Local Government and Insurance

Flood Insurance Pricing

As of March 2015, more than 93% of home building and contents insurance policies contain flood cover as a standard inclusion. This is largely due to rapid improvements in access to flood information, as well as insurers' ability to understand and price the risk of flood damage to properties across Australia. Prior to 2007, information about flood risk in Australia was considered so poor that most insurers were unable to provide flood cover.

Things have changed. We now know approximately 15% of properties in Australia are at some risk of flooding. For these properties, insurers may charge an additional flood insurance premium in order to collect sufficient premiums to meet the cost of future claims as they arise.

Whilst all insurers approach premium calculation in different ways, this fact sheet outlines the common approaches and generic process followed.

General insurance pricing in Australia

General insurers take on their customers' risk, turning them into a 'policyholder', allowing them to manage the financial burden of damage resulting from a specific event such as a flood. Insurers identify and then manage the costs of these risks to make sure there is enough money coming in through premiums to pay claims.

Broadly speaking, general insurance in Australia is risk rated. In a risk rated insurance market, an insurer calculates the premium payable on the basis of various factors specific to an individual property, such as the likely frequency and size of a claim and the estimated value of such claims during the term of an insurance policy.

Why flood risk is assessed separately to other risks

For events such as house fire, earthquake and hail damage, the chance of an event occurring is fairly evenly distributed – neighbouring properties will have roughly the same risk of being affected by an event and making an insurance claim.

Flood risk is different – most properties in Australia have little or no risk of being flooded. While around 15% of properties in Australia have some level of flood risk, only 2-3% of properties have a high risk.

The minority of properties which are at high or extreme risk of flooding contribute disproportionately to the claims paid out by insurers, and are more likely to make repeated claims. To ensure they are able to continue offering flood insurance in a sustainable manner, insurers need to charge an additional flood insurance premium that reflects the level of flood risk at each property.

What is a 'flood'?

Since 2014, all home building, home contents, small business and strata insurance policies have adopted a common definition of "flood":

> *"The covering of normally dry land by water that has escaped or been released from the normal confines of any lake, or any river, creek or other natural watercourse, whether or not altered or modified; or any reservoir, canal, or dam."*

Events such as a ruptured hot water system, water entering through windows and eves during a storm, sea level rise and storm surge are not considered "flooding" for insurance purposes. These events may be covered under other elements of an insurance policy.

Consumers should always read their Product Disclosure Statement (PDS) when entering into an insurance contract, to understand which events are covered under their policy.

Factors that affect a flood premium

Flood insurance premiums generally reflect the level of flood risk at a property and the cost of repairing or rebuilding the property. In practice, this can be broken down to three factors which would be assessed by all insurers when setting a flood premium for a property:

- ✓ Likelihood of flooding;
- ✓ Expected depth of flooding relative to the insured building; and
- ✓ Expected cost of recovery.

Likelihood and depth of flooding are assessed at an individual address level, using results from computer flood modelling which simulates how water flows through a catchment. Expected cost of recovery includes repair, rebuild and replacement costs, temporary accommodation, and other factors such as the potential shortage of materials and labour after a flood event.

Some insurers may also consider property-specific information such as number of storeys, floor levels, building materials used and construction type

Information insurers use to assess the level of flood risk at a property level

Insurers prefer to use the highest quality flood modelling available - this usually means a local or state government flood study. Where government makes flood hazard data available to the industry, the raw data is:

- incorporated into the industry's National Flood Information Database (NFID) which provides an assessed depth of flooding (if any) for all addresses in Australia in a format usable by underwriters; and

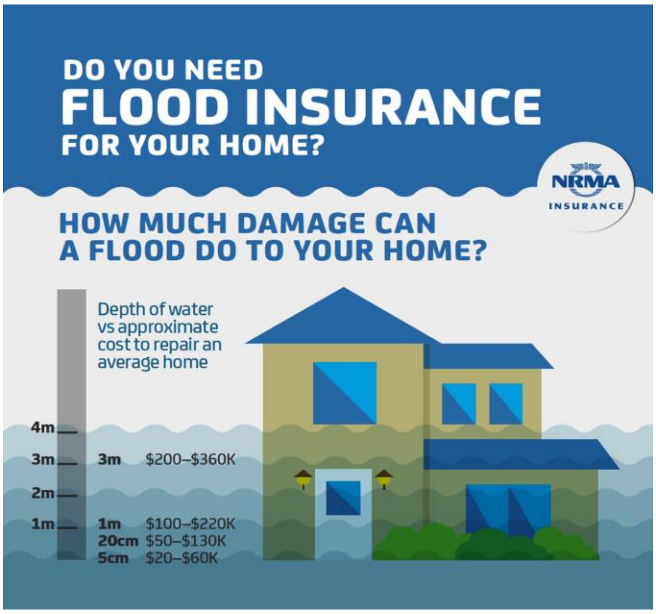
- shared with all participating insurers.

In areas where a government chooses not to share data with insurers or where government flood data is not available, insurers are often forced to refer to alternative sources of flood data including historical flood extents and non-government flood modelling datasets. You can read more about this in the ***Sharing Flood Risk Information*** fact sheet.

The cost of damage caused by floods

Flood damage can range from just ruining carpets and contents, to destroying entire kitchens, electrical wiring and even causing structural failure requiring a complete rebuild - the cost of recovering from even minor flooding can be surprisingly high.

The diagram below shows indicative costs to recover from floods of various depths, from one insurance company:



Flood insurance premiums are proportional to the flood risk at a property – this high cost of recovery can unfortunately result in high premiums in areas with a high likelihood of flooding.

Why insurers charge a flood premium for properties outside a Council's flood risk zone

Most local governments only apply planning controls in areas identified as 1-in-100-year flood zones (i.e. a 1% chance of flooding per year).

Flood insurance covers ALL flood events, including much larger (or less-likely) floods than the 1-in-100-year event. In some parts of Australia, extreme flood events can occur with depths 8-10m higher than the 1-in-100 year event, affecting properties well outside the 1-in-100-year flood zone.

In reality, if you live in a 1-in-100-year flood zone there is a 55% chance that you will experience a flood event larger than the 1-in-100-year flood within an 80-year lifetime. As insurers cover all flood events they have to take all flood risk into account when setting flood premiums, not just the flood risk up to the 1-in-100-year event.

Insurers do not assess flood risk based on postcodes

Flood hazard is very location-specific and insurers understand that it is not possible to make confident estimates of flood risk based on a postcode. To ensure that insurance premiums reflect the risk at each individual address, insurers have access to address-specific flood hazard data through the National Flood Information Database (NFID) and other sources.

Insurers don't include climate change or sea level rise in the cost of premiums

You may have seen media reports about projected sea-level rise or climate change scenarios leading to higher insurance premiums. This is a myth. Insurers are not covering risk in 25, 10 or 5 years time. They are covering the next 12 months from when a policy begins. This means insurers are interested in current risk and set premiums based on the current risk, not the risk under any projected future climate scenarios.

What to do if you think an insurer has assessed flood risk incorrectly

The insurance industry makes significant investments in sourcing the best quality up-to-date flood information. However insurers do not have access to all information relevant to every property. This is more likely for newer subdivisions which have been raised to reduce flood risk, for houses elevated on piers to reduce flood vulnerability, and for houses built on the high part of large rural blocks.

If you have evidence that an insurer has incorrectly assessed risk of flooding (e.g. a Council flood study, floor level survey, site-specific flood report or similar), please contact the insurer directly to discuss. Many major insurers have dedicated flood premium review processes in place and welcome information that helps improve the accuracy of their flood risk assessments. The Insurance Council of Australia (ICA) can also assist in reviewing information if an insurer cannot. Providing the insurer or ICA documentation will assist in this discussion.

It is also important to shop around if you are not satisfied by the premium or cover offered by your insurer.

Go to insurancecouncil.com.au or floods.org.au for further information including contact details.