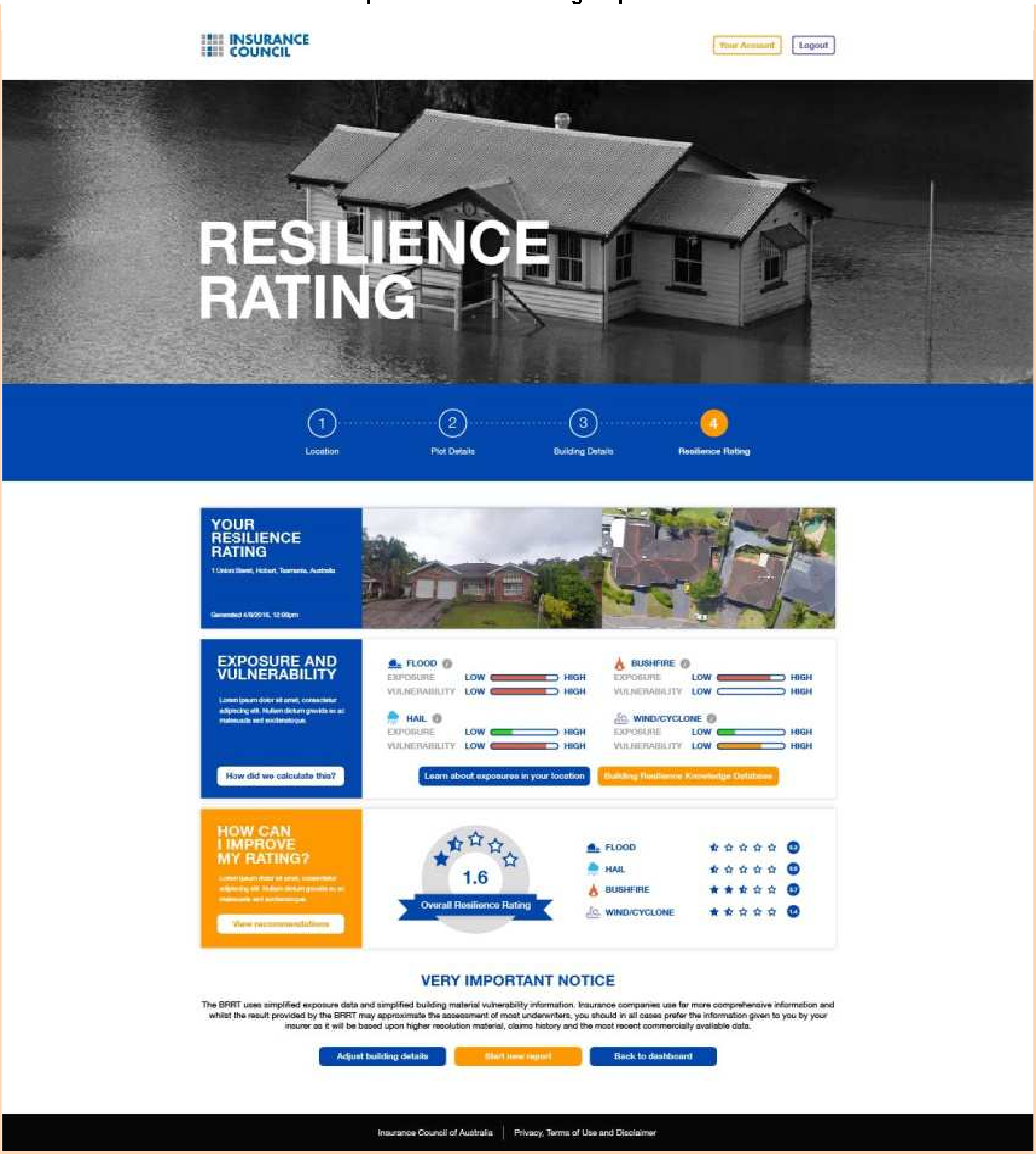
[19] For example, see *Building an Open Platform for Natural Disaster Resilience Decisions*, Deloitte Access Economics published by the Australian Business Roundtable 2014.

[20] Insurance Council of Australia, *Building Resilience Rating Tool,* viewed 30 December 2016, https://www.resilient.property.

vulnerability and natural hazard exposure, and how to enhance resilience. The website shows this sample of the property report it can provide.

The hazard risk information currently provided by governments on public websites is complex, intended for a purpose other than informing householders of their hazard risk levels, and requires fairly specialist knowledge to understand and use.

Insurance Council of Australia Sample Resilience Rating Report



For the whole of Victoria, most government online mapping is provided for the purposes of land use planning or building control, including mapping of flood and bushfire prone areas as defined. The website **Planning Maps Online**[21] provides a facility to show, for any part of Victoria, whether an area as small as

[21] Department of Environment, Land, Water and Planning, *Planning Maps Online*, viewed 24 March 2017, http://services.land.vic.gov.au/maps/pmo.jsp.

a single property is in the Designated Bushfire Prone Area[22], and/or in a defined floodway or land subject to inundation overlay. However, these maps can easily be misunderstood by community members, as the risk areas often extend beyond the boundaries of zones shown on maps.

For some high risk areas in Victoria, emergency services produce locally-specific information for flood and bushfire intended to assist with preparing for and dealing with emergencies when they happen. They contain simple maps that easily convey to people which addresses are most at risk.[23]

Interestingly, the Resilient Property website mentioned above states that it is based on publicly-available data and information supplied by government agencies not the more detailed information held by insurers.

NRMA insurance provides a website that enable policyholders to see the insurer's risk rating of selected risks including theft, home fire and water leaks, at a suburb (not individual property) level for areas in New South Wales and Queensland.[24]

The other aspect of disclosure by insurers concerns the estimated current cost of replacement and reinstatement of damaged house and contents. This matter is addressed on page 18.

If understandable and accessible hazard risk information were available, it may result in higher levels of home and contents insurance among low-income Victorians. However, the relationship between householders' understanding of their level of hazard risk and their management of their financial risk, through holding adequate insurance, is unclear. The market research commissioned by the department found that **2 in 5 who know themselves to be a risk of natural disasters are not adequately insured or insured at all**. It may be that affordability and attitudes to insurance are far more significant factors.

Discussion questions

4.1	What are some examples of existing and potential targeted approaches to improve the understanding among low-income people of hazard risk and financial risk, and the management of both?
4.2	What is the effectiveness of hazard risk information, whether provided via websites or other means, in improving the risk awareness of low-income people?
4.3	To what extent may improved hazard or financial risk awareness translate into greater uptake of insurance?
4.4	To what extent may different approaches be required for different segments of the target audience? Home owners and renters? Young people and elderly people? What are some specific approaches that could be adopted for different target audiences?
4.5	Aside from providing hazard and financial risk information, what are some other ways of communicating the importance and value of insurance to low-income and other vulnerable Victorians?

[22] Department of Environment, Land, Water and Planning, *Designated Bushfire Prone Area*, viewed 24 March 2017, http://services.land.vic.gov.au/maps/bushfire.jspv.

[23] For example, see Victoria State Emergency Service, *Your Local Flood Information,* viewed 24 March 2017, https://www.ses.vic.gov.au/get-ready/your-local-flood-information.
And Country Fire Authority, *Community Information Guides*, viewed 24 March 2017, http://www.cfa.vic.gov.au/plan-prepare/community-information-guides/.

[24] NRMA, *Safer Homes*, viewed 24 March 2017, https://saferhomes.nrma.com.au.

5. Taking out insurance: the cost

Affordability is perhaps the greatest barrier to insurance coverage for low-income Victorians. The Essence research found that the primary reason for Victorians being uninsured and underinsured is affordability.[25] The Australian Strategic Policy Institute Special Report, *Sharing the Risk*, noted that:

> *Affordability has a profound impact on the levels of private insurance. There are distinct correlations between the uninsured and social demographics: younger age groups and low-income households are less likely to have insurance coverage than other groups. Many of these groups are transient—up to 56 per cent of renters claim that they're unable to insure their contents. One of the main problems in offering insurance for individuals with few assets is that the administrative costs of an insurance policy are relatively high compared to the value of the coverage.*[26]

The primary cost driver for insurance is the level of risk as assessed by the insurer. For house and contents insurance, the unfortunate reality is that premiums in higher risk locations are very likely to be higher than in other areas, noting that the risk profile may well be about theft rather than fire, flood or storm. For low-income people who live in higher risk locations, where housing costs may be lower, the insurance affordability gap will be the highest.

Part of the issue has been that low-income families and individuals present a market challenge for insurers. As the 2013 Good Shepherd Discussion Microfinance Paper suggested, there "is a perception that low-income policyholders with low value policies will yield low returns, making the development of such policies unattractive and fuelling a suspicion that if such policies were introduced they would be unsustainable." This is coupled with the impact financial stress can have on sales of an insurance product, drop-out rates and the inability to pay excesses.[27]

Only very recently have **insurance products geared to low-income people** been available in Australia, as a result of collaboration between Good Shepherd Microfinance and the two leading general insurers in Australia, Suncorp Group and Insurance Australia Group. The "Good Insurance" program has seen the co-design of new products that offer limited cover for a lower premium, along with other features that make the products more affordable and accessible to people on low-incomes. If these products prove effective, more may come on to the market, and alleviate affordability, along with other barriers to insurance uptake identified in this paper.

Current **awareness of these products is limited**, although information is available on the internet, targeted referral activity takes place in community organisations, and community finance stores such as Good Money.[28]

Affordability options

There is the need to explore options to address the affordability of house and contents insurance for low-income Victorians. Some ideas which could be explored further include:

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[25] Essence Communications 2016, *DHHS Underinsurance Quantitative Findings* October, p. 15.

[26] Mortimer, et al, op. cit., p. 4.

[27] Good Shepherd Microfinance 2013, *Insurance for low-income Australians: taking innovative action* (Discussion Paper), p. 12.

[28] For example, see InsureLite, *Essential Cover for Big Events,* viewed 24 March 2017*,* https://www.insurelite.com.au/#/index.

Essentials by AAI, viewed 24 March 2017, https://www.essentialsbyaai.com.au.

IAG, Insurance4That, viewed 24 March 2017, https://www.insurance4that.com.au/.

Social housing tenants paying insurance premiums with rent payments

In the United Kingdom, it is common for the managers of social housing to offer tenants the opportunity to purchase contents insurance specially geared to the needs of low-income people. Tenants are often provided the facility to pay for the insurance with their weekly rent.

The reduction or removal of stamp duty for insurance

The Victorian Government levies a stamp duty charge of 10 per cent of the premium (including GST) on all general insurance policies. Reduction or elimination of this charge would make insurance more affordable, provided that it is passed on in full.

As a point of comparison, the elimination of the "fire services levy" (FSL) in Victoria on 1 July 2013 was closely observed, communicated to policyholders, and enforced by a specially-appointed Fire Services Levy Monitor (Monitor) to maximise the pass through of reduced costs to insurance policyholders. In his final report, the Monitor concluded that "given the known changes in FSL rates during 2012–13, potential changes in total premium can be estimated assuming that base premiums did not change. In such circumstances, the average total premium changes pre- to post-abolition for:

- insurance on residential property located in the MFESB region, would be 14.3 per cent lower in 2013–14 than 2012–13
- insurance on residential property located in the CFA region, would be 19.3 per cent lower in 2013-14 than 2012–13."[29]

His report went on to conclude that "the analysis of price data … leads to the conclusion that **the benefit of the abolition of FSL, in the form of reduced total premium levels, on the whole was passed on relatively quickly to consumers** of residential property insurance who were the focus of the Monitor's activities."[30]

Accordingly, Victoria has already experienced the elimination of a government charge on insurance significantly higher than the current level of stamp duty. It is **not known what impact, if any, this reduction in insurance premium costs had on the sales of insurance, either on the number of policies or sums insured.** In passing, the Monitor noted significant price variations between insurers, and made the point that "the message for consumers remains very clear. It pays to shop around by comparing the price of different insurers before purchasing or renewing policies."[31]

Improvements in hazard risk management

In relation to natural hazards, risk management is mainly the responsibility of all three levels of government to manage with a lesser degree of responsibility on the householder.

Management of natural hazard risk to dwellings involves a range of physical activities, usually mandated by regulation, such as land use planning, building siting, design and materials, specific hazard management activities such as flood works or fuel reduction burning, and others. Bushfire risk is somewhat responsive to householder action, such as clearing around and active defence of the house, if safe.

Funding of explicit risk reduction (mitigation) projects generally falls to government, while funding of implicit risk reduction, such as the higher costs imposed by bushfire-specific building regulations, is borne by the private sector and individuals.

The extent to which mitigation activities contribute directly to reduction in insurance premiums is entirely dependent upon the methods insurers use to determine the likelihood and degree of loss. If an insurer

[29] Fire Services Levy Monitor 2014, *Enhancing the consumer experience of home insurance: Shining a light into the black box* (Discussion Paper), 2014, p. xxv

[30] Ibid p. xxviii.

[31] Ibid p.41.

rates bushfire risk by measuring the distance between the house and dense bushland, a householder's efforts to maintain a garden with minimal fuel as a firebreak may have no influence on their premium.

There are a few examples in Australia of risk situations affecting large numbers of houses, where substantial public investment in mitigation has led to lowering of insurance premiums to affordable levels.

In 2014, Suncorp announced it would reduce flood insurance premiums by 45 per cent on average, and up to 90 per cent for a few, in the town of Roma, Queensland. Roma residents with Suncorp and Vero home cover would now pay an average of $1,000 if protected by the levee and own a property on which the council has provided additional flood risk information. The premium on a $400,000 home previously considered a major flood risk could fall by $7,000.[32] That was due to the opening of Stage 1 of a new flood levee that cost about $16 million, designed to protect about 500 premises.

Projects with dramatic results such as these are rare.

Peer-to-peer insurance

Peer-to peer (P2P) insurance is a very recent trend in insurance markets, already operating in several countries. The concept is like other P2P models such as Uber and Airbnb that are operated through websites and apps, that link customers directly with providers. The concept involves groups of peer-assessed members pooling part of their premium to meet the cost of small claims, and the deductible (excess) costs for larger claims, with the site acting like a broker between members and insurance companies.

Because the group is made up of likeminded peers, they are less likely to make exaggerated or fraudulent claims that would adversely affect the group. This relates to what is called the moral hazard, the theory that if an insured person doesn't bear the financial consequences of their actions, they do not act with the same level of caution as someone who does. Because the members are acting in the best interests of the group, they are less likely to make claims, and costs are cheaper as a result.[33]

Members expect that the money they contribute to the group's combined small claims and excess costs will be less than they would pay individually on a claim, with any moneys left over being refunded to the group. The German Friendsurance model enables customers to receive up to 40 per cent of their premiums back annually if no claims are made. Customers never pay more than the initial premium and large claims are still paid by their insurer.[34]

In Australia, Huddle is offering motor vehicle and travel insurance under the P2P model.[35] However, strict insurance industry regulations may limit the use of the P2P model in Australia.

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[32] InsuranceNews.com.au 2014, 'Suncorp to slash premiums as Roma levee nears completion', 28 July, viewed 20 January 2017, *http://www.insurancenews.com.au/local/suncorp-to-slash-premiums-as-roma-levee-nears-completion.*

[33] P2P insurance, viewed 4 January 2017, *https://www.finder.com.au/p2p-insurance.*

[34] A. Keane 2016, 'Covering your mates may be the next wave of change for insurance', 7 November, viewed 4 January 2017, www.news.com.au.

[35] Huddle, viewed 24 March 2017, https://huddle.com.au.

Discussion questions

5.1	What are some possible actions for government, insurance companies or community groups to improve the affordability and suitability of insurance products for low-income vulnerable Victorians?
5.2	What, if any, evidence is there of an increased uptake of insurance when the 'fire services levy' was removed?
5.3	What are the ways to improve the way people pay for their insurance? Such as through fortnightly payments or through Centrepay[36]
5.4	What are the opportunities to explore peer-to-peer or group insurance as a way of improving insurance coverage among low-income and vulnerable Victorians?
5.5	What, if any, potential is there to link risk management activities (either individual, community/group based, or government funded) to insurance premiums?

[36] Centrepay is a free voluntary bill paying service. Deductions come from Centrelink payments and can be used to pay many types of bills, such as child care, electricity bills or rent, viewed 11 January 2017, https://www.humanservices.gov.au/customer/services/centrelink/centrepay.

6. Trusting the insurer and the product: industry practice

The Essence research identified a lack of trust in insurance companies as another reason people choose not to insure.

> *General distrust is present and many would not insure even if they had the money to. Respondents held the various beliefs that insurance companies might not pay claims or specific items of value might not be covered, that even if the insurance companies paid out, they would still have to pay an excess that they could not afford, and many also held the belief that natural disasters are not covered.*[37]

Regardless of the objective truth of these beliefs, the perceptions show a mistrust of insurers and are a significant barrier to increasing levels of insurance coverage for low-income people.

This phenomenon has also been noted by academics Kate Booth and Andrew Harwood in their article *Insurance as catastrophe*. They report on interviews with several people living in bushfire-prone areas.

> *Both [people] are sceptical about insurance companies, express mistrust of insurers paying out after a disaster and consider house insurance to be expensive. They are, however, confident in their own ability to re-build if the need arises. Tom also speculates that having house insurance means one is more likely to leave in the face of a major bushfire. There is a sense here that not having insurance ties one more to the building and the place, and demonstrates a commitment to living in the bush….For those who chose not to insure, they understand those with insurance to be in moral jeopardy – as aligned with profit-driven and unscrupulous insurers and lacking the skills and fortitude associated with self-reliance.*[38]

Specific mistrust/misunderstanding – the product

The purchase of appropriate and adequate insurance is not a simple matter. The customer must assess their needs for insurance and choose from a range of slightly different offerings from insurers, not merely on the basis of price, but also on the details of the policies and what they do and do not provide.

In recent years, regulations on disclosure have increased the amount and accuracy of formal information provided to the public by insurers to the point where it can be a formidable reading exercise. In addition, the objective of that disclosure – more informed customers making better decisions – has very likely not been achieved.

In its 2015 paper *Too Long; Didn't Read*, the Insurance Council of Australia (ICA) taskforce noted the situation in which there is mandatory disclosure of information "without the necessary regard for the consumer's ability to make use of that information".[39] The taskforce recommended that the ICA commission and publish research to determine pre-purchase consumer behaviour and how disclosure can be used to nudge appropriate decision-making. New and innovating disclosure tools and techniques should be trialled, based on principles of transparency. This would assist in promoting "trust and confidence"' in the industry.[40]

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[37] Essence Communications 2016, *DHHS Underinsurance Creative Evaluation Report Findings,* December, p. 12.

[38] Booth, K, & Harwood, A 2016, 'Insurance as catastrophe: A geography of house and contents insurance in bushfire-prone places', Geoforum 69, p. 50.

[39] Insurance Council of Australia Effective Disclosure Taskforce 2015, *Too Long; Didn't Read*, Insurance Council of Australia, p. 3.

[40] Ibid p. 5.

The Insurance Council of Australia already maintains an excellent website Understand Insurance[41] that clearly explains many aspects of insurance and selecting policies. A similar website Know Risk[42] is maintained by the Australian and New Zealand Institute of Insurance and Finance to improve people's understanding of insurance and how it relates to managing the many risks faced in life. It provides a smartphone app to enable people to keep all their insurance information in one place, keep records of assets and policies and facilitate policy changes or claims.

However, the complexity of the subject-matter means that a commitment of time and energy is required to work through the issues and make decisions. This may exceed the capability or patience of many people.

For purchases of a range of other services there are comprehensive comparison websites available that compare a wide range of products and providers, thereby assisting consumers to choose what best suits them. This is not the case for home and contents insurance.

Specific mistrust – comparability

Late in 2016, media organisation News Corporation and the One Big Switch organisation sought signatories for their petition to the Federal Parliament advocating the creation of a government-run home and car insurance comparator website, similar to that operated by the Commonwealth for home and contents insurance in North Queensland.[43] The principal drivers for this were premium increases over the years 2010 to 2013 outstripping wages growth[44] and noticeably affecting family budgets, as well as the difficulty faced by One Big Switch in negotiating bulk discount premium offers for its members as it had done for home loans, electricity, gas, solar panels, health insurance and broadband.[45]

They claimed that none of the four major insurers' policies can be compared in the one place and that major private-sector comparison sites only compare products connected to their parent companies.[46] "A consumer wanting to compare the entire market would currently have to enter the same data into as many as 10 websites because there is no comprehensive insurance comparison service."[47]

As a result, in November 2016, the Senate referred an inquiry into Australia's general insurance industry and a comparison service to the Senate Economics References Committee, for report by 22 June 2017.

[41] Insurance Council of Australia 2017, *Understand Insurance*, viewed 24 March 2017, http://understandinsurance.com.au/.

[42] Australian and New Zealand Institute of Insurance and Finance, *Know Risk*, https://knowrisk.com.au/, viewed 24 March 2017.

[43] Australian Government, *North Queensland Home Insurance,* viewed 24 March 2017, http://nqhomeinsurance.gov.au/.

[44] Equity Economics 2016, 'Home Building & Contents Insurance; Briefing note'.

[45] One Big Switch, *About One Big Switch,* viewed 10 January 2017, https://www.onebigswitch.com.au/about-us.

[46] Rolfe, J 2016, 'Why family budgets are at breaking point', *Daily Telegraph*, 8 November.

[47] Gibson, J 2016 'Consumers urged to support campaign for simpler insurance comparison', One Big Switch, 21 November, viewed 22 January 2017. www.onebigswitch.com.au/news.

Inquiry into Australia's general insurance industry

Senate Economics References Committee: Terms of Reference:

- the increase in the cost of home, strata and car insurance cover over the past decade in comparison to wage growth over the same period;
- competition in Australia's $28 billion home, strata and car insurance industries;
- transparency in Australia's home, strata and car insurance industries;
- the effect in other jurisdictions of independent home, strata and car insurance comparison services on insurance cover costs;
- the costs and benefits associated with the establishment of an independent home, strata and car insurance comparison service in Australia;
- legislative and other changes necessary to facilitate an independent home, strata and car insurance comparison service in Australia; and
- any related matters.[48]

Discussion questions

6.1	What are some possible improvements that could be made with regard to insurance industry practice?
6.2	To what extent is there a lack of trust in insurance companies among low-income Victorians? What are the causes of any such lack of trust?
6.3	How does a lack of trust affect the uptake of adequate insurance?
6.4	What possible actions can be undertaken to address a lack of trust among low-income Victorians?
6.5	In what ways could an industry code of practice for emergencies assist to improve trust?
6.6	Who might be appropriate independent intermediaries to assist people to understand their insurance needs and the options available, and to support purchase decisions?
6.7	What opportunities exist for collaboration between government, the insurance industry and community sector organisations in order to improve industry practice and increase levels of trust?

[48] Journals of the Senate 2016, No. 17 Tuesday, 22 November, Item 10, p. 561.

7. Is market failure evident?

In 2011, the then Assistant Treasurer, the Hon Bill Shorten MP is reported as saying that “if insurance products are fair and reasonable and people who can afford insurance choose not to take it out then that is their issue. But, if people cannot afford insurance and therefore they do not take it out, that is our problem.”[49]

Australian governments have intervened in the provision of market goods or services in the community where there is clear evidence of ongoing market failure.

The Commonwealth Government has taken at least two specific actions in relation to general insurance where market failure has been demonstrated.

The first is the formation of the Australian Reinsurance Pool Corporation (ARPC), established following the withdrawal of terrorism insurance cover by the private insurance market after the 11 September 2001 terrorist attacks in the United States. The government was concerned that the lack of comprehensive insurance cover for commercial property or infrastructure would lead to a reduction in financing and investment in the Australian property sector. [50]

The Chair of the ARPC recently reported that “At the time of writing, Australia’s national terrorism threat level remained “probable”. ARPC’s loss modelling shows probable maximum insured losses would exceed the reinsurance capacity of the private insurance market, resulting in market failure. Inadequate private insurance capacity to cover all Australian commercial assets is an ongoing problem, which ARPC fully addresses.” [51]

The second action has been to establish the North Queensland Home Insurance comparison website,[52] through the Australian Securities and Investments Commission. In releasing a discussion paper in 2014, the Minister for Finance, the Hon Mathias Cormann MP, stated that;

> *While committed to deregulation, the Government recognises the importance of the insurance industry in helping Australians to manage risk. Appropriate regulation that complements industry but fills any gaps in private sector efficiency may sometimes be necessary, after the costs and benefits of any such regulation are assessed*.[53]

Views of economists

Two bodies that have recently explored the issue of market failure in relation to home and contents insurance in Victoria are the Fire Services Levy Monitor and the Productivity Commission.

The Fire Services Levy Monitor noted significant inefficiencies and possible regulatory failure in the home and contents insurance market and put forward evidence as follows.

> *There are indicators suggesting that general insurance markets are not operating efficiently, nor are consumers of insurance necessarily well-informed. Insurance is already a strongly regulated market – regulated because, left to its own devices, the insurance market might fail to adequately protect the interests of policyholders. However, if the regulated market still fails to deliver efficient*

[49] House of Representatives Hansard 2011, Bernie Ripoll MP, Member for Oxley, 14 June, http://www.aph.gov.au/Parliamentary_Business/Hansard/Hansard_Display?bid=chamber/hansardr/64a5ad95-2dab-4361-aead-92c2f4ab0aac/&sid=0114.

[50] Australian Reinsurance Pool Corporation 2016, Media Fact Sheet, October.

[51] Fitzpatrick, J 2016, Report from the Chair, Annual Report 2015-16, Australian Reinsurance Pool Corporation.

[52] Australian Government, *North Queensland Home Insurance,* viewed 24 March 2017, http://nqhomeinsurance.gov.au/.

[53] Australian Government, Department of the Treasury 2014, *Addressing the high cost of home and strata title insurance in North Queensland: Discussion Paper*, May, p. vii.

outcomes and the interests of policyholders remain compromised, it must be concluded that there is also a degree of regulatory failure.

The indicators of insurance market inefficiency and disadvantage to policyholders that currently characterise residential property insurance include the following:

- *many insurers offer substantial discounts for new business, yet there is no objective evidence available on rates of switching between insurers to suggest such discounting is widely known*
- *some policyholders subsidise others by paying for cover they do not need*
- *some insurers use unverifiable 'no claim bonuses' and 'loyalty discounts' to discourage policyholder switching between insurance providers*
- *insurers fail to disclose the extent of additional charges incurred by policyholders who choose to pay premiums by instalments*
- *existing regulated policy disclosure requirements are misdirected*
- *insurers fail to adequately explain, or even acknowledge, substantial premium changes on renewal*
- *insurers' assessment of key property risks such as flood is imperfect but consumers do not have adequate opportunity to correct inaccurate information used by insurers*
- *(some) insurers make hollow claims regarding restrictions on their ability to share information with policyholders*
- *there are substantial differences in the premium charged for similar cover on the same property by different insurers*
- *high profitability has been sustained within the general insurance industry for several years without being competed away, even during a period of significant natural disasters and a global financial crisis.*

The insurance industry claims there is strong competition in the residential property insurance market given there are several suppliers and only moderate barriers to entry. However, the indicators identified above do not paint a picture of robust price competition – there are clearly problems on the demand side of the market.[54]

The Monitor came to the conclusion that market failure existed, and concluded that "by improving the efficiency of insurance markets, through removing information asymmetry and making competition more effective, disadvantage to policyholders should diminish and premiums will fall, thereby making insurance more accessible."[55]

The Productivity Commission (PC) also considered the issue of market failure in its 2014 Inquiry into natural disaster funding arrangements. It received evidence that potential consumers' cognitive and attitudinal biases, together with information asymmetries in the insurance market, may be inhibiting the effective use of insurance as a risk management tool.[56] Both of these factors can constitute market failure for specific segments of the insurance market.

The PC concluded that "some parties are probably making a rational choice to not take out insurance for the full value of their property. Households might also be self-insuring. However, the evidence that some parties do not understand what, and how much, they are insured for is indicative of information asymmetries in the market. Where this is the case, governments and insurers should address this directly

[54] Fire Services Levy Monitor 2014, *Enhancing the consumer experience of home insurance: Shining a light into the black box,* (Discussion Paper), July, p. xii.

[55] Ibid, p. 50.

[56] Productivity Commission Inquiry 2014, Report No 74 *Natural Disaster Funding Arrangements* Volume 1, 17 December, p. 216.

(for example, information asymmetries), rather than trying to increase coverage through measures such as mandatory building and contents insurance, or the mandatory imposition of total replacement cover."[57]

> Considering other potential insurance market interventions, the PC reviewed a number of government or government-backed insurance schemes in several countries, and the experience of them over many years. It concluded as follows:
>
> *In summary, international experience reveals significant disadvantages to government provision or underwriting of natural disaster insurance for private property. These schemes have often failed to meet the objectives they were originally set up to achieve. Reducing or capping premiums can weaken the price signals that insurance sends people about the risks they face, and therefore discourage mitigation. It can also crowd out private initiatives. Moreover, government-backed insurance schemes are not always successful at reducing calls on government budgets after a natural disaster. And on a number of occasions governments have had to bail out their schemes because they failed to accumulate sufficient reserves to pay claims or did not have adequate reinsurance.*[58]

The Commission rejected any notion that Australian governments should intervene in a significant way in insurance markets. However, it did recommend that all governments and the insurance industry collaborate to make hazard information more readily available, using private sector intermediaries where suitable.[59] It also recommended that state taxes and levies on general insurance be phased out and replaced with less distortionary taxes.[60]

A third inquiry recently reported on insurance affordability in northern Australia. The Northern Australia Insurance Premiums Taskforce was established by the Commonwealth Government to assess the viability of certain options to lower consumer insurance premiums in regions of northern Australia where insurance affordability is considerably worse than other areas in Australia, due to the cyclone hazard. The Taskforce assessed the feasibility of two specific options involving government participation — a mutual cyclone insurer and a cyclone insurance pool — along with other options. Its report was released by the Commonwealth in March 2016.

The Taskforce reported that recent premium increases were due to better insurance industry modelling and that premiums now more accurately reflected the risk. It also reported the insurance industry views that there is no market failure in northern Australia and that any intervention that lowers premiums will disguise underlying risks, resulting in less mitigation effort.[61]

The Taskforce recommended against government intervention in the ways suggested, because of the high likelihood of a continuing need for support from the Commonwealth budget. However, it explored and recommended a range of actions that could and should make insurance more affordable in the area, such as mitigation (including stronger building standards, research, education) and insurers making premiums more sensitive to householder mitigation.[62] To date, the Commonwealth has not formally responded to the report.

Responses

While these three investigations do reveal market failure of one type or another in these particular markets, Australian governments are extremely reluctant to intervene, instead relying on improved information, as well as improved risk mitigation and its recognition by insurers.

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[57] Productivity Commission Inquiry 2014, Report No 74, *Natural Disaster Funding Arrangements* Volume 2, 17 December, p. 449.

[58] Ibid, p. 562.

[59] Productivity Commission Inquiry 2014, Report No 74, *Natural Disaster Funding Arrangements* Volume 1, 17 December, pp. 42-43.

[60] Ibid, pp. 4-5.

[61] Australian Government, The Treasury 2015,Northern Australia Insurance Premiums Taskforce *Final Report* November, p. 19.

[62] Ibid, p. 86.

Market failure arises from the issues of perceptions of risk, and understanding of and trust in insurance and its providers. Clearly the state and its agencies should not promote specific insurance policies or their providers, but there is scope for government to communicate broadly and persuasively the benefits and value of insurance, possibly with reference to the situation of the uninsured after emergencies.

This communication can occur in direct ways, and also be included in a range of other materials. For example, to encourage adequate insurance for house and/or contents as an essential element in household and community emergency preparedness. Partnering with Red Cross, for example, who support members of community to prepare emergency plans through its RediPlan program, could be productive in this regard.

While the household emergency planning guides issued by the Country Fire Authority[63] and the Victoria State Emergency Service[64] include references to insurance in their householder bushfire and generic emergency planning brochures, they could provide more detail on what constitutes adequate insurance, and where to find further information.

There are many who would view the level of uninsured and underinsured among specific groups in Victoria as evidence of an issue that could and should concern governments. Bearing in mind the discussion on financial resilience on page 8, insurance can be seen as an essential household purchase, like housing, food and power, not merely discretionary. This paper opened with concern about the uninsured and underinsured in emergency situations and the severe consequences for this cohort after emergencies that damage or destroy house and/or contents.

Policy dilemma

There is a significant policy dilemma in relation to the trend towards accurate risk-based premium pricing and affordability in high-risk areas, as recognised by one group of experts at Macquarie University's Risk Frontiers research centre:

> *On the other hand the imposition of risk-reflective premiums by the private sector insurers will inevitably lead to situations where they may choose not to insure certain households or only at costs that many may find unaffordable. Although it would be a mistake to imagine that those, or even most of those, living in vulnerable locations are poor, the reality, given varying socio-economic demographics in vulnerable locations, is that the next major event will likely find significant numbers of impacted homeowners without insurance and with an expectation of emergency financial aid from government. In New Zealand, there has been no succour for those in Canterbury who had chosen to self-insure (uninsured). This is easier politically when most homeowners are insured as is the case in New Zealand and Australia and avoids the tendency of acts of post-event generosity by government to further reduce incentives for homeowners to take out insurance.*
>
> *The dilemma outlined above is well known, but resolving it is not easy. In fact it does not seem possible to arrive at a definitive conclusion about the merits of government pools vis-à-vis private sector insurance.*[65]

Governments do not currently incentivise people to take out insurance, however in situations where the risk-based premium pricing has resulted in the cost of the insurance becoming too great for low-income households, there may be scope for consideration. The overall cost of incentivising a defined cohort to take out insurance may be significantly more cost-effective than the current assistance provided by government after an emergency. This theory is based on the underlying assumption that the risk is insurable.

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[63] Country Fire Authority 2013,*Fire Ready Kit,* http://www.cfa.vic.gov.au/plan-prepare/fire-ready-kit/, viewed 22 January 2017.

[64] Victoria State Emergency Service 2013, *Home Emergency Plan,* https://www.ses.vic.gov.au/get-ready/at-home, viewed 22 January 2017.

[65] McAneney, J, McAneney, D, Musulin, R, Walker, G, Crompton, R 2016, 'Government sponsored natural disaster insurance pools: A view from down-under', *International Journal of Disaster Risk Reduction*, vol.15, pp.1-9.

Discussion questions

7.1 What, if any, further action is required to ensure those who are unable to buy insurance due to cost are afforded the opportunity to do so?

7.2 What is the nature and extent of market failure with respect to low-income Victorians and especially those in high risk locations?

7.3 What impact may premium concessions offered by government for low-income and vulnerable Victorians have in enabling them to obtain appropriate levels of insurance coverage?

7.4 To what extent would a government-backed insurance scheme for this segment of Victorian society be appropriate?

7.5 What are the risks associated with these and other forms of government intervention?

7.6 What alternative ways exist for governments to be directly (financially) involved in the private-sector provision of insurance for low-income people that avoid the problems experienced in other countries?

7.7 What are suitable media, or places and times that are conducive to encouraging low-income Victorians to purchase insurance?

7.8 What are some actions the Government, the insurance industry or insurers individually or the community sector can take to ensure this segment of Victorians have the opportunity to buy appropriate insurance cover?

8. How to respond to this discussion paper

You are invited to respond to this discussion paper to inform the development of a strategy for state government consideration. This can include responding to some or all of the stimulus questions under each theme, and/or making relevant comment about the topics raised and/or suggestion unrelated to the specific questions.

Bear in mind that the various themes explored in the discussion paper are interlinked, and that aspects of the issue are covered under more than one theme in both the discussion and the key questions. It is recommended that you read the whole paper before commencing your response.

Most of the legislation affecting and statutory regulation of the insurance industry is the responsibility of the Commonwealth Government, not the State. However, the State may consider taking non-legislative actions aimed at improving the insurance status of low-income Victorians.

Remember that your responses need not relate solely to government action. The scope of the strategy and partners involved encompasses industry and the community sector as well.

Please submit your response by email to recovery@dhhs.vic.gov.au by 19 May 2017.

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