

Natural catastrophes and insurance in Australia: is it time for a national insurance scheme for natural disasters?

The article will examine the existing legal and regulatory framework for insurance within Australia and the specific measures taken to deal with property losses arising from natural disasters. In doing so it will examine how recent reviews have suggested the need for a specific catastrophe insurance solution.

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1. Introduction

In Australia, insurance contracts covering household structure and contents are governed nationally by the *Insurance Contracts Act 1984* (Cth). They are the only insurance products available to consumers to cover damage arising from catastrophic events. Other aspects of disaster-risk financing and disaster-risk management are dealt with at a state level.¹ Private insurance provides the first layer of relief and government programmes and volunteers provide secondary layers of relief.

Household property and contents insurance in Australia generally covers damage or destruction caused by theft, fire, wind-related events, storms (including hailstorm) and in some instances (where specified in the insurance contract), flooding. Flood insurance coverage is available on an 'opt-out' basis. While this has helped to ensure more people (particularly those predisposed to acquiring full insurance) are covered under flood insurance policies, it fails to resolve the problem of non-insurance and underinsurance nationally.



During the Queensland floods, more than 78% of the state was affected with more than 58,463 homes and businesses experiencing inundation and a further 72,203 insurance claims arising from Cyclone Yasi.

The insurance industry is regulated by the Australian Prudential Regulatory Authority² as well as the standards outlined in the *Insurance Act 1974* (Cth). Minimum standards are set under s8 of the *Australian Prudential and Regulatory Authority Act 1998* (Cth) to ensure the fiscal stability of insurers. It is a criminal offence for a general insurer to have less than the required minimum level of assets.³ The operation of the prudential requirements is clarified by the Australian Prudential Regulatory Authority under the *Prudential Standard GPS 110: Capital Adequacy*. Articles 24–34 of this *Standard* prescribe the economic models to be applied to each insurance company in determining capital adequacy. The amount of primary insurance, assets or reinsurance coverage is influenced largely by the Australian Prudential Regulatory Authority acting under *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital*. The Australian Prudential Regulatory Authority does not dictate the exact layering structure but measures capital adequacy.

At the Commonwealth level, there are two government compensation schemes of note. First, the Australian Government has discretion to provide Disaster Recovery Allowance payments to individuals who

¹ Danuta Mendelson and Rachel Anne Carter, 'Catastrophic Loss and the Law: A Comparison between 2009 Victorian Black Saturday Fires and 2011 Queensland Floods and Cyclone Yasi' (2012) 31(2) *University of Tasmania Law Review* 31, 36–39.

² Under s 32 of the *Insurance Act 1973* (Cth), the Australian Prudential Regulatory Authority has the power to determine and set out prudential standards.

³ *Insurance Act 1973* (Cth) s 28.

experience a loss of income as a direct result of natural disasters. Secondly, the Australian Government Disaster Recovery Payment is made to individuals to cover emergency expenditure incurred following the determination that a natural disaster has occurred.

The Australian Government's Natural Disaster Relief and Recovery Arrangements exist to ensure that the burden of providing assistance to individuals is shared between the Commonwealth and state or territory governments. There is an ex-post distribution of resources between the federal and state levels of government such that the magnitude of involvement by the Australian Government increases with the economic effect of the disaster. Under the Arrangements, an Australian State that suffers losses beyond a threshold amount determines where they wish disaster funds to be allocated.

This article will now explore some recent catastrophic events in Australia and how the insurance and regulatory system operated during these events. The first event studied is the Queensland Floods of December 2010 – February 2011 and the second is the Victorian Black Saturday Bushfires during February 2009.

2. Case Study – Australian Insurance Industry dealing with Catastrophe: Queensland Floods and Cyclone Yasi

From December 2010 to January 2011, torrential rain and fierce winds enveloped large parts of Queensland resulting in vast flooding. The damage was so widespread that almost every council in Queensland was affected. Exacerbating this, Cyclone Yasi hit tropical North Queensland in February 2011. The cumulative effect was that 'since November [2010] more than 99% [of Queensland] was affected by floods and cyclones and 37 Queenslanders lost their lives as a result of nature's fury'.⁴ It was stated that the '2010/2011 floods were historically unique due to their causes and wide-ranging impact'.⁵ The economic implications of these disasters were severe, with insured claims arising from the flooding exceeding AU\$2.6 billion by the end of April 2011, plus approximately AU\$967 million resulting from the damage caused by Cyclone Yasi.⁶ The estimated cost to local insurers (Australian-based companies) was approximately AU\$1 billion.⁷ The final damage bill exceeded US\$7.3 billion.⁸

During the Queensland floods, more than 78% of the state was affected with more than 58,463 homes and businesses experiencing inundation and a further 72,203 insurance claims⁹ arising from Cyclone Yasi. Due to the huge numbers of insurance claims, the average period to initiate the claims process

⁴ Queensland Reconstruction Authority, *Operation Queenslander: The State Community, Economic and Environmental Recovery and Reconstruction Plan 2011–2013* (March 2011)

<<http://www.qldreconstruction.org.au/u/lib/cms2/operation-queenslander-state-plan-1.pdf>>

⁵ World Bank and Queensland Reconstruction Authority, *Queensland: Recovery and Reconstruction in the Aftermath of the 2010/2011 Flood Events and Cyclone Yasi* (World Bank, June 2011) 5.

⁶ Insurance Council of Australia, 'Insurance Council of Australia Historical and Current Data Statistics at 25 March 2011' (Statistics, Insurance Council of Australia, 25 March 2011)

<<http://www.insurancecouncil.com.au/IndustryStatisticsData/CatastropheDisasterStatistics/tabid/1572/Default.aspx>>.

⁷ Ibid.

⁸ Munich RE, 'Topics Geo Natural Catastrophes 2011: Analysis, Assessment and Position' (Report, Münchener Rückversicherungs-Gesellschaft, Munich, 2012) 50.

⁹ Queensland Flood Commission Inquiry, *Final Report*, March 2012, 32, 288–289.

<http://www.floodcommission.qld.gov.au/__data/assets/pdf_file/0007/11698/QFCI-Final-Report-March-2012.pdf>

was 28–35 business days (under normal circumstances the claims process would occur within 10 business days).¹⁰

After the Queensland floods a 'total of \$31.7 million was disbursed to more than 360 households with payments ranging from \$10,000 to \$280,000 with an average payment of \$87,657'.¹¹ The approach of the Queensland Government to charity in the aftermath of the Queensland floods differed from the approach of the Victorian Government in the aftermath of the Black Saturday bushfires in that insurance payments were considered when distributing charitable funds.

3. Case Study – Australian Insurance Industry dealing with catastrophe: Black Saturday bushfires

A second notable catastrophic event was the Black Saturday bushfires in Victoria. These occurred in February 2009, killed 173 individuals, destroyed 1,100,000 acres of land and resulted in more than 10,280 insurance claims for property damage. The total cost of the Black Saturday bushfires exceeded AU\$4 billion.¹² From the total financial losses sustained, just over half of the property damage was covered by insurance. The insurance claims from the Black Saturday bushfires were approximately AU\$1.07 billion,¹³ arising from the 10,280 claims noted above.¹⁴ Many individuals residing in the worst affected areas lived in caravans,¹⁵ temporary housing or shipping containers for a considerable period after the event. Some individuals continue to live in this 'temporary' accommodation. The fires devastated 430,000 hectares of bushland, which included 51 towns and 78 communities.¹⁶ One survivor described Kinglake (one of the worst affected towns) as being akin to a war ground 'a black smoking mess, no structures left standing [...] the trees weren't just burnt, they'd had the life sucked out of them. Fences had vanished; even the white lines in the middle of the road had melted away'.¹⁷

4. Losses Suffered by Individuals

The Bushfire Cooperative Research Centre's Household Mail Survey indicated the following:

¹⁰ Ibid 290.

¹¹ Queensland Government, *Premier's Disaster Relief Appeal: Distribution Committee Report* (Queensland Government, October 2011) 19.

¹² Ibid 1.

¹³ Insurance Council of Australia, 'Insurance Council of Australia Historical and Current Data Statistics at 21 April 2011' (Statistics, Insurance Council of Australia, 21 April 2011).
<<http://www.insurancecouncil.com.au/IndustryStatisticsData/CatastropheDisasterStatistics/tabid/1572/Default.aspx>>.

¹⁴ Insurance Council of Australia, *Year in Review 2009* (2009)
<http://www.insurancecouncil.com.au/Portals/24/Year%20In%20Review%202009/InsuranceCouncil_YearInReview_PRINT2.pdf>.

¹⁵ 'Special Report: Black Saturday—Emerging from the Ashes, Members Reflect' (2010) February *The Police Association Journal* 10, 11.

¹⁶ Gary Banks, 'Report on Government Services 2011' (Productivity Commission Report, January 2011) 1, 9, 20.

<http://www.pc.gov.au/_data/assets/pdf_file/0015/105252/rogs-2011-volume1.pdf>.

¹⁷ Jane O'Connor, *Without Warning: One Woman's Story of Surviving Black Saturday* (Hardie Grant Books, 2010) 96.

Approximately one third (32%) of respondents reported that their house was destroyed in the bushfires. Rates of house destruction were significantly higher among respondents in the Murrindindi (46%), Churchill (38%) and Kilmore East (32%) fire complexes.¹⁸

As the Black Saturday bushfires were an extreme event, it was inevitable that some time would lapse between the event occurring and the payment of insurance compensation. This inevitability of delays was due to the absence of a specific insurance solution for catastrophic events and a corresponding claims handling procedure complete with a plan for additional staffing as required. This was one weakness which was evidenced in the aftermath of the fires.

Although more than half of the costs were covered by insurance, the lack of coverage still presented a problem. Initially, the victims of the Black Saturday bushfires, being the individuals, local businesses and local communities, had to absorb the remaining costs, though some losses were alleviated by government aid and donations. Subsequently, many individuals initiated class action litigation and received compensation in the form of out-of-court settlements.

5. Total Economic Cost

The Victorian Bushfires Royal Commission's *Final Report* published a table suggesting that there was a total of AU\$4.4 billion of economic and property losses arising from the Black Saturday bushfires. Some of the most significant costs included AU\$593 million spent by the Victorian Government in fighting the Black Saturday bushfires (including the cost of the time and resources provided by the Metropolitan Fire Brigade, Country Fire Authority, Australian Defence Force, Victoria Police, State Emergency Services and the Victorian Department of Sustainability and Environment). The economic value of the 173 lives lost was quantified at AU\$645 million. There was more than AU\$77 million in damages to public infrastructure and an additional AU\$1.1 billion spent by the Victorian Building Reconstruction and Recovery Authority to assist the restoration of private and community property, as well as more than AU\$1.2 billion in insured losses.¹⁹ The financial burden of the losses associated with the Black Saturday bushfires has been subsequently alleviated for some individuals as a result of litigation in out-of-court settlements. This has resulted in a shift in some of the economic burden from individuals to electricity companies and Victorian state instrumentalities.

6. Inadequacies of the Current Insurance and Regulatory System

Insurance is not the only mechanism to transfer risk between the various stakeholders in household property and contents. Notwithstanding this, recent events have shown that there is a greater role the insurance industry could play in transferring risk through the development of specific products and services designed for natural catastrophes.

Currently, as non-insurance or under insurance is significant, alternative risk transfer mechanisms are being utilised. The non-insurance or underinsurance of household property and contents arises in cir-

¹⁸ Joshua Whittaker et al, *Research Results from February 7th Victorian Fires Second Report on Human Behaviour and Community Safety* (Report from Household Mail Survey, Bushfire CRC, January 2010) 2.

¹⁹ Victoria, 2009 Victorian Bushfires Royal Commission, *Final Report*, Appendix accessed at <<http://www.royalcommission.vic.gov.au/>>.

cumstances where individuals either cannot (due to low income) or fail to arrange insurance to cover the entirety of losses arising in the wake of natural disasters. While there are some individuals who cannot afford insurance, others with objectively sufficient funds or sufficient disposable income to finance insurance premiums (if they budget or see it as a priority) choose not to do so. These individuals may inadvertently underinsure by neither budgeting for insurance nor seeing it as a priority. Alternatively, they may take a calculated risk to underinsure their property to pay cheaper insurance premiums. Commonly the issue of non-insurance or underinsurance is attributed to the lack of access to, or affordability of, insurance.

7. Constraints of the Private Insurance Market

The current private insurance system is designed to deal with standard contingencies and is effective and efficient in dealing with these relative to natural catastrophes. However, the existing constraints within the private insurance system mean the system is not suited to deal with natural catastrophes as effectively and efficiently as the system handles standard contingencies. Natural catastrophes result in a concentration of losses within a short period of time and often within confined geographical localities. Consequently, standard insurance practices designed to model independent risks and diversify these in a pool with many other independent risks are not feasible. The surge in demand for compensation places undue strain on the standard system premised on the operation of independent events such as for example a standard house fire, which is unlikely to affect another property.

The Australian House of Representatives Standing Committee began its report into the operation of the insurance industry during disaster events with a scathing account of the way in which insurers had dealt with recent natural disasters:

Claimants had nowhere to turn and no means of redress when they were unable to have their insurance claims resolved in a timely manner. Victims of extreme weather events all over Australia faced unacceptable delays in the assessment of their claims, misunderstandings about the scope and extent of their policies; a lack of information or communication from insurers; discrepancies or inaccuracies in damage assessment or third party reports and token efforts at dispute resolution. Those who tried to assert their rights in the labyrinth of the claims process found themselves on the wrong side of the power imbalance.²⁰

Due to an inability to rely entirely on the insurance system or as a result of non-insurance or under insurance, some individuals pursue class actions as a means of compensating their losses when they are unable to recover all of their losses from insurance. There is a genuine need for a solution to the inadequacies of catastrophe-risk insurance in Australia whereby rather than reliance upon uncertain mechanisms such as out of court settlements, the use of insurance as a risk sharing tool generates more certainty. Ideally, the solution would involve the government and the private insurance industry working together as explored below.

²⁰ House of Representatives Standing Committee on Social Policy and Legal Affairs, Parliament of Australia, *In the Wake of Disasters: The Operation of the Insurance Industry during Disaster Events* (2012) vii.

8. Beyond Uncertain Government Funding Arrangements

The Natural Disaster Insurance Review, which undertook an extensive analysis of the way insurance deals with disaster in Australia, went beyond consideration of uncertain funding arrangements to propose that the Australian Government take the lead in ensuring adequate funding for relief and recovery efforts. Under the Natural Disaster Insurance Review's proposal, a reinsurance facility would be operated by an agency that was funded by the Australian Government that would 'manage the national coordination of flood risk management and operate a system of premium discounts and a flood risk reinsurance facility, supported by a funding guarantee from the Commonwealth [Australian Government]'.²¹ Moreover, the recommended duties of the agency may include collection of the funds required for the reinsurance facility.²² Notwithstanding the reinsurance facility, the emphasis was on maintaining a workable private insurance market.

9. Insurance Alternatives – National Disaster Relief and Recovery Arrangements

The National Disaster Relief and Recovery Arrangements are a mechanism for dividing disaster-related costs between the Commonwealth and state governments. If state governments decide that their disaster-related expenditure should encompass costs associated with household structural damage under the Natural Disaster Relief and Recovery Arrangements, they are able to seek reimbursement for such expenditure. However, in practice, household structural damage has not constituted a large proportion of the disaster costs allocated to state governments from the Natural Disaster Relief and Recovery Arrangements because generally, disaster expenses by the states have been concentrated in other areas.²³ During the Black Saturday bushfires and the Queensland Floods (see above) funds were mainly allocated towards costs associated with funeral expenses, clean up and recovery, temporary living expenses and temporary re-establishment costs, concessional interest loans for small business, restoration of public assets and personal hardship grants.²⁴

10. Insurance Alternatives – Class Actions and Out-of-Court Settlements

When individuals have been unable to recover the full amount of their losses from insurance due to underinsurance, lack of insurance cover or the existence of sub-limits, there has been a recent trend

²¹ Natural Disaster Insurance Review, *Final Report Inquiry into Flood Insurance and Related Matters* (14 November 2011), Pivotal Recommendation 1.

²² Ibid Recommendation 25.

²³ Attorney-General's Department, *Australian Emergency Management: Natural Disaster Relief and Recovery Arrangement Guidelines—NDRRA State and Territory Thresholds* (14 October 2012) <<http://www.em.gov.au/Fundinginitiatives/Naturaldisasterreliefandrecoveryarrangements/Pages/NaturalDisasterReliefandRecoveryArrangementsGuidelines.aspx>>.

²⁴ Natural Disaster Relief and Recovery Arrangements, *Disaster Assist: Victorian Bushfires (January – February 2009) – Individual Assistance* (22 August 2013) <[http://www.disasterassist.gov.au/PreviousDisasters/StateandTerritories/Pages/VIC/Victorianbushfires\(JanuaryFebruary2009\).aspx](http://www.disasterassist.gov.au/PreviousDisasters/StateandTerritories/Pages/VIC/Victorianbushfires(JanuaryFebruary2009).aspx)>; Disaster Assist (Australian Government), *Queensland Floods (November 2010 – February 2011)* (4 September 2013) <[http://www.disasterassist.gov.au/Currentdisasters/Pages/QLD/Queenslandfloods\(November2010February2011\).aspx](http://www.disasterassist.gov.au/Currentdisasters/Pages/QLD/Queenslandfloods(November2010February2011).aspx)>; Queensland Government, *Disaster Finance Arrangements* (April 2011) <www.disaster.qld.gov.au/support>.

towards pursuing class actions. For example, after the Black Saturday bushfires,²⁵ class actions targeted a variety of defendants: electricity companies, the Country Fire Authority, Department of Environment and Sustainability and Victoria Police. As such, the Victorian Government was named a co-defendant in many of the class actions despite the argument (which is developed below) that it had no legal compulsion to act but rather a moral obligation. No official sources provide the total cumulative value of all the class actions and the number of individuals involved however, some of the settlements illustrate their significance.

a) Black Saturday Bushfires

To illustrate the size of some of the recent out of court settlements, a brief examination of some of the class actions will now be undertaken. In *Perry v Powercor Australia Ltd*²⁶ and *Thomas v Powercor Australia Ltd*,²⁷ the settlement agreement required the defendant to pay 55% of the claimants' losses arising from the Black Saturday bushfires, penalty interest from the date of the proceedings and party-party costs. In the case of *Merieca v SPI Electricity*,²⁸ the agreed settlement included 45% of the losses claimed by each individual member within the class action. The total compensation available for all of the individual members of the class action was set at AU\$32.85 million.²⁹ In *Place v Powercor Australia Ltd*,³⁰ the defendant paid 100% of the claimants' losses, penalty interest³¹ and party-party costs.³² *Matthews v SPI Electricity*³³ resulted in a total settlement cost of AU\$494.7 million.³⁴ Under this settlement, SP Ausnet agreed to pay the claimants AU\$378.6 million, Utility Services Corporation agreed to pay AU\$12.5 million and parties associated with the State of Victoria, including Victoria Police, the Country Fire Authority and the Department of Sustainability and Environment agreed to pay AU\$103.6 million in compensation.³⁵ On 6 February 2015 the Murrindindi-Marysville class action settled for AU\$300 million.³⁶ Cumulatively these costs amount to a significant sum of money. If the insurance system had better catered for natural catastrophes and provided more affordable products, there would have been a more efficient risk transfer from individuals, companies and government departments to insurers, who are, in turn, better able to diversify risks.

²⁵ See *Place v Powercor Australia Ltd* [2013] VSC 6; *Matthew v SPI Electricity (Ruling Number 16)* [2013] VSC 74; *Mercieca v SPI Electricity* [2012] VSC 204; *Thomas v Powercor Australia Ltd* [2011] VSC 614.

²⁶ *Perry v Powercor Australia Ltd* [2012] VSC 113 [5].

²⁷ *Thomas v Powercor Australia Ltd* [2011] VSC 614.

²⁸ *Merieca v SPI Electricity* [2012] VSC 204.

²⁹ *Ibid* [21]–[23].

³⁰ *Place v Powercor Australia Ltd* [2013] VSC 6.

³¹ *Penalty Interest Rates Act 1983* (Vic) s 2.

³² *Place v Powercor Australia Ltd* [2013] VSC 6 [6].

³³ *Matthews v SPI Electricity* [2013] VSC 74.

³⁴ Maurice Blackburn, 'Record Settlement Gets Go Ahead for Kinglake Bushfire Survivors' (Media Release, 23 December 2014).

<<http://www.mauriceblackburn.com.au/about/media-centre/media-statements/2014/record-settlement-gets-go-ahead-for-kinglake-bushfire-survivors/>>.

³⁵ Maurice Blackburn Lawyers, 'Kilmore East—Kinglake Bushfire Class Action Information Sheet' (2014) <http://www.mauriceblackburn.com.au/media/2423/proposed_settlement_info_sheet.pdf>; Michael Eburn, 'Black Saturday Bushfire Survivor Secures \$500 million in Australia's Largest Class Action Payout' in Michael Eburn, *Australian Emergency Law* (15 July 2014)

<<http://emergencylaw.wordpress.com/2014/05/20/bushfires-the-price-we-pay-for-electricity/>>; Jane Lee, Richard Willingham and Timna Jacks, 'Black Saturday Victims Win \$500 Million Settlement' *The Age* (online), 15 July 2014 <<http://www.theage.com.au/victoria/black-saturday-victims-win-500m-settlement-20140715-zt7jh.html>>.

³⁶ Maurice Blackburn, 'Murrindindi—Marysville Bushfire Class Action'

<<http://www.mauriceblackburn.com.au/legal-services/general-law/class-actions/current-class-actions/bushfire-class-actions/murrindindimarysville-bushfire-class-action/>>.

The inclusion of the Victorian State Government or state instrumentalities as defendants suggests that the Victorian Government may be responsible for preventing losses to households, despite the efforts of firefighting services and emergency-management teams employed to suppress fires. As these matters were settled out of court, there was no opportunity for a court to specify the basis for the legal responsibility of the Victorian Government. State and territory governments are under a duty in relation to emergency management however, unless specifically prescribed in legislation, individuals do not have a common-law or statutory duty to protect their personal household property. State fire services and emergency services will protect public and private infrastructure. In the context of the Black Saturday bushfires, there was no actionable failure by the Victorian Government to comply with a legal duty. The unprecedented size of the fire front, coupled with other factors such as the wind speed and direction, meant that despite the best efforts of the Victorian emergency services, it took many days to bring the fires under control.

Notwithstanding the arguable absence of a legal duty, Dr Eburn suggested that due to the responsibilities imposed on the Victorian Government and government instrumentalities, there was a pressure to settle matters out of court. This often-faced moral/political responsibility³⁷ manifests itself in Victoria endeavouring to be a model litigant.³⁸ Under the Victorian Government Department of Justice Guidelines, (*Model Litigants Guidelines: Guidelines on the State of Victoria's Obligations to Act as a Model Litigant*), 'being a model litigant requires that the state and its agencies, as parties to litigation, act with complete propriety, fairly and in accordance with the highest professional standards. The expectation that the state and its agencies would act as a model litigant has been recognised by the courts'.³⁹

b) Queensland Floods

Similarly, in the aftermath of the Queensland Floods, the Queensland Government was the subject of class actions. *Rodriguez & Sons Pty Ltd v Queensland Bulk Water Supply Authority*⁴⁰ was a class action on behalf of homeowners, tenants, business owners and others who had experienced property damage, business interruption, temporary relocation, rebuilding or repairs as a result of the flooding. The action was based on negligence against Sequwater, Sunwater and the Queensland Government for failure to monitor the predictions of rain and minimise any effects downstream from the Wivenhoe and Summer-set dams once they overflowed. Unless the case sets a new legal precedent imposing an obligation on state governments, state governments will continue to have only moral/political responsibilities and no legal duties in the context of reparations following natural catastrophes.

³⁷ Michael Eburn, 'Bushfires: the Price We Pay for Electricity' in Michael Eburn, *Australian Emergency Law* (20 May 2014).

<<http://emergencylaw.wordpress.com/2014/05/20/bushfires-the-price-we-pay-for-electricity/>>.

³⁸ Victorian Department of Justice, *Model Litigants Guidelines: Guidelines on the State of Victoria's Obligations to Act as a Model Litigant* (2012)

<<http://www.justice.vic.gov.au/home/justice+system/laws+and+regulation/victorian+model+litigant+guidelines>>.

³⁹ See *Melbourne Steamship Limited v Moorhead* (1912) 15 CLR 133, 342; *Kenny v State of South Australia* (1987) 46 SASR 268, 273; *Yong Jun Qin v The Minister for Immigration and Ethnic Affairs* (1997) 75 FCR 155.

⁴⁰ *Rodriguez & Sons Pty Ltd v Queensland Bulk Water Supply Authority* Proceeding No 2014/200854 <http://www.supremecourt.justice.nsw.gov.au/supremecourt/sco2_class_action/floods.html>.

11. Towards a National Insurance Scheme for Natural Disasters

A series of reviews (National Disaster Insurance Review, Victorian Bushfires Royal Commission and House of Representatives Standing Committee report *In the Wake of Disasters: The Operation of the Insurance Industry during Disaster Events*) concluded that it is preferable to enact legislative amendments to transform aspects of the existing legal and institutional framework for insuring damage that occurs from catastrophic events rather than retain the status quo.

To date, the reviews have largely emphasised the need to maintain a workable private insurance market. The private insurance industry has inherent features limiting its ability to provide, in the national interest, broad-based relief and recovery following a natural catastrophe. There are both demand-side and supply-side forces at work that result in widespread non-insurance and underinsurance.

On the demand side, the sale of commercial insurance and the operation of a competition-driven market suggest that insurance would be a sought-after product with demand reflecting need and pricing. This assumes that consumers of insurance are both rational and risk neutral. Risk neutrality implies that the consumer would only insure to the point to which they benefit from insurance. That is, the value attributed to the reduction in risk must equal or exceed the cost of the financial investment of purchasing insurance before the consumer would consider this purchase. In an efficient insurance market, competition between insurers would be expected to produce this outcome. However, the reality that many individuals do not possess insurance cover suggests that assumptions of rationality and risk aversion may be misplaced.

On the supply side, insurers operate as commercial entities.⁴¹ The need for insurers to maintain adequate capital reserves and institutional factors, including those arising from accounting, taxation and take-over risk, make insurers reluctant to develop catastrophe-risk insurance products.⁴² Although there is capacity within the commercial insurance market to write insurance covering catastrophe events for lower premium rates due to a 'soft' market, this is not guaranteed to remain.⁴³ Rather, insurance is cyclical, with projections that the market will harden with less capital and higher prices in the future. However, if the market remains 'soft', suboptimal features may emerge, including adverse selection and failure to reduce moral hazard.

In contrast to private insurance markets, the use of a public natural-catastrophe scheme could overcome many of the supply-side and demand-side problems. On the demand side, there is scope to make a national scheme compulsory, thereby avoiding the problem of irrational consumers. Compulsion can aid the operation of a natural catastrophe system. On the supply side, pricing and capital-reserve requirements could be controlled and institutional factors affecting the private insurance industry could be avoided with a public scheme, depending on the way in which that scheme is structured.

⁴¹ Patrick M Liedtke, Kai-Uwe Schanz and Walter R Stahel, 'Climate Change as a Major Risk Management Challenge: How to Engage the Global Insurance Industry' (Background Paper No 15, The Geneva Association: Risk and Insurance Economics) 1, 6.

⁴² Dwight M Jaffee and Thomas Russell, 'Catastrophe Insurance, Capital Markets and Uninsurable Risks' (1997) 64(2) *Journal of Risk and Insurance* 205–230.

⁴³ Willis Re, *Managing Extremes: 1st View—Market Reshaping a Reality* (Willis Re Report, January 2015) 3.

12. National Disaster Coordination and a Proposed National Insurance Scheme for Natural Disasters

There is no doubt that the private insurance industry constitutes a powerful group and would play a role under any transformed natural catastrophe insurance and regulatory system. Creating a national scheme that retains a role for the private insurance industry, while avoiding the inherent limitations of that industry (as identified above), fits within the general thrust of the recommendations made by the Natural Disaster Insurance Review. In effect, a national scheme may 'put the insurance industry's capacity to assist in context'.⁴⁴

13. What could a National Insurance Scheme for Natural Disasters look like within an Australian context?

The article refers to a series of reviews, proposals and recommendations that support greater coordination of insurance specifically designed for natural catastrophe at the Commonwealth level. The Productivity Commission on Disaster Funding Arrangements has suggested creating a pool of funding allowing up to AU\$200 million per annum to be distributed by the Commonwealth to the states. The Natural Disaster Insurance Review has suggested the creation of an agency sponsored by the Australian Government that would 'manage the national coordination of flood risk management'⁴⁵ and concluded that it is optimal to fund insurance initiatives at a national level.⁴⁶

The idea of interaction between the insurance industry and the government was supported by Allianz Australia's General Manager of Corporate Affairs, Nicholas Scofield. In the context of flood insurance, Scofield suggested that integrating a government-reinsurance pool or a similar insurance mechanism to facilitate flood insurance would be preferable to the status quo, provided it was implemented within the confines of the existing insurance regime. He stated that he views 'the Government's lack of response on the issue of affordability as "an opportunity lost"'.⁴⁷ Scofield focused the need for any solution to work with the insurance industry.⁴⁸

Common reasons behind creating national schemes for disaster risk are the failure of private insurance markets in specific high risk localities, extreme catastrophic events or a combination of both. Over the past five years, Australia has experienced natural disasters involving unprecedented costs to the community. Combined with the identified inadequacies of the private insurance market to deal with relief and recovery in the national interest, these circumstances may create a 'perfect storm' for a transition to a National Insurance Scheme for Natural Catastrophes.

⁴⁴ Senate Economics Legislation Committee, Parliament of Australia, Canberra, 11 March 2011, 20 (Richard Denniss, Executive Director of Australia Institute).

⁴⁵ Natural Disaster Insurance Review, above n 21, Pivotal Recommendation 1.

⁴⁶ Bill Shorten, 'National Disaster Insurance Review' (Press Release, 039, 4 March 2011).

<<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/039.htm&pageID=003&min=brs&Year=&DocType=0>>.

⁴⁷ 'Insurers Back Government Flood Decisions', *InsuranceNews.com* (Australia) (online), 23 March 2013 <<http://insurancenews.com.au/local/insurers-back-government-flood-decisions>>.

⁴⁸ Ibid.

One potential solution could be to introduce a scheme which focuses on providing household building insurance cover. As Australia is exposed to a variety of catastrophe risks, like in New Zealand, Spain and France, it may be appropriate to introduce a National Insurance Scheme for Natural Disasters which provides named peril insurance cover for a variety of catastrophe events (such as for example flood, wind storm, earthquake etc). The proposed National Insurance Scheme for Natural Disasters could apply nationally to ensure that it satisfies constitutional limitations. In this way it could provide cover for all Australians regardless of the state or territory in which the individual resides. The introduction a proposed system, would prevent the continuation of the status quo where the amount of resources dedicated to relief and recovery efforts by a state or territory is currently within the prerogative of that state or territory, which may lead to inconsistent outcomes. By providing compensation consistently nationwide, the proposed National Insurance Scheme for Natural Disasters removes uncertainty and inconsistency.

14. Access and Affordability

All established Australian households should have access to insurance products at affordable rates. In March 2015, the Assistant Treasurer referred to 'high insurance premiums in North Queensland [and other areas] creat[ing] a public policy issue'.⁴⁹ Debate around the introduction of a compulsory National Insurance Scheme for Natural Disasters is thus timely and may offer a means to resolve this problem.

One option for a proposed National Insurance Scheme for Natural Disasters is for it to operate in a compulsory manner. The compulsion would resolve some of the issues of adverse selection and ensure that all Australians have access to insurance cover. The current proposal for a National Insurance Scheme for Natural Disasters would need to ensure affordable insurance yet enable fiscal stability so that the system could continue to operate in the medium to longer term. Although fiscal stability requires a projection that the Scheme would remain relevant to the future, such a presumption could be made on the premise that a Scheme would operate until the insurance industry is willing to provide affordable cover for natural catastrophe for all existing Australian properties.

⁴⁹ 'Australia: Insurance in N Queensland Needs to be More Affordable', *Asia Insurance Review* (online), 3 March 2015.

Conclusion

Existing Insurance Infrastructure in Australia and the need for a proposed National Insurance Scheme for Natural Disasters

The legal and regulatory system in Australia providing household building and contents coverage against catastrophe is not separate from the insurance system covering standard contingencies. The legislation governing this is the *Insurance Contracts Act 1984* (Cth). Although the system works well for ordinary contingencies, the recent catastrophic events being the Black Saturday bushfires and the Queensland Floods indicate it would be preferable to have a different insurance system for catastrophic events.

A series of reviews have exposed areas which could be reviewed and strengthened including access, affordability, claims handling, delays and misunderstandings. Some of the recommendations arising from the reviews have been remedied such as the introduction of a uniform definition of flood to prevent misunderstandings. However there are many others which still require attention and a dedicated resolution. On this basis, in line with the recommendations of the recent reviews, the article recommends the implementation of a proposed National Insurance Scheme for Natural Disasters. The structure and format of the Scheme would need further consideration and debate. In order for such a Scheme to operate with constitutional validity it would need to operate nationally. In addition to the constitutional validity issues, a further benefit of this operating nationally would be alleviating adverse selection and in doing so seeking to promote a stable economic base upon which the Scheme can collect premiums and grow capital reserves.