

3 July 2024

Committee Secretary
Standing Committee on Economics
Parliament House

By email: floodinsurance.reps@aph.gov.au

Dear Committee Secretary

Inquiry into insurers' responses to 2022 major floods claims

Thank you for the opportunity to provide brief input to the *House of Representatives Economics Committee Inquiry into insurers' responses to 2022 major floods claims*.

COBA is the industry association for Australia's customer owned banks (mutual banks, credit unions and building societies). Collectively, our sector has over \$175 billion in assets and is the fifth largest holder of household deposits. Our members range in size from less than \$200 million in assets to around \$25 billion in assets – all significantly smaller than our ASX-listed peers. Customer owned banks (i.e. mutual banks) account for around two thirds of the total number of domestic Authorised Deposit-taking Institutions (ADIs) and deliver competition and market leading levels of customer satisfaction in the retail banking market.

Key points

COBA members recognise the risks that natural disasters, including floods, have on their businesses and strive to work with customers to appropriately manage the risks to both the bank and mortgage holders.

Lending for retail mortgages is the core of COBA members' business model and COBA members manage the physical risks to mortgaged properties on a portfolio-wide basis and on an individual borrower basis.

Appropriate insurance cover must be held at the time of mortgage origination. COBA members seek to work with customers to address insurance affordability concerns where possible. For example, this could be through treating the unaffordability of insurance as a form of customer hardship and so seeking a mutually beneficial solution going forward through the hardship process.

Key points (continued)

COBA members can employ limits to loan-to-value ratios in addressing an increased flood risk for a property.

COBA members understand their customers and the areas in which they operate very well. This close community connection means that customers can be supported to manage the natural disaster risks that arise from ownership of a particular property. For example, encouraging customers to explore alterations to a property which could increase its flood resilience and therefore reduce risk.

Insurance affordability and accessibility is a critically important element to support Australians in their home ownership journey. The challenges facing the insurance industry are significant and need to be addressed to provide certainty and security for homeowners and lenders alike.

COBA and its members recognise the significant impacts that recent flood events have had on individuals and the wider community and understand that the risks of future natural disasters need to be managed in an appropriate way. This will require a whole-of-ecosystem approach with governments, insurers and the broader financial system playing an important role to ensure that home insurance is accessible and affordable for those who rely on it.

COBA members serve a wide variety of communities in geographic areas across Australia and as a result, some members are more likely to be exposed to flood risks in their lending books than others, primarily because of a geographic concentration in the mortgage portfolio. Risk management is a very important aspect of COBA member lending practices, as banks take on long term risks when offering a mortgage. Mortgages are usually written for a 30-year term, while home insurance policies are usually only offered on 12-month terms. Insurance policies which appropriately cover homeowners for the physical perils which they face over the course of home ownership are a critically important component of prudent risk management.

COBA members are committed to supporting Australians to own their own home and lending for retail mortgages is the core of COBA members' business model. Given the prevalence of natural disasters in recent years, some COBA members have customers who have been affected by recent flood events. Members have sought to work closely *with* their customers to provide support during natural disasters and assess hardship applications arising from exposure to flood events. Ultimately, COBA members are owned by their customers, so they are committed to working cooperatively with their customer members and helping them to manage the risks arising throughout their property ownership journey.

Risk Management

The customer owned banking sector is increasing its maturity in understanding and incorporating climate risk into risk profiles; currently flood risks are assessed at a portfolio level and also at an individual borrower level, at the time of loan origination. The Australian Prudential Regulation Authority (APRA) requires lenders to appropriately manage risks that may affect their business. In particular, APRA's prudential guide CPG 229¹ provides guidance on prudent practices in relation to climate-

¹ <https://handbook.apra.gov.au/ppg/cpg-229>

related financial risk management. Customer-owned banks utilise this guidance in developing risk management strategies.

A number of COBA members undertake portfolio evaluations on a periodic basis in order to better understand the physical risk associated with their current portfolios. This can include current and projected flood risks. The modelling assists the bank in long term risk profiling at a whole-of-portfolio level. COBA members are generally able to appropriately manage existing climate risks at a portfolio level.

Flood risk (and other climate risks) are also managed at an individual borrower level primarily through the independent property valuation undertaken at mortgage origination. A detailed physical property valuation would be required where a property is deemed to be in a known flood risk area or where an applicant self-declares a flood risk exists. Furthermore, where a valuation identifies a flood risk, a bank may choose to impose conditions on the provision of a mortgage which could include loan-to-value ratio (LVR) limits.

COBA members, particularly those based in regional areas, understand their customers and the areas in which they operate very well. This close community connection means that customers can be supported to manage the risks that arise from ownership of a particular property (for example, encouraging customers explore alterations to a property which could increase its flood resilience and therefore reduce risk).

Some COBA members are also considering developing more comprehensive risk management models which could better assess the risk stemming from physical perils at an individual property level, however the development of such models is a very costly exercise for COBA members given their small size.

Insurance Requirements

Insurance cover is a requirement for mortgages written by COBA members and proof of insurance is requested prior to settlement. Generally, insurance cover is not monitored post-settlement. Many COBA members do however send regular reminders to mortgage holders outlining the requirement to maintain insurance cover.

Monitoring existing insurance cover held by mortgagees is a complex and costly exercise, particularly for small, resource-constrained customer-owned banks. This is especially so given that a mortgage holder could cancel their insurance policy at any time even if cover was held at the time of assessment. Should a mortgage holder be unwilling or unable to hold insurance cover for their property, COBA members are generally limited in their ability to respond. Although a failure to hold insurance could constitute a non-monetary default under the mortgage terms and conditions, COBA members seek to work with customers to address insurance affordability concerns. For example, this could be through treating the unaffordability of insurance as a form of customer hardship and so seeking a mutually beneficial solution going forward through the hardship process.

At mortgage origination, COBA members are required to assess a borrower's capacity to service their loan. This serviceability assessment includes an insurance cost assessment based on current insurance prices. Further serviceability assessments in response to changes to insurance cover are not undertaken once a loan has been written.

Risk Based Pricing

COBA members do not currently undertake risk-based pricing of mortgages to account for increased flood risk. Generally, when a decision is made to manage an increased flood risk, it is typically achieved through limiting the LVR which a borrower is able to obtain on the mortgage. Furthermore, an independent valuation (which accounts for flood risk) is used to determine the property value as a basis for the LVR.

Insurance Affordability

Insurance affordability and accessibility is a critically important element to support Australians in their home ownership journey. The challenges facing the insurance industry are significant and need to be addressed to provide certainty and security for homeowners and by extension COBA members who provide mortgages to them.

Increasingly unaffordable insurance premiums or the inability to access home insurance at all is a concern for COBA members. Increasing natural disaster risks combined with constraints on the provision of home insurance are expected to increase the risks and potential costs on COBA members over the longer term.

Thank you for the opportunity to provide a submission. If you wish to discuss any aspect of this submission, please contact Alexander Woloszyn, Policy Manager (awoloszyn@coba.asn.au).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Michael Lawrence', is positioned above the printed name.

MICHAEL LAWRENCE
Chief Executive Officer