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# Floods, earthquakes and insurance coverage – issues, problems and solutions

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*The recent floods in Queensland and elsewhere in Australia as well as the recent earthquakes in New Zealand have again given rise to very significant uninsured losses. This article looks at the issue of cover protection against catastrophes such as floods and earthquakes affecting home buildings and contents insurance and the standard cover provisions of the Insurance Contracts Act 1984 (Cth). It points also to the possibility of a national scheme to cover natural disasters including floods.*

## <DIV>INTRODUCTION

The January 2011 floods in Queensland and parts of New South Wales and Victoria caused enormous property damage and tragic loss of life. In the immediate aftermath of the floods numerous insurance issues and problems have arisen. These relate to:

- Whether flood insurance was in place in respect of the property destroyed or damaged by flood waters;
- If so, whether the policy in question on its construction covers the loss that was sustained. In this context the proximate cause of the loss is critical;
- The claims handling and claims resolution processes where individuals and families are in very difficult circumstances pending the outcome of insurers' deliberations.

Widespread criticism has been directed at the insurance industry. For example, Queensland's primary newspaper, *The Courier Mail* on its 9 February 2011 Editorial states:

<blockquote>

A uniformly plain-English insurance contract that drops the jargon and the legalese would be a good start to ending the agonising charade that is played out so often in Australia when disaster strikes. The last thing we want is to be left in an interminable legal purgatory while the insurance industry hires teams of anonymous hydrologists to assess whether the flooding was riverine in nature, surge-related or due to a good old downpour.<sup>1</sup>

</blockquote>

To these criticisms may be added speculation as to whether insureds received adequate disclosure of information from their insurers as to the exclusion of, or limitations to, flood cover.<sup>2</sup>

This article examines these issues and problems and recommends certain solutions.

## <DIV>FLOOD COVER

Numerous insurers<sup>3</sup> with diverse policy wordings are, through their insureds, enmeshed in the claims process and proximate cause issues. To illustrate this divergence three examples are given:

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<sup>1</sup> "Insurers Must End Agony", *The Courier Mail* (editorial, 9 February 2011) <http://www.couriermail.com.au/ipad/editorial-insurers-must-end-agony/story-fn6ck620-1226002422830> viewed 28 March 2011.

<sup>2</sup> *The Courier Mail* (9 February 2011) p 7. See the *Insurance Contracts Act 1984* (Cth), ss 34, 35 and the *Insurance Contracts Regulations 1985* (Cth), regs 10 and 14. [There is no author as it is their own editorial. http://www.couriermail.com.au/ipad/editorial-insurers-must-end-agony/story-fn6ck620-1226002422830](http://www.couriermail.com.au/ipad/editorial-insurers-must-end-agony/story-fn6ck620-1226002422830)

- Mansions of Australia Home and Contents Insurance provides cover for accidental loss or damage to the insured building up to the replacement cost. No exclusions relating to flood or water damage applies.
- QBE's Gold Star Home and Contents Policy insures against malicious damage, accidental loss or damage to the insured's home and contents during the period of insurance. This includes loss caused by "water and/or other liquids and/or substances discharged and/or overflowing and/or leaking from any apparatus and/or appliance and/or pipes" and loss or damage directly caused by "storm, tempest, rainwater, wind, hail, tornado, cyclone or hurricane, freeze or weight of snow". Flood cover is optional with flood defined as "the inundation of normally dry land by water escaping from any watercourse, lake, canal, dam or reservoir". The insured must elect this option and pay an additional premium – the insured is then covered for physical loss, destruction or damage caused directly by flood and the policy schedule will note this election.
- The Residential Strata Insurance Plan provided through CHU Underwriting Agencies provides expressly that the insured is not covered for damage caused by flood. The definition of flood in this policy means "when water that is normally contained in a Water Catchment System increases because of rainfall, or snow melt (whether in the immediate region or elsewhere) or is deliberately released by an authority, and the water overflows onto land that is not normally covered by water". While flood cover is excluded loss or damage to fences and gates as a result of the storm and/or tempest is covered, as is loss or damage to insured property caused by tsunami.

These three examples reflect the range of options available – flood cover included, flood cover possible if the insured so elects to add such cover and pays an additional premium, and flood cover not offered.<sup>4</sup>

#### **<DIV>STANDARD COVER**

An insured who does not have flood cover under the provisions of his or her policy may nevertheless be able to recover from the insurer pursuant to the *Insurance Contracts Act 1984* (Cth). This Act provides for standard cover in respect of a limited number of insurances – included in this list are home buildings insurance and home contents insurance.<sup>5</sup> The combined effect of the Act and the *Insurance Contracts Regulations 1985* (Cth) is that where an insured makes a claim under a prescribed contract (that is, a contract to which the standard cover provisions apply) and that claim is in respect of loss arising from an event prescribed in the Regulations, the insurer must pay the insured the minimum amount specified in the Regulations. The insurer cannot rely on the terms of the contract to deny liability or reduce the amount of liability below a certain prescribed minimum unless the insurer proves that before the contract was entered into, the insured was clearly informed in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise) or that the insured knew, or that a reasonable person in the circumstances could be expected to have known, that the insurer was liable only for the lesser amount or that the particular risk was not covered by the contract of insurance.<sup>6</sup>

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<sup>3</sup> Including CGU, NRMA, RACQ, Allianz, Real Insurance, Guild Insurance, QBE, Suncorp, Westpac, National Seniors and Mansions of Australia.

<sup>4</sup> Flood insurance must, in this context, be contrasted with cover for storm damage or cover against rain water – essentially storm water damage. Early hydrology reports seem to confirm that the overwhelming preponderance of the damage in the Brisbane and Bremer catchments is flood damage and not more limited storm water damage. See [M. Solomon, "Conflict of Interest" in reports, The Courier Mail, \(22 February 2011\)](#).

<sup>5</sup> See the *Insurance Contracts Act 1984* (Cth), ss. 34, 35 and the *Insurance Contracts Regulations 1985* (Cth). Other types of insurance to which the standard cover rules apply are motor vehicle, personal accident and illness, consumer credit and travel insurance.

<sup>6</sup> *Insurance Contracts Act 1984* (Cth), s 35(1) and s 35(2)

In the context of home buildings and home contents insurance it is provided in the standard cover provisions that the destruction of, or damage occurring to the home or contents that is caused by or results from “storm, tempest, *flood*, the action of the sea, high water, tsunami, erosion or land slide or subsidence” is a prescribed event (emphasis added).<sup>7</sup> Therefore unless the insurer can successfully invoke s 35(2) of the *Insurance Contracts Act* by proving notice of derogation from the standard cover, or actual knowledge by the insured, or of a reasonable person in the circumstances, the insurer must pay the minimum amount specified in the Regulations.<sup>8</sup> In home buildings insurance, the minimum amount is the amount required to indemnify the person who made the claim for the loss flowing from the prescribed event. The minimum amount is also taken to include the reasonable cost of emergency accommodation as well as demolition and removal of debris.<sup>9</sup>

The Australian Law Reform Commission (ALRC)<sup>10</sup> in advocating the introduction of standard cover in relation to certain fields of insurance observed:

<blockquote>

Policies contain numerous terms which affect in unexpected ways the cover offered. In a few cases, the insured’s attention is drawn to the relevant limitation at the time when the cover is arranged. In the vast majority of cases, however, nothing is said. The insured’s ignorance remains undisturbed until he makes a claim. ... An insurer should be free to market policies which offer less than the standard cover. If it chooses to do so, it should have to draw attention to that fact and to the nature of the relevant diminution in cover. If it fails to do so, the contractual terms should be overridden to the extent to which they provide cover which is less than the standard.<sup>11</sup>

</blockquote>

In putting forward the standard cover regime for the legislature’s consideration, the ALRC did not contemplate that derogation from the standard might be achieved by handing a prospective insured a copy of the proposed contract. Depending on the length and/or clarity of this document a prospective insured may or may not become aware of such derogation. No controls over length or comprehensibility appear in the *Insurance Contracts Act*. Moreover, it is further provided in the Act that in relation to the renewal, extension or reinstatement of a contract where the insurer has given information to the insured as required by s 35 previously, the requirement in s 35 to give information shall be deemed to be satisfied at or before any subsequent renewal, extension or reinstatement of the contract.<sup>12</sup>

It should be further noted that an insurer may comply with the requirement of notice “in writing” about a particular maximum amount or exclusion of cover by giving the information orally.<sup>13</sup> This is only permissible where it is not reasonably practicable for the information to be given in writing at the time the contract was entered into, and in any event must also be given in writing within 14 days after the day into which the contract was entered.

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<sup>7</sup> *Insurance Contracts Regulations 1985* (Cth), regs 10(a)-(xi); and 14(a)-(xi).

<sup>8</sup> *Insurance Contracts Act 1984* (Cth), s 35(2).

<sup>9</sup> *Insurance Contracts Regulations 1985* (Cth), [reg 12](#).

<sup>10</sup> Australian Law Reform Commission (ALRC), *Insurance Contracts*, Report No 20 (1982).

<sup>11</sup> [ALRC](#), n 10, paras 69, [and](#) 70.

<sup>12</sup> *Insurance Contracts Act 1984* (Cth), s 11(10)(a).

<sup>13</sup> *Insurance Contracts Act 1984* (Cth), s 69.

The effectiveness of the standard cover regime is greatly undermined by the ease with which its provisions may be evaded. Simply giving a prospective insured a copy of a home building or home contents policy that excludes flood cover, for example, is not, it is strongly contended, clearly informing the insured of derogation from the standard.<sup>14</sup> This matter should accordingly receive consideration by the legislature as a priority in any review of the *Insurance Contracts Act* arising out of the 2011 floods, or otherwise.

### <DIV>NATURAL DISASTER INSURANCE SCHEMES

The discussion above focuses upon private sector insurance options available to insureds to cover their homes and contents against flood damage. Ironically it was in the aftermath of the January 1974 floods in Brisbane that the Insurance Conference Committee,<sup>15</sup> with the support of the Federal Government, investigated the feasibility of introducing into Australia a natural disaster insurance scheme to cover the risks of earthquake, flood and tropical cyclone. The Committee concluded that while cover against earthquake was freely available and that a substantial amount of flood protection was provided by the private insurance market, both these risks were uninsurable in principle.<sup>16</sup>

Accordingly, the Committee recommended that a form of compulsory natural disaster insurance should be introduced into Australia to cover the risks of earthquake, flood and tropical cyclone. A Working Party, comprised of officials, prepared a report entitled, *A Natural Disaster Scheme for Australia*<sup>17</sup> outlining a scheme whereby a pool would directly underwrite these risks, meeting claims from its own resources with a layer of reinsurance cover to augment that pool. Above that amount it was proposed that the Commonwealth would provide further reinsurance to a predetermined amount. Cover was intended to apply initially to domestic buildings and contents and to small businesses. While the Working Party recognised that it might be necessary to make it compulsory to insure with the pool, it was contemplated that cover would be made available on a voluntary basis at first.<sup>18</sup>

After initially giving in-principle support to the introduction of a natural disaster insurance scheme, the Federal Government in January 1979 resolved not to proceed with the Scheme. As the ALRC reported,<sup>19</sup> there were perceived difficulties with such a scheme; namely:

<blockquote>

- an excessive degree of intervention by government in activities traditionally the responsibility of the private sector;
- a likely need for compulsion on either or both insureds and insurers for the scheme to be fully successful;
- widespread concern that the selected hazards to be covered by the scheme would not be in line with the needs, risks and exposures of some States;
- the ensuing need for a major reorganisation of present natural disaster insurance arrangements, possibly resulting in a reduction in the level of reinsurance available from the international reinsurance market; and

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<sup>14</sup> See Tarr J, "Respecting Contractual Intentions & Balancing Consumer Expectations with the Sanctity of Contract in the Context of Standard Form Insurance Contracts" (2001) 7 *International Trade & Business Law Annual* 287; Tarr J, "Disclosure under the Prescribed Insurance Contracts Regime: Section 35 of the Insurance Contracts Act 1984 and Consumer Protection Revisited" (2001) 28 ABLR 198.

<sup>15</sup> Established by the Insurance Industry in 1970.

<sup>16</sup> Insurance Conference Committee, *Feasibility Study into the Introduction of a Natural Disaster Scheme for Australia* (1974).

<sup>17</sup> Published in 1976.

<sup>18</sup> *A Natural Disaster Insurance Scheme for Australia* (1976); [ALRC, n 10](#), para 375.

<sup>19</sup> [ALRC, n 10](#).

- potential payouts by the Commonwealth of possibly large and unforeseeable amounts that could disrupt sound budgetary planning and management.<sup>20</sup>

</blockquote>

The validity of these difficulties and obstacles deserve further examination. There is no shortage of examples where government intervention is necessitated by obvious market failure. As David Middleton comments in relation to New Zealand's Earthquake Commission (EQC):

<blockquote>

In practice, disaster after disaster in the last quarter of the last century has demonstrated that the insurance mechanism does not work well for (natural disaster) events. Policies cost too much and are too restrictive. People choose not to purchase.<sup>21</sup>

</blockquote>

As far as compulsion on either or both insureds and insurers for the scheme to be fully successful is concerned there is, again, no shortage of examples where compulsion is necessary where circumstances warrant it. The obvious example that may be cited relates to compulsory third party motor vehicle insurance. Further, while it is clear that the needs, risks and exposures of all States do not correspond and that there will be some cross-subsidisation in any compulsory scheme of those who choose to build or live in high risk areas, the level of subsidisation is less pronounced if the range of risks covered is carefully developed and has regard to Australia as a whole – so the focus extends beyond flood and cyclone, to the earthquake and bush fire losses, and to other natural disaster events.

Concern about a major reorganisation of natural disaster insurance arrangements and the potential impact upon international reinsurance arrangements is a very real concern that would have to be addressed in the way in which any scheme was structured and implemented with a very careful assessment of retention levels. The experience of the New Zealand's EQC does give some comfort as the Commission reports that the size of the program and its ability to provide quality analysis make it a prestigious client in the worldwide insurance market.

The final mooted difficulty to the introduction of a national natural disaster scheme was the potential payouts by the Commonwealth of possibly large and unforeseen amounts that could disrupt sound budgetary planning and management. This, when measured against present arrangements, surely has little merit. At present in the absence of any forward planning as evidenced by, for example, the creation of a natural disaster fund, an ad hoc funding solution to cover disaster relief must be found – such as the imposition of an increased levy on targeted taxpayers. This admittedly relates to reinstatement of public infrastructure and not reimbursement of private parties, but, as a matter of principle it is suggested that the necessity for appropriate contingency planning exists for public and private sectors. It is surely far better to have a natural disaster plan and fund to anticipate the inevitable cycle of national disasters.

While accepting that the creation of a natural disaster insurance scheme posed great practical problems, the ALRC noted that these concerns had been extensively canvassed in the studies that nevertheless concluded that a natural disaster insurance scheme should be introduced.<sup>22</sup> However, given the Federal Government's decision not to proceed with such a scheme, the Commission concluded that it would not be appropriate for it to further review the merits of such a scheme.<sup>23</sup>

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<sup>20</sup> [ALRC, n 10](#), para 376.

<sup>21</sup> See Middleton D, "The Role of the New Zealand Earthquake Commission" (2001) *Australian Journal of Emergency Management* 57, at 59.

<sup>22</sup> [ALRC, n 10, para 377](#).

<sup>23</sup> [ALRC, n 10, para 377](#).

Accordingly, the thrust of the Commission's response to natural disaster risks was to include them within the relevant standard cover in an endeavour to meet the reasonable expectations of the insuring public in particular fields of insurance. No recommendations were made in their Report to deal with the wider problem of natural disaster insurance.

However, for the reasons that are mentioned above it is recommended that the establishment of a national natural disaster insurance scheme be re-visited.

In this regard it is instructive to look at natural disaster insurance arrangements in place in other jurisdictions. For purposes of this article two examples are chosen – New Zealand's Earthquake Commission scheme and the United States of America National Flood Insurance Program. These schemes provide polar examples of arrangements that could serve to inform any model for an Australian scheme, if introduced.

### **<subdiv>New Zealand Earthquake Commission**

The *Earthquake and War Damage Act 1944* established a Commission "to make provision with respect to the insurance of property against earthquake damage and war damage".<sup>24</sup> This Act was repealed by its successor, the *Earthquake Commission Act 1993*, and significant changes were effected to the scope and operations of the Commission.

The *Earthquake Commission Act* is broader in its coverage than its predecessor as it extends to damage caused by earthquake and a range of natural disasters – natural landslips, volcanic eruption, hydrothermal activity and tsunami, storm and flood.<sup>25</sup> It is narrower in scope than its predecessor in its exclusion from the non-residential market.<sup>26</sup>

The features of the Earthquake Commission insurance scheme are as follows:

- Where a person enters into a contract of fire insurance with a private insurer in respect of any residential building in New Zealand that building is deemed to be insured under the Act against natural disaster damage for its replacement value.<sup>27</sup> Similarly, provision is made for personal property<sup>28</sup> and residential land upon which an insured residential building is situated also receives natural disaster coverage.<sup>29</sup> The maximum sum insured is modest – \$NZ100,000 on each dwelling and \$NZ20,000 on contents.<sup>30</sup>
- The Scheme is compulsory in the sense that if a home is insured, the insurance company is obliged to pay the Commission a premium and the EQC is obliged to insure. The premium rate is 5 cents per \$100 of cover and EQC insures approximately 90% of New Zealand homes.<sup>31</sup>

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<sup>24</sup> *Earthquake and War Damage Act 1944*, Preamble.

<sup>25</sup> *Earthquake Commission Act 1993* (NZ), s 2 (definition of "natural disaster").

<sup>26</sup> As Middleton, n 21 at 59, explains: "until 1993, commercial property owners were also compelled to insure with the Earthquake Commission (EQC). Continuation of this would have necessitated a far more complex form of cover and increased EQC's liabilities to unmanageable levels. It appears that the insurance industry is needed here in all its choice and variety; commercial risk management choices, including alternatives like facility duplication and avoidance of risk prone areas."

<sup>27</sup> *Earthquake Commission Act 1993*, s 18.

<sup>28</sup> *Earthquake Commission Act 1993*, s 20.

<sup>29</sup> *Earthquake Commission Act 1993*, s 19.

<sup>30</sup> *Earthquake Commission Act 1993*, s 18(1)(c) and s 20(b).

<sup>31</sup> *Earthquake Commission Act 1993*, s.14(1)(a),. See Middleton, n 21 at 59.



- The perils insured against are earthquake, volcanic eruption, hydrothermal activity, landslip and tsunami. Fire following any of these is also covered. Covered in the case of residential land only is storm or flood.<sup>32</sup>
- A Natural Disaster Fund is established and this fund has as its main source of revenue the premiums collected on behalf of the Commission by the various insurance companies and paid into the Fund.<sup>33</sup> The Commission reports that a “substantial nest egg” has accumulated<sup>34</sup> with around \$NZ5.6 billion in the Fund backed up by reinsurance from overseas groups and a Government Guarantee. Whether these accumulated funds will be sufficient to meet liabilities in the aftermath of the tragic earthquakes in September 2010 in Canterbury and February 2011 in Christchurch is unknown at this time but must be doubtful. However, it is provided that if the assets of the Commission are not sufficient to meet liabilities the Minister for Finance may provide a grant or advance to the Commission out of public money.<sup>35</sup>
- In a time of major disaster, such as a large earthquake, the Commission has a well tested catastrophe response program setting out how substantial increases in resources will be harnessed and deployed as expeditiously as possible. A recent review of this response programme concluded that historically it had been effective as assessed by anecdotal evidence and customer reactions.<sup>36</sup>

The Earthquake Commission Insurance scheme has the merit of providing simple, universal and affordable insurance of New Zealanders’ homes against natural disaster. Moreover, it is clear that there is in place a uniform and comprehensive plan to respond to any natural disaster. Further the Commission undertakes an extensive program of public information, supported by research and science, on how communities can make themselves less vulnerable to the effects of extraordinary natural events.<sup>37</sup>

### **<subdiv>The United States’ National Flood Insurance Program**

In the United States, legislation providing flood cover for communities in flood prone zones was created under the *National Flood Insurance Act 1968* to address problems such as those encountered in Queensland in 1974 and 2011. The National Flood Insurance Program (NFIP)<sup>38</sup> carries the two-fold goals of:

<blockquote>

- providing flood insurance for structures and contents in communities that adopt and enforce an ordinance outlining minimal floodplain management standards; and
- identifying areas of high and low flood hazard for purposes of establishing flood insurance rates for structures located within the borders of these flood hazard areas.

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<sup>32</sup> *Earthquake Commission Act 1993*, s 2 (definition of “natural disaster”).

<sup>33</sup> *Earthquake Commission Act 1993*, ss 13, 14.

<sup>34</sup> See <http://eqc.govt.nz/abouteqc.aspx> viewed 28 March 2011.

<sup>35</sup> *Earthquake Commission Act 1993*, s 16.

<sup>36</sup> See Earthquake Commission, *Review of New Zealand Earthquake Commission’s Catastrophe Response Operational Capacity* (May 2009) <http://www.eqc.govt.nz/downloads/pdfs/CRP-Review-Report-final-280509.pdf> viewed 28 March 2011.

<sup>37</sup> See Middleton, n 21 at 62.

<sup>38</sup> For an overview of the operations including insurance policies and administrative documentation, see *Information for Insurance Professionals* (Federal Emergency Management Agency, United States) <http://www.fema.gov/business/nfip/infoa.shtm> viewed 28 March 2011.



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The Act, following in the wake of a long history of property damage and loss of life, was catalysed by the 1965 flood surges generated by “Billion Dollar Betsy,” a category 4 hurricane that was widely perceived at that time to be the first storm to cause losses in excess of one billion dollars.

Amendments over the last four decades have included:

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- the Flood Disaster Protection 1973 – which introduced compulsory purchase requirements for flood insurance on property located in Special Flood Hazard Areas (SFHAs);
- the *Coastal Barrier Resources Act* (CBRA) which in 1982, for purposes of discouraging coastal development in fragile and high risk areas, designating a matrix of coastal areas<sup>39</sup> in which new or significantly improved structures are ineligible for direct or indirect federal financial funding assistance; and
- the *Flood Insurance Reform Act 2004*<sup>40</sup> further amended this legislative approach to minimise losses to properties for which repetitive flood insurance claim payments have been made.

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Features of this Program include:

- The provision of an affordable ~~government-~~backed flood insurance policy for property owners and renters in participating communities for losses arising out of flooding. The scheme, introduced in response to escalating concerns over building repair and content losses, is intended as an insurance alternative to disaster assistance flood programs and is administered by the Federal Emergency Management Agency (FEMA).
- Cover is provided on the prerequisite that the community in which the applicant is located has joined the NFIP and agreed to the design and enforcement of sound floodplain management standards.
- As a federal program, the NFIP ensures policy rates are set and are uniform across companies or agents. Policies can be purchased directly through property and casualty agents with over 90 private insurance providers currently participating.<sup>41</sup> Rates depend on many factors, including the date and type of construction of homes as well as the buildings assessed level of risk. As of April 2010, the program insured about 5.5 million homes, the majority of which were in Texas and Florida.
- Under the NFIP local communities and the Federal Government contract to adopt and enforce a management plan to reduce future flood risks to new construction in SFHAs in exchange for the Federal Government making flood insurance available within the community.

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<sup>39</sup> The John H. Chaffee Coastal Barrier Resources System (CBRS) provides a series of maps outlining, at present, 585 fragile, high risk and ecologically sensitive areas in order to: 1) minimise the loss of human life by discouraging development in high risk areas vulnerable to storm surges and hurricane winds; 2) reduce wasteful expenditure of Federal resources; and 3) protect the natural resources associated with undeveloped coastal barriers. See The *Coastal Barrier Resources Act* (Public Law 97-348); amended in 1990, *Coastal Barrier Improvement Act* (Public Law 101-591); See *Digest of Federal Resource Laws of Interest to the US Fish and Wildlife Service* (16 USC 1451-1464, Ch 33; PL 92-583, October 27, 1972; 86 Stat. 1280) <http://www.fws.gov/laws/lawsdigest/COASZON.HTML> viewed 31 March 2011.

<sup>40</sup> *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004* (Public Law 108-264), introduced initially in 2003 somewhat more colourfully as the Bill, “Two Floods and You are Out of the Taxpayers’ Pocket Act of 2003”.

<sup>41</sup> For a comprehensive list and overview [http://www.floodsmart.gov/floodsmart/pages/about/nfip\\_partnership.jsp](http://www.floodsmart.gov/floodsmart/pages/about/nfip_partnership.jsp) viewed 31 March 2011.

This program, unlike the New Zealand Earthquake Commission Scheme, has some very serious drawbacks and problems. The Institute for Policy Integrity at New York University School of Law<sup>42</sup> reports that because of below-market insurance rates and the intense hurricane-related floods in recent years that the NFIP has accrued substantial deficits in the order of \$19 billion, which under current structuring the program would not be able to repay. The report adds that since the NFIP cannot charge market rates, hold reserve funds, or purchase reinsurance, the program faces a constant financial risk of insolvency. Moreover, the availability of the program has encouraged relocation to areas more susceptible to flood damage – as opposed to prior patterns of building based only on the availability (or lack thereof) of private flood cover insurance. Losses incurred from flood damage therefore rested on the property owner, on high priced special policies and premiums in some instances, on dispute over claims interpretation of water damage terms and on limited disaster relief and aid programs. Under FEMA regulation of this program, owners of properties in flood plains frequently receive disaster aid and payment for insured losses, which in many ways negates the original intent of the NFIP. Consequently these policy decisions have escalated losses stemming from floods in recent years, both in terms of property and life. These costs – financial risk and ecological damage – are widely distributed to United States taxpayers.<sup>43</sup>

Numerous other criticisms are also directed at the Program. For example, that the provisions within the NFIP increase the likelihood that flood-prone properties will be occupied by people least likely to be in a position to recover from flood disasters, which further increases demand for aid. Acquiring flood insurance in flood-prone areas is not compulsory unless the property is secured by a home loan. Consequently, uninsured properties hit by flood losses tend to be disproportionately owned by elderly/retired individuals or investors who have acquired the properties for rental income purposes. Both these groups may be particularly vulnerable as the equation as to whether to take out cover or “just risk it” is often somewhat precariously financially balanced.<sup>44</sup>

The New Zealand and United States schemes serve as working examples of natural disaster responses at a national, public level. Like the Natural Disaster scheme mooted in Australia in 1976 they are not free of difficulties but are worthy of consideration in any review of how to respond to future natural disasters. The New Zealand scheme does appear to provide a very effective mechanism to address losses within the limited financial caps of that scheme. Regrettably the tragic recent earthquakes in Christchurch will again test the resources and capacities of that Scheme. The United States program in contrast to the New Zealand model has serious deficiencies and exemplifies the dual problems of cross subsidisation and inadequate pricing.

## <DIV>CONCLUSIONS

It is clear that as with the 1974 Brisbane floods, the 2011 Queensland floods will give rise to very substantial uninsured losses. These natural disasters, including major bushfires such as the 1983 Ash Wednesday bushfire in South Australia and the 2009 Black Saturday bushfire tragedy in Victoria as well as cyclones Tracy and Yasi, demonstrate serious deficiencies in the private insurance market's capacity to address these events. There are problems with coverage and the definition of flood and other natural disasters in policies, there are problems with people choosing not to purchase flood or other disaster cover and problems of availability and cost.

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<sup>42</sup> Holladay JS and Schwartz JA, “Flooding the Market – the Distributional Consequences of the NFIP”, , Policy Brief No 7 (April 2010).

<sup>43</sup> Holladay and Schwartz, [n 42](#) at 6.

<sup>44</sup> See, for example, Consumer Federation of America, *Re: Oppose the Flood Insurance Reform Priorities Act of 2010 (HR 5114), on the House Floor this Week*, ( 14 July 14, 2010) [http://www.consumerfed.org/elements/www.consumerfed.org/file/Flood\\_Insurance\\_House\\_Bill\\_letter.pdf](http://www.consumerfed.org/elements/www.consumerfed.org/file/Flood_Insurance_House_Bill_letter.pdf) viewed 31 March 2011.

A judicial inquiry into Queensland's floods headed by Holmes J, has been established and there will, no doubt be detailed findings and recommendations flowing from the enquiry. In parallel it is suggested that there are certain measures that can and should be taken. These recommended measures are as follows:

**In relation to private insurance, there should be a standard definition of "flood".**

In this regard the definition in the QBE policy cited above would be a good starting point. "Flood" means the inundation of normally dry land by water escaping from any watercourse, lake, canal, dam or reservoir". Similarly, the United States NFIP<sup>45</sup>-endorsed definition as it appears across all residential and commercial contracts of insurer-participants adopts this approach, delineating a flood as "a general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two or more properties (at least one of which is your property) from:

<blockquote>

- overflow of inland or tidal waters; and
- unusual and rapid accumulation or runoff of surface waters from any source.<sup>45</sup>

</blockquote>

A standard definition will promote greater certainty and remove one area of dispute.

**Standard cover, including flood and other natural disaster cover, should apply in the absence of clear notification to the contrary.**

The ALRC,<sup>46</sup> in advocating the standard cover regime, required the insurer *to clearly inform the insured in writing* of any derogation from the standard. To this was added the situation where the insured knew, or a person in circumstances of the insured could reasonably be expected to have known, that the cover was not being provided. These are legitimate circumstances in which natural disaster cover, such as flood cover, might be excluded. Simple delivery of the policy document is not. It is recommended that specific notice as to the absence of flood cover should be required on the face of the policy document. This notice should be prominent and unambiguous.

**A review should be conducted into whether a National Natural Disaster Scheme should be established.**

The difficulties in introducing such a scheme are certainly present but are not insurmountable. Not surprisingly private insurers have already foreshadowed reservations relative to any change to the private insurance market. Suncorp Insurance's Chief Executive Officer, Patrick Snowball, has stated that government should not go down the path of creating a natural disaster scheme but instead should improve water management, land zoning and building design measures in order to reduce risks and should improve flood mapping.<sup>47</sup> Insurers express a valid concern relative to management by governments and local authorities of developments in flood prone areas, for example, and more comprehensive flood mapping will facilitate better insurance and reinsurance outcomes. Measures to address these concerns undoubtedly should be considered and implemented but given repetitive market failure and significant uninsured losses in the aftermath of each natural disaster, a national natural disaster scheme deserves careful consideration and evaluation. With a compulsory scheme assuming a universal but relatively modest primary tier of cover the private insurance market would continue to participate in providing top-up cover against natural disaster events on a voluntary basis. At least on such a basis everyone would be covered to some degree and the level of uninsured losses faced by those individuals and families with limited resources and no natural disaster insurance significantly reduced.

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<sup>45</sup> See FEMA, *National Flood Insurance Program Summary of Coverage*, [http://www.floodsmart.gov/floodsmart/pdfs/NFIP\\_Summary\\_of\\_Coverage.pdf](http://www.floodsmart.gov/floodsmart/pdfs/NFIP_Summary_of_Coverage.pdf) viewed 31 March 2011.

<sup>46</sup> ALRC, n 10, para 70. See also Appendix A, cll 35 and 36.

<sup>47</sup> [Fraser A., "Don't rush insurance reform, Suncorp warns government", The Australian, 18 February 2010. <http://www.theaustralian.com.au/business/dont-rush-insurance-reform-suncorp-warns-government/story-e6frg8zx-1226007826906AQ>, See also O'Halloran F (QBE Chief Executive Officer)]

**The problem of claims processing and payment can be acute in the context of natural disasters where destitution and homelessness are consequences of events like flood or earthquake.**

It is beyond the scope of this article to explore this in detail, but the problem is not easily addressed in the context of the private insurance market. Sanctions are provided in the *Insurance Contracts Act* for late payment<sup>48</sup> and there are mechanisms for the resolution of complaints and disputes between insurers and their customers under the General Insurance Code of Practice. However, the insurer must be allowed a reasonable time to investigate and quantify claims under private insurance contracts and this “limbo” period can be very difficult for insureds. In this context interim or other support payments by the government or under a natural disaster insurance scheme are the obvious solutions.

The tragedy and trauma that has accompanied Australia’s all too frequent cycle of natural disasters is well documented and felt keenly by its communities. It is hoped, however, that if this round of public inquiries and legislative reviews can be firmly focussed on clarity, transparency, risk management and minimisation through long term planning, at least some benefit will derive from the midst of these disasters.

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<sup>48</sup> *Insurance Contracts Act 1984* (Cth), s 57.