



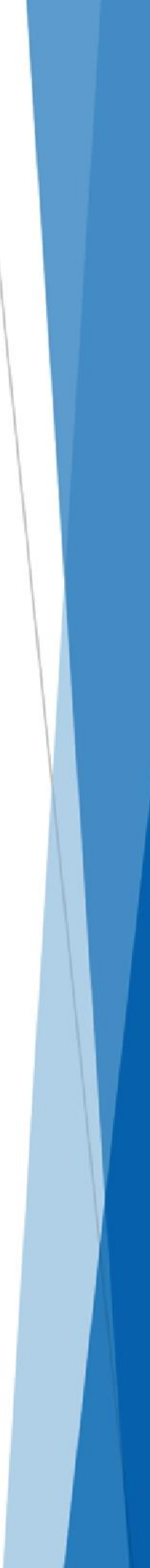
Australian Banking
Association



INQUIRY INTO INSURERS' RESPONSES TO 2022 MAJOR FLOODS CLAIMS

House of Representatives Standing Committee on Economics

5 July 2024



ABA submission to the Inquiry into insurers' responses to 2022 major floods claims

The Australian Banking Association (**ABA**) welcomes the invitation to provide a submission to the Inquiry into insurers' responses to 2022 major floods claims led by the House of Representatives Standing Committee on Economics (**Committee**).

This submission is made in two parts, first, outlining banks' active support of customers during natural disasters and second, responding to the questions in respect to impacts of insurance unaffordability put to the ABA.

1. Banks play an active role to support customers during natural disasters

Banks' response to natural disasters, including floods, when they arise is to ensure a consistent, supportive and timely response by the banking sector. Banks and the ABA regularly encourage any customer affected by natural disaster to contact their bank as soon as possible for assistance and implement several steps to ensure those affected are supported.

This support is delivered in part through the ABA's Natural Disaster Response Protocol, which sets out how the ABA and member banks work together following a natural disaster event to support on-the-ground efforts.

Collaboration with banks ensures the ongoing provision of banking services to affected communities, including:

- Facilitating access to cash, deployment of mobile ATMs and Bank in a Box services to locations that are significantly impacted by natural disaster, for example, due to major road closures, electricity failures or branch disruptions.
- Communication and coordination between government, peak bodies and community groups who may be affected, as needed, to proactively identify and address issues as they arise.

Australian banks also offer direct support options to customers that are impacted by natural disasters. These are broad and may include:

- A deferral of scheduled loan repayments, on home, personal and some business loans.
- Waiving of fees and charges, including for early access to term deposits.
- Debt consolidation to help make repayments more manageable.
- Restructuring existing loans free of the usual establishment fees.
- Offering additional finance to help cover cash flow shortages.
- Deferring upcoming credit card payments.
- Emergency credit limit increases.

The ABA and our members publish communications materials via online platforms and local news outlets to notify communities of the assistance banks can offer to help customers during and following a natural disaster. The ABA is also a member of the Banking and Finance Group of the Trusted Information Sharing Network and works cross-sector to manage significant natural disaster impacts, as well as regularly participating in cross-industry forums held by the National Emergency Management Agency.

2. Impacts of natural disasters on insurance affordability

Climate change is resulting in a greater incidence of natural disasters¹, which has seen an impact on the affordability and availability of insurance policies across Australia.

The Actuaries Institute Home Insurance Affordability Update of August 2023 identified that 12% of households (or 1.24 million Australia households) face extreme insurance affordability stress,² although the ABA notes there is no one comprehensive and reliable data set by which peril risk (and impacts on insurance affordability) can be measured nationally.

However, some banks report on the outcomes of climate risk assessments of their home loan portfolios in public climate reports, which broadly identify that such risk currently represents a small proportion of banks' total mortgage books.

We provide the following responses to the Committee's questions to the ABA:

Q1: How banks are incorporating the higher risk profiles insurers are applying to properties, particularly for flood risk, into their own risk profiles, and

Q2: Actions banks are taking to monitor insurance cover as part of their requirements for taking out and maintaining a mortgage, and any actions taken in response to mortgagors removing flood cover as a component of their insurance, or not being able to afford insurance altogether

Under APRA requirements APS and APG 220 – Credit Risk Management (and as part of general mortgage terms and conditions for most banks), customers must hold an insurance policy to take out a mortgage over a property. Insurance is checked by banks as part of the mortgage origination and verification process before settlement over a property occurs.

Banks have a range of processes in place to proactively identify and manage risks on their books. These processes are subject to credit and risk policies of individual banks but can include measures such as:

- Obtaining a more detailed property valuation for properties in high-risk locations.
- Issuing annual reminders to mortgage holders regarding insurance.
- Proactively contacting customers in high-risk locations or with certain customer-specific factors to check insurance coverage.
- Verification of certain peril-specific coverage where properties are identified as high-risk.
- Adoption of risk management frameworks and using climate-related data on physical, transition risks to help identify, assess, monitor and manage potential risks to banks' residential home loan portfolios.
- Resilience-specific programs led or supported by banks to provide customers with information and tools to make informed decisions regarding their home's climate resilience, and to identify areas of their homes that may increase their vulnerability to potential climate hazards.³

Banks also have a range of processes they may carry out where they identify that a borrower no longer holds insurance or has removed a component of their insurance policy relevant to their property (such as the flood component of their policy).

For example, a bank may remind the customer of their insurance obligations under the mortgage contract and work with the customer to support the customer to reinstate their insurance policy. They may also work closely with the customer to understand the reason for not holding adequate insurance. If a customer indicates affordability issues with their insurance or mortgage repayments, some banks may explore hardship arrangements for the customer based on their circumstances to support them with repaying

¹ Royal Commission into Natural Disaster Arrangements 2020.

² Affordability stress is defined as paying more than four weeks of household gross income towards home insurance premiums.

³ For example, the Resilient Building Council's Bushfire Hazards Rating App, which some members support.

their loan or paying for insurance. Banks may also assist customers with searching for a new insurance policy and connect them to the bank's insurance broker where alternative insurance options exist.

Q3: Any changes banks have made to their mortgage offerings for properties with a higher than average risk of future impacts by floods (e.g. 2%, 5% or higher risk of flooding)

Q4: Any changes banks have made to their mortgage offerings, as a result of increased premiums insurers have required to insure properties for flood

Q5: Any changes banks have made to offerings of construction loans to mortgagors during the rebuild phase following a flood event to account for increased risks of a second flood event

Individual banks structure and price their product offerings to account for risk based on their individual credit and risk policies.

Q6: How cash settlements are handled and, in particular, whether cash settlements are ever needed to pay off mortgages without the mortgagor's explicit consent?

Currently, banks have varying policies on the treatment of insurance cash settlements. While the customer must work directly with their insurer regarding an insurance claim, if a customer has a mortgage and intends to make an insurance claim on their home, it is a good idea for them to contact their bank to discuss their circumstances and the options available. The bank will work with the customer to understand their situation, future intentions, and options available for the insurance cash settlement.

Factors that banks consider include:

- The amount of equity available in the home
- If the home loan involves lenders mortgage insurance
- The scale of the damage (non-structural, structural, or total loss)
- The value of the insurance cash settlement received
- A customer's repayment history
- Evidence of the customer's desired plan (re-build, repair or relocate)
- Whether the customer has experienced a change in their financial situation? E.g., employment situation, household income, living expenses, liabilities.

The bank will work with all parties to determine the appropriate release or payout process, depending on the bank, their assessment and the customer's future intentions. Ultimately, how claims are settled is decided between a customer and their insurer and/or bank.

To assist customers with understanding the process that banks may follow on cash settlements, the ABA has published a fact sheet (see **Appendix**) on insurance cash settlements after natural disaster, available on the ABA website.⁴ The ABA and our members also publish communications materials via online platforms and local news outlets to notify communities of the assistance banks can offer to help customers during and following a natural disaster and have resources available online on support options available, including the ABA Financial Assistance Hub.⁵

⁴ <https://www.ausbanking.org.au/wp-content/uploads/2022/07/Treatment-of-Cash-Settlements-Fact-Sheet-2022.pdf>.

⁵ <https://www.ausbanking.org.au/financial-assistance-hub/>.



Appendix



Insurance cash settlements after natural disaster

Don't tough it out on your own. Call your bank. They are here to help.

What support is available?

Understanding what support is available is essential in times of disaster. Depending on a customer's personal circumstances, banks in Australia have a range of measures available, including:

- A deferral of scheduled loan repayments on home, personal and some business loans
- Waiving of fees and charges, including early access to term deposits
- Debt consolidation to help make repayments more manageable
- Restructuring existing loans free of the usual establishment fees
- Offering additional finance to help cover cash flow shortages
- Deferring upcoming credit card payments
- Emergency credit limit increases

The support banks provide is assessed on a case-by-case basis. To find out what support is right for an individual, they can contact their bank to discuss options.

Understanding insurance cash settlements

While the customer must work directly with their insurer regarding an insurance claim, if a customer has a mortgage and intends to make an insurance claim on their home, it is a good idea for them to contact their bank to discuss their circumstances and the options available.

How does the process work?

A customer contacts their insurer to make an insurance claim. The insurer will then contact the bank, if the insurer is settling a customer's claim under a cash settlement.

Note: the bank will usually be noted on the insurance policy, and if not, the insurer will inquire to see if there is a mortgagee.

The bank will work with the customer to understand their situation, future intentions, and options available for the insurance cash settlement.



Understanding the customer's situation and future intentions:

Banks currently have varying policies on the treatment of insurance cash settlements.

Factors that banks consider include:

- The amount of equity available in the home
- If the home loan involves lenders mortgage insurance
- The scale of the damage (non-structural, structural, or total loss)
- The value of the insurance cash settlement received
- A customer's repayment history
- Evidence of the customer's desired plan (re-build, repair or relocate)
- Whether the customer has experienced a change in their financial situation? E.g., employment situation, household income, living expenses, liabilities.

Options that may be available for the insurance cash settlement

The bank will work with all parties to determine the appropriate release or payout process. Depending on the bank, their assessment and the customer's future intentions, potential options for insurance cash settlements may vary.

The customer intends to re-build or repair the property:

- If adequate equity is available (based on an updated valuation), customers may be allowed to have access to the funds to do with as they see fit. For example, the land value alone is sufficient to cover the outstanding debt.
- If insufficient equity is available or there has been a change in personal circumstances, proceeds from the insurance cash settlement may:
 - o Be paid into the loan and redrawn in progressive payments, paid directly to the builder or repairer. Some banks may have the requirement to re-originate the loan under a construction basis to allow progressive drawdowns. Customers may be required to provide the bank with a building contract schedule, and progressive valuations may be required at various stages of the construction or repair process.

- o Partially reduce the loan balance and any remaining insurance cash settlement funds released to the customer to self-manage the build or repair process. For example, this may be suitable where the size of the damage is non-structural and less than \$50,000.
- o Payout the existing home loan, and the bank will assist the customer to re-apply for a new loan if required. For example, the customer may require additional funds greater than the insurance cash settlement amount to rebuild or repair the property, the customer may have sufficient savings to fund the re-build or make repairs without the need for future lending or the customer may sell the property in its current condition.
- In situations where the customer has no insurance, or the insurance cash settlement does not cover the home loan balance, re-build or repairs, banks will work on a case-by-case basis with customers to support in these circumstances.

The customer does not intend to re-build or repair the property:

- The insurance cash settlement may be used to pay out the loan, and any remaining insurance cash settlement funds will be released to the customer. If finance is required in the future, the customer can apply with the bank.
- In situations where the insurance cash settlement does not cover the home loan balance, banks will work on a case-by-case basis with customers to support in these circumstances.

Case-by-case

Banks will assist all customers on a case-by-case basis, taking into consideration their individual circumstances when an insurance cash settlement is received.

More information:

www.ausbanking.org.au/assistance/

If you're not satisfied with your bank, you can lodge a complaint with your bank or the Australian Financial Complaints Authority. Generally, AFCA won't deal with your dispute until you've given your bank a chance to resolve things. For more information, go to www.afca.org.au or phone 1800 931 678.