

**Response to Issues Paper on  
Natural Disaster Funding Arrangements**

**Legal Aid NSW submission  
to the  
Productivity Commission**

**June 2014**

## **Introduction**

Legal Aid NSW welcomes the opportunity to make a submission to the Productivity Commission Inquiry into Natural Disaster Funding Arrangements. Our submission focuses on the first, second and fourth terms of reference<sup>1</sup>. Our extensive experience and knowledge in the provision of legal services post-disasters form the basis of our submissions to this Inquiry.

Consumer law matters constitute the largest category of the civil law advice and minor assistance work Legal Aid NSW undertakes. In 2013, we assisted 8668 people with consumer law advice and minor assistance, and consumer law matters represented a significant proportion of the civil law legal aid grants. We bring our expertise in this area of law, particularly in the area of insurance disputes, to our provision of disaster recovery legal services.

Legal Aid NSW's approach to legal service delivery, including in the context of disaster recovery, is to provide targeted and holistic legal services with a focus on early intervention. Our Civil Law Division applies this approach to legal services delivered by way of legal advice, assistance, representation, community legal education and publications. We have expertise in a wide variety of practice areas, some of which are directly relevant to disaster-affected individuals such as insurance law.

Over the past decade, Legal Aid NSW has assisted countless communities to recover after natural disasters by providing various levels of legal service. Because of our strong connections with legal aid providers in other jurisdictions, we have been able to work collaboratively to assist communities not just in NSW but in other states. Our membership

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<sup>1</sup> Issues Paper on the *Inquiry into Natural Disaster Funding Arrangements*, Productivity Commission, at pp. 35-36.

of National Legal Aid, for example, places us in an ideal position to leverage the expertise of legal aid commissions across the country to respond effectively to natural disasters.

**Appendix A** provides a summary of the key disasters that we have been involved in since 2007. Through this work, we have accumulated valuable insights into issues affecting natural disaster mitigation, resilience and recovery.

In terms of our work in NSW, Legal Aid NSW is now widely recognised as a major stakeholder in coordinating legal services and responding to disasters. Under the NSW Legal Assistance Forum (NLAF) disaster plan, Legal Aid NSW is identified as the lead agency in coordinating legal assistance services. By working collaboratively with the NSW Ministry for Police and Emergency Services, and our legal partners such as LawAccess NSW and the National Insurance Law Service<sup>2</sup>, Legal Aid NSW has developed a streamlined and targeted approach to disaster recovery. As a government funded independent organisation, we are uniquely placed:

- to identify and resolve systemic legal issues impacting on disaster-affected communities as they arise, in particular within insurance law,
- to advocate on behalf of and assist in the recovery of these communities without vested interests, and
- to contribute to the development of natural disaster mitigation initiatives to build community resilience, thereby preventing further disadvantage to these highly vulnerable communities.

### Outline of this submission

**Part I** of this submission provides a background of the disaster recovery work conducted by Legal Aid NSW after natural disasters, and examples of legal issues faced by disaster affected individuals. The section illustrates the importance of legal assistance services in the disaster recovery process.

**Part II** provides Legal Aid NSW's observations of the dynamics at play after a natural disaster event, particularly in relation to individual insurance. Through our casework experience, we observe a number of important factors which impede individuals' and communities' ability to recover. The sustainability and effectiveness of any mitigation, resilience and recovery initiatives are highly dependent on a proper understanding of these dynamics at play.

**Part III** focuses on a number of common themes relating to insurance which are relevant to natural disaster mitigation and community resilience. This section sets out a range of levers that are available to government to manage and mitigate risk. In particular, issues in relation to underinsurance, affordability and insurance product safety are addressed in light of

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<sup>2</sup> A project run by the Financial Rights Legal Centre (formerly the Consumer Credit Legal Centre).

natural disaster mitigation and resilience. References are made to relevant findings from two (2) surveys Legal Aid NSW conducted of our clients after the Queensland and Riverina floods of 2010-2011 and the Blue Mountains bushfires of 2013.

### Summary List of Recommendations

1. That government recognises the critical role of legal assistance services in disaster recovery, and facilitates early provision of legal services after natural disasters.
2. That specialist legal services are consulted on insurance-related matters in relation to any government sponsored or facilitated schemes (such as the government clean-up scheme).
3. That authorities (e.g. local councils) charged with the responsibility to design and coordinate recovery efforts after natural disasters are required to consider, as best practice, setting up disaster recovery centres where possible to enhance individual and community recovery.
4. That insurers be required to confirm in writing details of any settlement of claims even when claims are accepted and paid.
5. That disaster recovery measures be designed to minimise inherent power imbalances faced by disaster-affected individuals, including measures that ensure individuals have access to specialist legal support services (such as legal aid).
6. That any natural disaster funding model facilitates effective public education of building code changes and their impact on the cost of rebuild and individual insurance.
7. That home insurers be required to bring to the attention of their customers at the time the product is purchased key information that would significantly affect the cost of a rebuild, such as whether the home is in a flame zone, so customers can make informed choices about what level of cover to choose.
8. That sum insured policies of home insurance are phased out, and home insurers are required to provide full replacement policies.
9. That the Government considers the Natural Disaster Insurance Review recommendations for a new integrated system to address the availability and affordability of flood insurance.
10. That the Government considers the value of addressing product safety issues in insurance with:
  - a. Market-based 'supply side' solutions such as 'not unsuitable' or 'fit for purpose' tests;
  - b. Industry-based solutions such as disaster response protocols.

## Part I: Natural disaster recovery: the importance of legal assistance

Legal assistance services are an essential element of disaster recovery. There is a strong link between legal problems and social problems, and it is often ineffective in the long term to resolve one problem without resolution of the other. Research has shown that unmet legal needs can lead to a myriad of other social and legal problems and become disruptive to the day-to-day lives of people<sup>3</sup>.

In the context of natural disasters, legal assistance alleviates hardship for people affected by a disaster by assisting them to enforce their legal rights and resolve individual and systemic issues, particularly with insurers. For example, an insured individual being paid less than their legal entitlements under their insurance policy may lead to problems such as:

- homelessness from insufficient payment of temporary accommodation costs,
- financial hardship from delays or shortfalls in payment of claim,
- social disconnection and related problems from being forced to move away from the community support networks due to the lack of finance to rebuild which affects both the relocated individual and the community that is fractured as a result.

Legal assistance is acutely important when people are traumatised by recent events and have reduced capacity to advocate for themselves and organise their affairs, particularly in relation to insurance claims.

### The Legal Aid NSW approach

The Productivity Commission's recent draft report refers to the civil law division and services of Legal Aid NSW as the "leading practice" in the country<sup>4</sup>. Our approach to legal service delivery is to provide **targeted** and **holistic** legal services with a focus on **early intervention**. In the context of disaster recovery, we provide legal services:

1. That are targeted, flexible and responsive to the needs of disaster-affected individuals and community:
  - a. Predominantly in relation to advice and assistance in insurance law, as well as other matters such as financial hardship assistance on mortgages, replacement of important personal documents, employment rights and tenancy matters etc.

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<sup>3</sup> See for example, Pleasence, P. , Balmer, N. & Sandefur, R. (2013) *Paths to Justice: A Past, Present and Future Roadmap*, UCL Centre for Empirical Legal Studies, London.

<sup>4</sup> Productivity Commission (2014) *Access to Justice Arrangements – Draft Report*, <http://pc.gov.au/projects/inquiry/access-justice/draft>, at page 631.

- b. At an appropriate level of response (e.g. from less involved formats like community forums to more involved formats like individual advice and representation) based on factors such as:
      - the particular community's level of legal needs,
      - scale of the disaster and number of people affected
      - number of refused insurance claims, e.g. high level of refused insurance claims in the Queensland floods called for additional legal assistance to the community
      - level of uncertainty in the community about insurance rights.
2. On the front line of community assistance at the earliest stage of disaster recovery possible which enables us to:
  - a. Minimise information asymmetry as a result of individuals generally not having previous experience in insurance claims and being ignorant of insurance laws and consumer rights,
  - b. Reduce hardship, and
  - c. Identify any systemic issues to enable early intervention and prevention.

It is our experience that individuals are better equipped to recover from natural disasters if they are provided with early legal advice and assistance.

3. By providing a collaborative response to disaster affected individuals and communities through integrated service delivery, in particular, working with other agencies at Disaster Recovery Centres, and allied legal services such as the National Insurance Law Service, LawAccess NSW and the private legal profession.

These services are unique and can only be delivered by lawyers, particularly those with consumer law expertise. A list of key disasters we were involved in since 2007 is set out in **Appendix A**.

In providing legal assistance to high volumes of disaster-affected individuals, we are uniquely well-placed to identify systemic issues. This in turn allows us to:

1. Negotiate with and resolve problems with relevant stakeholders (such as insurers) as they arise, for the greater benefit of the community who invest in insurance to mitigate their risk,
2. Contribute to relevant policy and law reform processes, and other mitigation initiatives to build community resilience to future natural disasters.

Below are several examples of how our work has been integral to assisting individuals and communities to address systemic issues arising as a result of a natural disaster:

### Example 1: Identify & resolve problems as they arise

Following the Blue Mountains bushfire in 2013, lawyers from Legal Aid NSW gave legal advice at the Disaster Recovery Centre. It quickly became apparent from the first two days that some residents were incorrectly told by a particular insurer that the cost of temporary accommodation was inclusive of their building sum insured despite insurance policy covers stating that the cost was an additional benefit payable on top of the sum insured.

Legal Aid NSW was able to liaise with senior executives of the nominated insurer within just a few days to rectify this issue. The expedient resolution of this problem prevented significant disadvantage to residents who may have compromised on finding suitable alternative accommodation in their attempt to conserve resources for rebuilding their destroyed homes. The resolution of this issue not only benefited Legal Aid's clients, but all customers of this insurer.

### Example 2: Negotiate protocols for good industry practice

Immediately following the bushfires, residents who have suffered total loss of their properties were asked by various insurers to provide an itemised list of everything they had lost. This practice was unnecessarily arduous given the trauma they had experienced, the further impact of considering and itemising every destroyed possession, and the ability of the insurers' assessors to easily determine total loss without reference to such a list.

Within the first few days following the disaster, Legal Aid NSW negotiated with the major insurers who agreed to cease this practice. We also led discussions with industry representatives, the Financial Ombudsman Service and the Insurance Council of Australia about this matter which resulted in a general consensus as to the standard for good industry practice in this regard.

### Example 3: Contribute to law and policy reforms

In working jointly with our colleagues at Queensland Legal Aid, Caxton Legal Centre and Insurance Law Service, a sector-wide consumer survey of 214 consumers across the country enabled us to capture common trends and issues in relation to disaster events that took place in 2010 and 2011, including the Queensland and Riverina floods. The results obtained from that survey identified the following issues:

- A concerning number of refused claims and withdrawn claims,
- Delays in payment of claims and refusal of claims,
- Delays as a result of multi-tiered internal dispute resolution processes,

- Failures to properly advise consumers of their right *to make a claim*,
- Failures to put in writing a refusal of claim,
- Failures to properly advise as to status of existing claims, and
- Failures to properly advise consumers of their right to internal and external dispute resolution processes.

These findings were included in submissions by Legal Aid NSW in September 2011 to the House of Representatives Standing Committee on Social Policy & Legal Affairs Inquiry into the operation of the insurance industry during disaster events. They were also used in a consumer perspective paper<sup>5</sup> in response to the Natural Disaster Insurance Review Issues Paper by the Natural Disaster Insurance Review Panel in September 2011. It is evident from Legal Aid NSW's recent survey of our clients from the Blue Mountains bushfire that some of these concerns, where they are relevant to bushfires and floods alike, have since significantly improved (see Appendices B & C, and discussions below).

#### **Recommendation 1**

That government recognises the critical role of legal assistance services in disaster recovery, and facilitates early provision of legal services after natural disasters.

#### Insurance expertise & representing the community's best interest

In advising a vast number of individuals in disaster-affected communities, Legal Aid NSW quickly gains an in-depth understanding of the various insurance policies relevant to the particular disasters. This includes familiarity of the coverage of various insurance products, such as whether each policy contains additional benefit for the cost of removal of debris (i.e. whether the cost of clean-up is paid on top of the building sum insured).

Our familiarity with insurance products relevant to the disaster-affected community and our role in acting for our clients' and the community's best interest place us in an ideal position to make solid recommendations on relevant matters to assist governments in making cost-effective decisions.

#### **Recommendation 2**

That specialist legal services are consulted on insurance-related matters in relation to any government sponsored or facilitated schemes (such as the government clean-up scheme).

### **Part II: Post-disaster issues – the dynamics at play**

<sup>5</sup> Connolly, Chris (September 2011) *A consumer perspective on the NDIR Issues Paper, prepared in consultation with consumer representatives* (including Legal Aid NSW), [http://www.ndir.gov.au/content/commissionedpapers/2011/consumer\\_perspective\\_sept\\_11.pdf](http://www.ndir.gov.au/content/commissionedpapers/2011/consumer_perspective_sept_11.pdf).

Through our extensive disaster recovery experience, Legal Aid NSW has observed a number of common issues and dynamics at play that significantly impact on individuals' ability to recover after natural disasters. In our view, the effectiveness and sustainability of natural disaster resilience and recovery strategies are dependent on a proper understanding of these important factors.

Individuals impacted by natural disasters generally suffer a high level of trauma that affects their ability to comprehend and absorb information. Ordinarily capable individuals may experience difficulty in concentration and often describe some level of memory problems. Disaster-affected individuals are particularly vulnerable in the early days and weeks after a natural disaster. Crucial and life-changing decisions, including decisions regarding insurance claim settlements, are also being made at this time. Any effective disaster recovery strategy or initiative must therefore take into account these factors to ensure that vulnerable individuals are provided with the support they require.

#### Information asymmetry needs to be minimised early

It is our experience that most individuals in disaster-affected communities have little or no experience in insurance claim processes and are largely ignorant of their legal rights, such as consumer rights to have the insurer's decisions reviewed. Recovery is therefore enhanced if information asymmetry is minimised effectively at an early stage.

While information about legal rights may be disseminated in different ways such as through printed brochures, online materials or community forums, it is Legal Aid NSW's experience that one of the most effective means is through disaster recovery centres given some of the symptoms of trauma as described above. In disaster recovery centres, agencies are co-located to provide holistic support, and individual advice and assistance immediately after disasters. Affected individuals are allowed time to discuss their own circumstances and obtain advice that is relevant to their particular needs. They are therefore more likely to absorb the information given to them and more likely to reconnect with us for further legal assistance if necessary.

The effectiveness of delivering tailored legal advice to individuals to minimise information asymmetry is enhanced if it is delivered as early as possible in the recovery phase. In some circumstances, time is of the essence because delay in action may result in harm that would have been avoidable with early advice and intervention. Below are two case studies to illustrate this.

#### *Case study – Paul's flood claim*



Paul's home was damaged as a result of the Wagga Wagga flood in 2012. His carpet was damaged, mouldy and smelly. The carpet needed to be removed and replaced urgently so as not to affect the family's health. However, Paul was anxious that he couldn't do this before the insurer has assessed the damages in case their insurer would not pay his claim. Our early legal advice had meant that Paul did not have to wait for the assessor to attend, and could remove his carpet to prevent harm to his family's physical health.

*Case study – Sarah's temporary accommodation*

After a fire at a large apartment block at Bankstown NSW, residents of all 96 units in the building were evacuated. Sarah and her family were paid an amount for temporary accommodation that was substantially less than their entitlements under the strata insurance policy. The amount they were paid was barely enough to cover their rental cost of an unfurnished 1-bedroom apartment on a short term basis. Her family of 6, including 4 young children under the age of 6 years, lived on second hand mattresses in this small apartment with mouldy walls for 2 weeks until they finally sought legal assistance. The insurer ultimately agreed to relocate them to a 2-bedroom serviced apartment for which they were entitled under the policy.

Early advice about legal rights also reduces the impact of any misinformation. After a natural disaster, individuals tend to rely on whatever information is available to them to make important decisions, regardless of the reliability or accuracy of such information. Information sources include neighbours, members of the community, other service providers and the media. Individuals who are traumatised after disaster events are particularly vulnerable to relying on incorrect information to make key decisions such as insurance payout.

*Case study –Wagga Wagga floods 2012*

One service provider at the disaster recovery centre relied on their knowledge from previous disasters to advise disaster-affected individuals that their temporary accommodation costs came out of their sum insured. In fact, insurance policies were updated and for most people temporary accommodation was an additional benefit payable on top of their sum insured once incurred. Those who relied on incorrect information were disadvantaged as they would have unnecessarily settled for less than adequate standard of temporary accommodation in their attempt to maximise their insurance payout for the purpose of rebuilding their homes.

*Case study – Kempsey floods 2013*

Floods are common in Kempsey NSW, and many residents affected by the 2013 floods had had previous experience with floods. At the Disaster Recovery Centre, Legal Aid NSW saw many residents who instructed that they did not make an

insurance claim for their losses because they assumed that their insurance policy would not cover floods as they had never done so previously. These residents were not aware that the law on flood coverage had changed, and were relying on previous experience and the 'word on the town' in deciding not to lodge a claim.

**Recommendation 3**

That authorities (e.g. local councils) charged with the responsibility to design and coordinate recovery efforts after natural disasters consider, as best practice, setting up disaster recovery centres where possible to enhance individual and community recovery.

Pressures affecting decisions need to be minimised

From the perspectives of supporting agencies (including legal aid services) and the insurance industry, efficient and effective response is one of our main priorities. However, this sometimes involves individuals being asked to make very important and life-changing decisions with little opportunity to consider their position or to seek legal advice.

*Case Study – Jill's underinsurance settlement*

Jill had two houses on her property, one of which was totally destroyed as a result of the 2013 bushfire at the Blue Mountains. At the time of the fire, her home building insurance policy covered both buildings to the maximum sum insured of approximately \$650,000. When the insurer's assessor estimated that the cost to rebuild her destroyed house was to be \$600,000, the insurer made an offer on the telephone to settle her claim for only \$150,000 on the basis that she was underinsured. The insurer pressured her to make a decision that day as it was the deadline for Jill to qualify for the Government clean up scheme. She made a counter offer on the telephone to settle her claim for \$250,000 and this counter offer was immediately accepted by the insurer. The money was transferred into her account within days. Jill was not provided with any record of the insurer's position in writing or with any offer for her to get advice.

The pressures affecting decisions could be minimised by measures such as requiring all insurers to provide letters of settlement to disaster affected consumers once the decisions to settle are made. Currently, many insurers do not provide letters of settlement where claims are paid. This means that consumers have no written communication about the nature and details of the claims settlement. Consumers often rely on their recollection of telephone conversations with their insurers about what their settlement payments pertain to, and trust that they had been paid their entitlements fully.

*Case study – Peter's accepted claim*

Peter lost his home entirely in the 2013 Blue Mountains bushfire, and was paid a settlement amount of approximately \$520,000. Looking at his insurance policy, he was entitled to additional benefits (over and on top of his sum insured) such as 12 months of temporary accommodation, the cost of removal of debris, and other miscellaneous costs. His building sum insured is \$480,000, and all he remembered is that his insurer had told him over the telephone that they would pay him an additional amount. Peter did not recall the details of that conversation because "a lot was happening" at the time. He did not receive any letter from his insurer to confirm the settlement calculations.

Currently, the General Insurance Code of Practice requires member insurers to provide written reasons only when claims are denied<sup>6</sup>. As the above case study illustrates, individuals in natural disaster situations whose claims are accepted should also receive written confirmation of their payments within a reasonable period of time.

#### **Recommendation 4**

That insurers be required to confirm in writing details of any settlement of claims even when claims are accepted and paid.

#### Minimising inherent power imbalances through legal aid support

There is an inherent power imbalance between individuals and large corporations such as insurance companies and banks because the latter are repeat players of the legal system compared to individuals with limited means and experience. Many people tell us at disaster recovery centres that they do not question their insurers' decisions and processes because they have faith in the insurers' knowledge and experience. This unquestioning trust in insurers, coupled with the vulnerability of individuals affected by disasters (e.g. feeling overwhelmed, memory problems and inability to concentrate) make them particularly disadvantaged and vulnerable to unintentional harm.

In some disasters, the degree of power imbalance is further increased due to extenuating circumstances. For example, after the devastating floods at Grantham, residents and support agencies were not permitted to enter the disaster-affected areas for a week as authorities were attempting to retrieve bodies. When they were ultimately allowed to return to the area, cars were still hanging on trees. Confronting images such as these led to cognitive deficits and a compromised ability to make sound decisions about insurance claims.

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<sup>6</sup> General Insurance Code of Practice (2012), at clause 3.5.5.

It should be noted here that the need for legal support to minimise inherent power imbalance is not confined to the more serious and devastating natural disasters. People may be less likely to detect legal problems when there is a smaller scale natural disaster that does not attract as much media and community attention.

**Recommendation 5**

That disaster recovery measures be designed to minimise inherent power imbalances faced by disaster-affected individuals, including measures that ensure individuals have access to specialist legal support services (such as legal aid).

### Part III: Mitigation and resilience building – dealing with systemic problems

In Parts I and II, we discussed and made recommendations on issues relating to disaster recovery based on our advice and casework experience. In assisting a vast number of individuals in natural disasters over the years, we have recognised the value in capturing our clients' experiences to help us better understand the needs of the community, to identify systemic legal issues (especially insurance issues), and to allow us to contribute to processes that help build community resilience to natural disasters.

For example, a survey was conducted jointly by Legal Aid NSW, Queensland Legal Aid, Caxton Legal Centre and Insurance Law Service in 2011 of our clients across the country to capture systemic issues arising from natural disaster events that took place in 2010 and 2011. Among many other issues identified, the survey found that there was a high level of general dissatisfaction of customers toward the insurance companies' services during the claims process following disaster events<sup>7</sup>. The findings from this survey were made available to a number of stakeholders, including the insurance industry. Our recent survey of our clients from the Blue Mountains bushfire in 2013 found that most participants indicated that their insurance company's services were good or very good<sup>8</sup>.

This part of the submission focuses on the following insurance issues as they are relevant to community resilience:

- (a) Underinsurance of homes,
- (b) Insurance affordability, and
- (c) Insurance product safety.

Discussions on these insurance issues come from our disaster recovery experience. Of most relevance are issues that arose out of the 2013 Blue Mountains bushfires. A survey of our clients from this disaster was conducted recently and the methodology and results of this survey are attached at **Annexure B and C** respectively. In discussing the above issues, references are also made to the results of the joint survey in 2011 by Legal Aid NSW, Queensland Legal Aid, Caxton Legal Centre and Insurance Law Service<sup>9</sup>.

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<sup>7</sup> Annexure B to Legal Aid NSW's submission to House of Representatives Standing Committee on Social Policy and Legal Affairs on the Inquiry into operation of insurance industry during disaster events, [http://www.legalaid.nsw.gov.au/\\_data/assets/pdf\\_file/0017/10826/Legal-Aid-NSW-Response-to-natural-disasters-Appendix-B-Survey-Results.pdf](http://www.legalaid.nsw.gov.au/_data/assets/pdf_file/0017/10826/Legal-Aid-NSW-Response-to-natural-disasters-Appendix-B-Survey-Results.pdf), at question 32. Over 80% of participants rated their insurance company's services as poor (22.90%) or very poor (59.81%).

<sup>8</sup> Refer to Question 21 at Appendix C to the current submission.

<sup>9</sup> See Annexure B to Legal Aid NSW's submission to House of Representatives Standing Committee on Social Policy and Legal Affairs on the Inquiry into operation of insurance industry during disaster events, [http://www.legalaid.nsw.gov.au/\\_data/assets/pdf\\_file/0017/10826/Legal-Aid-NSW-Response-to-natural-disasters-Appendix-B-Survey-Results.pdf](http://www.legalaid.nsw.gov.au/_data/assets/pdf_file/0017/10826/Legal-Aid-NSW-Response-to-natural-disasters-Appendix-B-Survey-Results.pdf).

## (a) Underinsurance of homes

The issue of underinsurance was of great significance at the Blue Mountains. The rate of underinsurance and the underlying causes of underinsurance were explored within this survey.

### Background to Legal Aid NSW's involvement at the Blue Mountains bushfire

Several communities in the lower and upper Blue Mountains were affected by the bushfires in October 2013, with 193 properties destroyed and 109 damaged in the lower Blue Mountains area alone. From the first day the Disaster Recovery Centre was established, Legal Aid NSW attended almost daily for seven weeks and provided face-to-face legal advice and assistance to individuals in the affected communities. During our presence, Legal Aid NSW saw the highest number of residents of all agencies at the Disaster Recovery Centre.

Legal Aid NSW is continuing to advise and assist individuals with their legal problems which are predominantly disputes in relation to their home and contents insurance. As of 11 June 2014, Legal Aid NSW has provided 565 counts of legal advice to individuals and 209 counts of legal assistance (including legal representation), predominantly relating to disputes with insurers.

### Summary of survey findings regarding underinsurance

The methodology, questions and results of the survey of our clients from this bushfire are detailed in **Annexures B & C**. A total of 126 clients were contacted and 120 participants agreed to be interviewed. Of these, 108 survey responses were received and 105 participants provided responses to insurance-related questions.

#### *The concept of underinsurance*

The results of the survey in relation to underinsurance, that is, the level of insurance cover being perceived as insufficient to cover a total loss<sup>10</sup>, are consistent with previous research<sup>11</sup> which showed that underinsurance with regard to building cover was a result of consumers underestimating the level of cover required, rather than a result of people choosing an insufficient cover in order to reduce their premium. It should be noted that, in this survey, underinsurance was self-identified by the survey participants on the basis of their insurance payout after their loss at the Blue Mountains bushfire.

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<sup>10</sup> Tooth, R (2012) *Australian Household Insurance: Understanding and Affordability*. SAPERE Research Group, <http://www.srgexpert.com/Sapere%20IAG%20Consumer%20Survey%20Report%20vPublic.pdf>, accessed on 18 June 2014.

<sup>11</sup> *Ibid.*

### *Extent of underinsurance*

The survey provides the following findings on underinsurance:

#### Insurer-identified underinsurance:

1. What insurers told individuals regarding home building cover:
  - a. Only 27.37% (26 people) of all participants said their insurer told them specifically that they were underinsured for their home building;
  - b. Of these, 7 people recall their insurer giving them an underinsurance estimate;
  - c. The estimated amount of underinsurance given by insurers ranged **between \$100,000 and \$500,000**;
  
2. What insurers told individuals regarding home contents cover:
  - a. Only 31.58% (30 people) of all participants said their insurer told them specifically that they were underinsured for their home content;
  - b. Of these, 7 people recall their insurer giving them an underinsurance estimate;
  - c. The estimated amount of underinsurance given by insurers ranged **between \$40,000 and \$200,000**;

#### Self-identified underinsurance:

Participants were asked the question: "[i]f you were underinsured for home building/content, what do you now think is the cause of your underinsurance?" Those who answered this question self-identified as being underinsured. The number of people who answered the questions (58 for building cover, and 59 for contents cover) was higher than the number of people whose insurers told them they were underinsured. It is likely that this is due to individuals discovering that they were underinsured while in the process of working out how much they needed to rebuild their homes or replace their contents.

When we analysed the data further, we found that the **rate of self-identified underinsurance was particularly high for those who had suffered a total loss** of their homes. Our findings for this particular group are as follows:

- a. 82.35% of the insured participants who suffered a total loss of their home self-identified as being underinsured for their home building, their home contents or both home building and contents<sup>12</sup>,

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<sup>12</sup> A total of 68 survey participants suffered a total loss of their home and contents and held a home insurance policy at the time of the bushfire. Of those people, 56 people self-identified as being underinsured for home building and/or home contents.

- b. Specifically, 67.65% of total loss participants self-identified as being underinsured for home building<sup>13</sup>,
- c. 66.18% of total loss participants self-identified as being underinsured for home contents<sup>14</sup>.

#### *Cause of underinsurance*

Of the people surveyed who considered themselves to be underinsured, they were asked why they thought they were underinsured for their home building cover:

- a) at least 70.69% identified their lack of awareness of cost of rebuild to be the cause of underinsurance;
- b) only 6.9% thought it was because of their attempt to reduce cost of insurance (i.e. affordability);
- c) at least 4 survey participants stated that they relied on their insurer's direct advice to reduce the amount of building sum insured, but after the bushfire they realised that the recommended amount was insufficient to cover the cost of rebuild.

The findings regarding the underlying causes of underinsurance in contents insurance were similar to the findings for home building insurance, with the majority of respondents (at least 74.58%) identifying lack of awareness of cost of replacement of contents to be the cause of underinsurance.

#### *Possible cause of lack of awareness of cost of rebuild/replace*

On countless occasions when Legal Aid NSW solicitors discussed with clients the source of underinsurance, they instructed that their lack of awareness of cost of rebuild largely stemmed from the lack of awareness of the high cost of rebuilding in bushfire prone areas as a result of amendments to the *Building Code of Australia* (2010) after the Victorian bushfires in 2009.

The Building Code imposes stringent criteria on rebuilding. In order to meet these criteria, properties in bushfire prone areas are each given a Bushfire Attack Level ('BAL') rating which is calculated on the basis of their exposure to the risk of bushfire damage. Depending on the rating given, property owners need to use particular types of materials and/or meet particular design requirements in order for their development applications to be approved by local council. Some clients have been told by their builders and architects that the estimated cost of meeting these additional building requirements due to high BAL ratings could be up to \$100,000 to \$150,000.

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<sup>13</sup> Of the 68 participants who suffered a total loss of their home and contents and held a home insurance policy at the time of the bushfire, 46 people self-identified as being underinsured for home building (irrespective of whether they were also underinsured for home contents).

<sup>14</sup> Of the 68 participants who suffered a total loss of their home and contents and held a home insurance policy at the time of the bushfire, 45 people self-identified as being underinsured for home building (irrespective of whether they were also underinsured for home building).



Comment by one client: "I spoke yesterday with many of the people [on my street] who [had] lost their homes, and it seems like insurance money is *just* covering the costs of people on the high side of the street who are BAL 29/19, but for the people on the low side of the street, where the BAL is assessed at Flame Zone or 40, the costs are much higher than the houses were insured for. If only we had known."

According to our survey:

- a) 91.49% did not take into account the additional rebuilding cost of meeting building regulations when deciding on sum insured,
- b) 79% had not heard of Bushfire Attack Levels (BAL) prior to the 2013 bushfires,
- c) 83% of those who knew about BAL prior to the bushfire did not take into account how the BAL impacts on their cost of rebuild when setting their sum insured.

The above results clearly show significant information asymmetry at the Blue Mountains. Prior to the bushfire, residents had little knowledge about the changes to the Building Code following the Victorian bushfires in 2009 which directly affected them as residents of bushfire prone areas. Clearly, the timely dissemination of information about changes to building regulations, potential changes to the cost of rebuild and other risks are important mitigation opportunities, and would likely have reduced the extent of underinsurance at the Blue Mountains.

Effective public education of building regulation changes that could impact cost of rebuild is essential. Any funding model in regards to natural disaster should facilitate this as an investment in mitigation.

#### **Recommendation 6**

That any natural disaster funding model facilitates effective public education of building code changes and their impact on cost of rebuild and individual insurance.

#### Insurers' obligations

Public education *alone*, as recommended above, is probably insufficient to ensure individuals are adequately covered by their insurance policies. In our recent survey, data was obtained about how sum insured was nominated on purchase and on renewal by the respondents. The survey findings show that consumers tend to look to their insurers for assistance in nominating their amount sum insured.

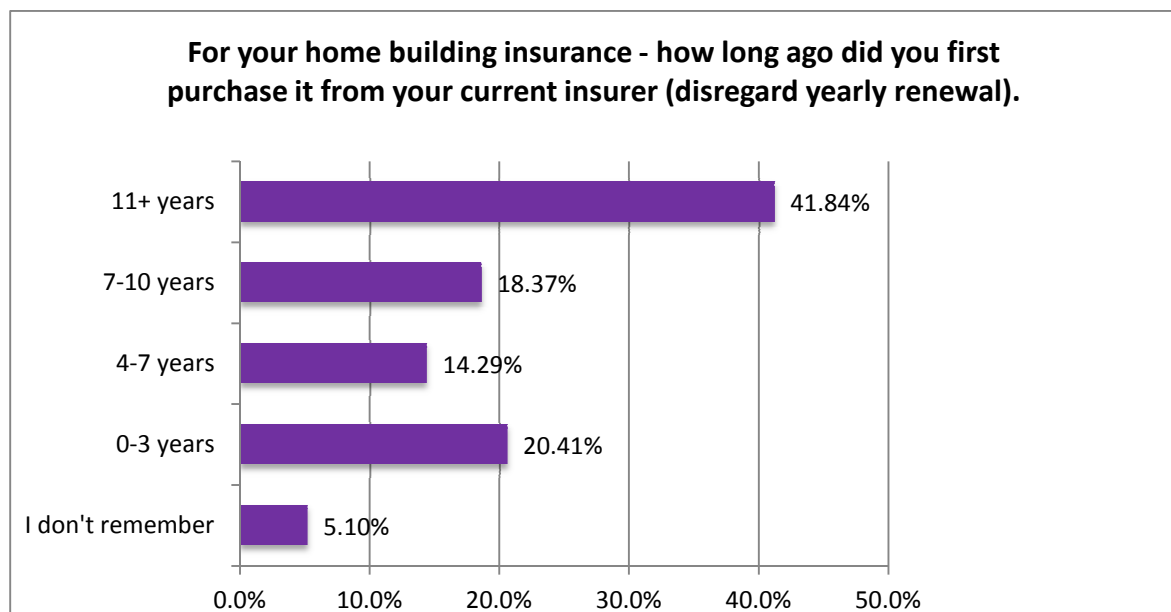
*Purchasing new policies:* Both our recent 2014 survey and the 2011 survey show that policies are largely obtained from the insurer directly rather than through third parties such as brokers. Moreover, the majority of policies are obtained in situations where the consumer interacts with the insurer by telephone or face to face.

2014 survey (Blue Mountains 2013)		2011 survey (Disasters 2010-11)	
Direct from insurer	66%	Direct from insurer	73%
Telephone	49.47%	Telephone	63.55%
Face-to-face	16.84%	Face-to-face	9.81%

The method which our 2014 survey participants adopted to help them nominate their building sum insured at the time of initial purchase varied widely. The most popular approach was by talking to insurers about the suitable amount (27.37%).

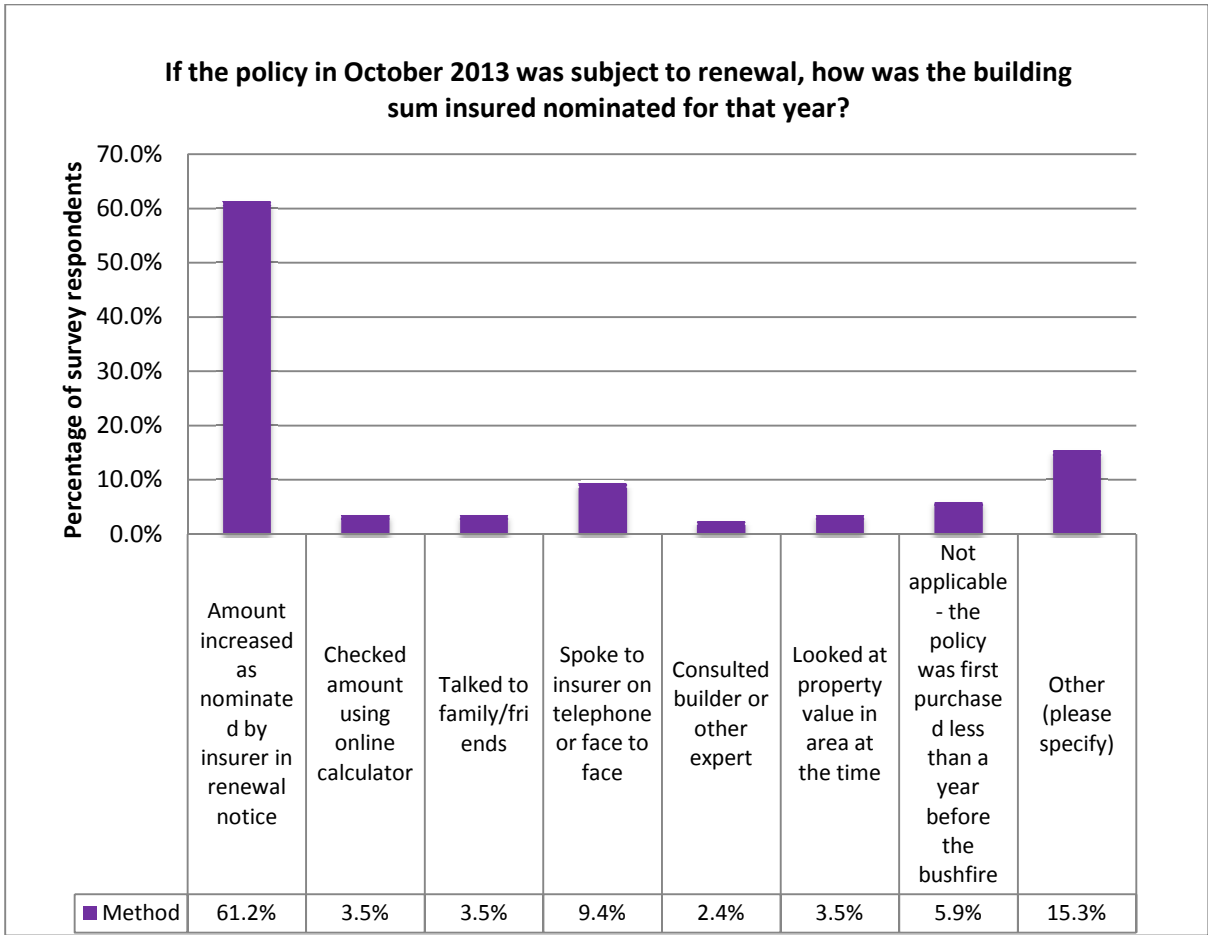
The above findings indicate that there is ample opportunity for insurers to disseminate direct and tailored information about individuals' risks at the time of purchase. The effect of doing so would likely enhance individuals' knowledge of their risks and would thereby improve their ability to make informed decisions about risk management.

*Renewals:* The majority of home building insurance policies applicable to October 2013 bushfires were as a result of renewal. In fact, almost 75% of respondents have held their home building policy with the same insurer for over 4 years. Figure 1 shows the extent of insurer loyalty.



**Figure 1:** Loyalty to insurers – number of years that respondents have held their home building insurance policy with the same insurer.

For renewal of policies, over 70% of survey participants relied on information provided by their insurer to determine their building sum insured. At least 61.18% of survey participants relied solely on the insurer's nominated amount in the renewal notice in setting their sum insured amount on renewal (see Figure 2). A further 9.4% of respondents spoke to their insurer to assess their level of sum insured at the time of renewal.



**Figure 2:** How sum insured is nominated at time of policy renewal.

Again, the above findings show that people look to their insurer for information about the risk for which they need to insure, and rely heavily on information provided by their insurer in setting the amount of sum insured for their home building.

In fact, throughout the course of holding their policies, almost 50% of survey participants had spoken to their insurer at some point to assess their level of building sum insured (not just at the initial stage of purchasing the insurance policy). It is therefore essential for individuals to be given by their insurer all the necessary information they require to assess their risks and mitigate their loss by ensuring that their properties are adequately insured.

To this end, insurers should be obliged to take a more active role in line with their duty of utmost good faith to fully disclose to consumers any information they hold that would impact on the cost of rebuild, including information about Bushfire Attack Levels and the additional cost required to meet the Building Code. Examples of this obligation include:

- insurers' online calculators and frontline staff (telephone and shopfront) should provide prospective and current consumers with the above information;

- At the time of purchase, customers should be told what the property's Bushfire Attack Level is so that the customer may make informed choices about their level of cover;
- Correspondence, especially renewal notices, should also provide clear and concise messages about Building Code changes;
- Suggested annual increments should automatically take into account any additional cost required to meet Building Code changes.

#### **Recommendation 7**

That home insurers be required to bring to the attention of their customers at the time the product is purchased key information that would significantly affect the cost of a rebuild, such as whether the home is in a flame zone, so customers can make informed choices about what level of cover to choose.

Over the past few years, many consumer advocates have recommended law reform changes to provide greater incentives (or perhaps even mandatory requirement) for insurers to provide total replacement policies, and phase out sum insured policies. In light of the high underinsurance rate in natural disasters, this option remains ideal in eliminating information asymmetry in regards to cost of rebuild and other risks.

#### **Recommendation 8**

That sum insured policies of home insurance are phased out, and home insurers are required to provide full replacement policies.

### **(b) Insurance affordability**

According to our survey, the issue of non-insurance for home and contents at the Blue Mountains was not significant. Only a total of 7.6% of those surveyed did not hold a home building and/or contents insurance policy at the time of the bushfires.

Nevertheless, the issue of non-insurance is prevalent, and remains a significant problem in Australia in general. One major cause of non-insurance is affordability, which remains an obvious and significant concern for economically disadvantaged and vulnerable consumers. The Brotherhood of St Laurence found that, '[o]verwhelmingly, affordability was reported as the greatest barrier to holding insurance at all... [s]imilarly, affordability was reported as the main reason for becoming uninsured'<sup>15</sup>.

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<sup>15</sup> Brotherhood of St Laurence (2011) *Reducing the risks: Improving access to home contents and vehicle insurance for low-income Australians*, [http://www.bsl.org.au/pdfs/Collins\\_Reducing\\_the\\_risks\\_insurance\\_2011.pdf](http://www.bsl.org.au/pdfs/Collins_Reducing_the_risks_insurance_2011.pdf), at page v.

We saw a number of residents affected by the Riverina floods in 2010 and 2012 who told us that they could not afford to buy insurance for their homes because the insurer had raised premiums too high to account for the risk of flood. In some cases, the result was that the home was not insured at all for any risk, and in other cases, the consumer had to choose to "opt-out" of having flood cover in their policy.

The issue of insurance affordability, particularly in flood prone areas, is addressed in the Final Report of the Natural Disaster Insurance Review. A number of recommendations were made, including recommendation for a system of premium discounts be introduced to enable certain consumers to receive a premium discount against the full cost of flood insurance.

#### **Recommendation 9**

That the Government considers the Natural Disaster Insurance Review recommendations for a new integrated system to address the availability and affordability of flood insurance.

#### **(c) Insurance product safety**

As discussed above, Legal Aid NSW observed significant underinsurance issues in the 2013 Blue Mountains bushfires. While most respondents were not told directly by their insurer the amount by which they were underinsured, those who were told were given large estimates in the range of \$100,000 to \$500,000 underinsured for home building insurance, and \$40,000 to \$200,000 underinsured for contents cover.

For these people, the home insurance products they had purchased were simply *not fit for the purpose* for which they were obtained. It could be argued that these individuals were effectively sold *unsafe* insurance products.

In the experience of Legal Aid NSW, there are significant product safety issues in insurance generally that need to be addressed with market based 'supply side' solutions. These issues are discussed in our submission to the *Financial System Inquiry*, and are directly relevant to the effectiveness of risk management measures available to individuals facing natural disaster risks. If unsafe insurance products are available to be purchased by individuals, their ability to recover from natural disasters would be greatly affected.

In our view, the market based 'supply side' solutions to address insurance product safety could include:

- Law reform in insurance law to incorporate safeguards regarding product suitability and safety, e.g. that consumers not be provided with unsuitable products (similar to the current consumer credit laws), or extending the current 'fit for purpose' test in general consumer law to apply to insurance products;

- Introducing consumer protection framework on unfair terms in standard form insurance contracts to lift the standard of drafting of key terms in these policies to community standards of fairness.

Industry-based solutions to market asymmetry and raising standards of market practice should be considered in light of these issues. The insurance industry could agree on disaster response protocols to set best practice standards for claims handling post-disaster. For example, at the recent Blue Mountains bushfire, general insurers were very responsive to the issue raised in "Example 2" of Part 1 above regarding total loss and contents lists. Opportunities exist to leverage off the back of innovative and responsive work of general insurers to ensure consistently good standards of practice are achieved across the insurance sector for consumers in disaster events.

**Recommendation 10**

That the Government considers the value of addressing product safety issues in insurance with:

- (a) Market-based 'supply side' solutions such as 'not unsuitable' or 'fit for purpose' tests;
- (b) Industry-based solutions such as disaster response protocols.

Thank you for the opportunity to make this submission. If you require further information, please contact Lillian Leigh, Senior Solicitor and Disaster Recovery Coordinator, Civil Law Division on telephone (02) 9765 4723 or [lillian.leigh@legalaid.nsw.gov.au](mailto:lillian.leigh@legalaid.nsw.gov.au).

## APPENDIX A

### Legal Aid NSW Response to natural disasters (2007 – June 2014)

Event date	Legal services provided by Legal Aid NSW	Issues arising from disaster event
Jan 2014 Perth Hills bushfires	<ul style="list-style-type: none"> <li>Trained Legal Aid WA lawyers to provide disaster insurance advice and assisted them to advise on specific issues, including the total loss protocol adopted by the insurance industry.</li> </ul>	WA based insurer had not been involved in industry discussions on total loss protocol so we came to an agreement with the insurer.
Oct 2013 Blue Mountains bushfires	<ul style="list-style-type: none"> <li>Springwood disaster recovery centre (DRC) – advice clinic and follow up assistance/representation provided;</li> <li>Participated in 5 public forums including an insurance forum organised by the Insurance Council of Australia;</li> <li>Media releases, and disseminated publications through local council, community forums, and other community service providers.</li> </ul>	Underinsurance due to lack of awareness of BAL, reliance on insurer's calculators and renewal amount suggestions. Underinsurance not due to consumers' desire to reduce premium.
Mar 2013 Mulwala tornado	<ul style="list-style-type: none"> <li>Provided advice clinic and follow up assistance/representation provided;</li> <li>Participated in 2 public forums with other government service providers;</li> <li>disseminated publications through local council, community forum</li> </ul>	<p>Sudden and unexpected tornado affected residents of caravan and long stay accommodation parks.</p> <p>High level of financial hardship in local area – insurers did not assist with emergency payment until we intervened. We assisted one couple who were unintentionally uninsured for an 8 hour period between the expiry of one contract and commencement of a new contract – the tornado destroyed their home within that 8 hour period. With our assistance their claim was paid.</p>
Feb 2013 Kempsey floods	<ul style="list-style-type: none"> <li>Kempsey DRC - advice clinic and follow up assistance/representation provided;</li> <li>Media releases and disseminated publications through local council, Disaster Welfare outreach, recovery centre</li> </ul>	<p>High level of misinformation in the community about perceived unavailability of flood cover for local residents due to past experience. Many were not aware that the industry had moved to a standard flood cover. Some insured for this event had no idea that they could claim. Service providers who were locals shared this misconception and often did not refer appropriately to our service for advice.</p>

<p>Jan 2013 Coonabarabran bushfires</p>	<ul style="list-style-type: none"> <li>• Coonabarabran DRC - advice clinic and follow up assistance/representation provided;</li> <li>• Media releases and disseminated publications through local council, Disaster Welfare outreach, recovery centre</li> </ul>	<p>This event was massive, sudden and quite dangerous, with many locals having to flee for their lives – one couple told us of driving the tractor off the burning property and having to choose the smallest wall of flame to drive through. Others told us of having packed a box of precious possessions and holding it in their arms before they had to drop the box and run to safety. Our lawyers attended the centre from its opening – before the huge fire was extinguished. One of our lawyers was unable to get to the centre due to a roadblock when the fire jumped the highway. This added to the distress of clients and staff at the centre.</p>
<p>Jan 2013 Hobart bushfires</p>	<ul style="list-style-type: none"> <li>• Assisted Legal Aid Tas by providing training materials for their lawyers.</li> </ul>	
<p>Mar 2012 Riverina floods</p>	<ul style="list-style-type: none"> <li>• Riverina DRC - advice clinic and follow up assistance/representation provided;</li> <li>• Media releases, including appearing on radio and TV about legal rights</li> <li>• Disseminated publications through local council, regional outreach visits, recovery centre</li> </ul>	<p>We were involved in the recovery centre from the start, using our local lawyers with some assistance from other legal aid offices around the state. The locals did appreciate being assisted by other locals with knowledge of the area. We had high visibility and assisted a large number of people, both at the centre and through local outreach with other service providers.</p> <p>This event involved a large evacuation. Many residents were distressed at not being allowed to return to their homes, and worried that their homes were being looted or inappropriately cleared out by defence personnel.</p>
<p>Feb 2012 Moree floods</p>	<ul style="list-style-type: none"> <li>• Moree DRC - advice clinic and follow up assistance/representation provided;</li> <li>• Attended public information meeting</li> <li>• Media releases and disseminated publications through local council, recovery centre, regional outreach visit</li> </ul>	<p>We were not able to attend the DRC until the second week and we missed seeing hundreds of people due to this delay – often people will only attend once, and will not self-identify that they need legal assistance. We did not get many insurance enquiries from this event.</p>
<p>Jan 2011 Queensland floods</p>	<ul style="list-style-type: none"> <li>• Legal services provided with other law services (Legal Aid NSW, Qld Legal Aid, Caxton Legal Centre, Insurance Law Service), collectively known as the Combined Insurance Law Response.</li> </ul>	<p>We assisted Legal Aid QLD by coordinating the collaborative legal response and by taking on the matters from Grantham, the small regional town that was suddenly inundated resulting in large loss of</p>



	<ul style="list-style-type: none"> <li>• Legal Aid NSW assisted and represented numerous disaster-affected individuals with their insurance disputes.</li> </ul>	<p>life and property. This small community was severely traumatized. They were not allowed to return to their homes until the emergency services and police had concluded searching for deceased. When they did return, the impact was shocking – with washed out cars hanging from trees and debris strewn from one end of town to the other. We assisted a number of residents obtain a full insurance payout that included the cost of participating in the land swap program so that they could rebuild on higher ground.</p>
Jun 2011 Mid North Coast floods	<ul style="list-style-type: none"> <li>• Kempsey Flood Recovery Centre, and public forum proposed.</li> <li>• Publications were disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
Oct/ Dec 2010 Wagga Wagga floods	<ul style="list-style-type: none"> <li>• Advice clinic at Wagga Wagga and follow up assistance/representation provided;</li> <li>• Attended 2 public forums at Adelong and Lockhart</li> <li>• Media releases, including appearing on radio and TV about legal rights</li> <li>• Publications disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	<p>Local staff were affected by this flood. No recovery centre but we did a lot of media to inform people of their right to make a claim and about the obligations of insurers in relation to limiting flood cover. We felt that we didn't provide an extensive enough service in the absence of a recovery centre – Lockhart is a small country town that was severely impacted and we are aware that a number of residents accepted settlements from their insurers far below what they were entitled to – we believe this happened because they were not aware of their legal rights.</p>
Dec 2009 Dubbo floods	<ul style="list-style-type: none"> <li>• Legal advice provided at Dubbo</li> <li>• Media releases, publication disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
Mar 2009 North Coast floods (Grafton Kempsey, Coffs)	<ul style="list-style-type: none"> <li>• Legal advice provided at Coffs Harbour flood forum and follow up assistance provided.</li> <li>• Newspaper and radio announcements regarding legal rights, publications disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
Feb 2009 Central West	<ul style="list-style-type: none"> <li>• Legal advice clinic provided at Bourke.</li> <li>• Publications disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	

<p>Jan 2008 North Coast floods</p>	<ul style="list-style-type: none"> <li>• Legal advice provided at recovery centre</li> <li>• Participated at 5 public forums Tweed Heads, Murwillumbah, Kyogle and Coraki</li> <li>• Newspaper and radio community service announcements regarding legal rights</li> <li>• Publications disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
<p>Dec 2008 Tamworth flood</p>	<ul style="list-style-type: none"> <li>• Participated at Tamworth public forum.</li> <li>• Publication disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
<p>Jun 2007 Central Coast &amp; Newcastle floods</p>	<ul style="list-style-type: none"> <li>• Advice clinics at Gosford and Newcastle and follow up assistance/representation provided;</li> <li>• Participated at 6 public forums at Gosford, Newcastle and Maitland</li> <li>• Newspaper and radio community service announcements regarding legal rights</li> <li>• Flyers and publication disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
<p>Jun 2007 Goulburn storm</p>	<ul style="list-style-type: none"> <li>• Media release and publication disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	
<p>Dec 2007 Western Sydney hail</p>	<ul style="list-style-type: none"> <li>• Advice clinics at Sydney and follow up assistance/representation provided;</li> <li>• Participated at 2 public forums at Blacktown (including 2 letter writing workshops)</li> <li>• Newspaper and radio community service announcements regarding legal rights</li> <li>• Flyers and publication disseminated through local courts, local councils, NGOs, MPs electorate offices</li> </ul>	

## APPENDIX B

### Blue Mountains Bushfires Survey Report

#### Purpose of the Survey

After having suffered a total loss of their home as a result of the bushfires, insurance assessors made assessments of individuals' estimated cost of rebuild. Many Legal Aid clients told us at the Disaster Recovery Centre that they were surprised to discover that their home buildings were underinsured significantly. The purpose of the survey was to gain a better understanding of the extent of underinsurance and to find out what the underlying causes of underinsurance were for the Blue Mountains disaster-affected community.

#### Methodology

Legal Aid NSW used an online survey tool, Survey Monkey ([www.surveymonkey.com](http://www.surveymonkey.com)) to conduct the survey. All Legal Aid clients were contacted by telephone, and responses were recorded in real time by the telephone operator. The telephone operators were two project officers employed by Legal Aid NSW, and were not previously and directly involved in the disaster recovery services provided by Legal Aid NSW.

All responses were obtained by telephone (rather than online or through other means) for the following reasons:

- (a) To ensure consistency between surveys;
- (b) Given the sensitive and emotional nature of the subject matter, a more 'human-approach' would be more appropriate to enable referral to counselling or other support services where appropriate.
- (c) To ensure that all responses are anonymous and individuals cannot be identified by their comments.

#### Results

Some of the relevant general findings of the survey have been set out in the body of the submission. A full copy of the questions and results is attached in annexure B.

## **APPENDIX C**

### **Blue Mountains Bushfires Survey Questions and Results**