Insurance on Flood & Other Water Perils

by Dr Allan Manning – LMI Group
February 2011

Nothing has dominated the media in the first 6 weeks of 2011 more than the storms and flooding that has affected much of Australia.

The Insurance industry is expected to pay out close to $3 billion in claims from these losses over and above all the other regular day to day level of claims lodged. This of course is great comfort to the over 100,000 claimants and of equal benefit to the economy. It must be remembered this season is not yet over as we see ex-tropical Cyclone Carlos still dumping rain on north-west Australia and Cyclone Dianne hovering off the coast of Western Australia.

It is often an overlooked fact just how much protection the insurance industry provides to home and business owners and to the Australian economy in general. In the year ended 30 June 2010, over $16.5 billion was paid out in claims by insurers. That is the equivalent of $2.05 to every man, woman and child in the country, every day of the year. This has an enormous spin-off effect to builders, panel beaters, retailers of all types, professionals and the list goes on. Yet, despite this great benefit, insurance is not considered important to most until a claim arises. Till then, it is just an expense that should be minimised with no thought to the implications of buying on price, until it is too late.

The media, in their usual sensationalistic style, has criticised the insurance industry for hiding behind small print and leaving their customers hanging. Other than perhaps drive-up viewer ratings, I am not sure that this does any good for anyone, and in fact may have two negative consequences. Firstly, it may encourage people not to take out insurance, believing it will not respond anyway and, secondly, it de-motivates the thousands of claims officers, loss adjusters and assessors who are working extraordinarily long hours in very difficult conditions to meet the needs of the insuring public. It must be remembered that these same claims staff have hardly drawn breath since the Victorian bushfires, just over 2 years ago. This was followed by 100,000+ claims from the Melbourne hail storm and, 6 weeks later, another 100,000 claims on the other side of the country arising from the hail storm in Perth. A billion dollars or more was paid out by insurers following each of these events. Between these hail storms, recent storms and floods, many have worked tirelessly in Christchurch following the massive earthquake. The current estimate is around $4 billion for this one event. Regrettably, yet another earthquake has just hit Christchurch, with extensive damage and tragic loss of life. Insurers are already responding.

Much has been made by some in the media about the fact that flood is not covered by some policies. This is quite true. However, even after the massive floods of 1974 in Brisbane, there has been a limited demand for the cover – until of course now when it is far too late after the person’s home or business has been flooded.
What occurs then, as is occurring now, is that during a time of great trauma, a home or business owner who, in the vast majority of cases, has never read their policy, has expectations of protection that are at odds with the coverage afforded by their policy.

The fact is that unless you live in a blatant flood-prone area, flood cover has been much more readily available over the past few years than ever before. Unfortunately, the insurers that offered the cover did not receive the support that was expected for their initiative. On the other hand, the Insureds and brokers that did support them are of course now pleased they did so.

To say that the policy hides behind small print or hidden exclusions is also simply not true. Policies make it quite clear, often in the first few pages and/or in large print and/or in many places, that flood is not an insured peril.

There were at least 203 different home and contents policies that were in force at the time of the Queensland floods. Taking the first of these policies in alphabetical order as an example, I am not sure how you could make it any clearer. My example is the AAMI Home Building Insurance Policy, which is shown below.

While not presented in the same format, RACQ Insurance (another oft-cited insurer of late) makes it equally plain. Adjacent is an extract from page 2 of their Household Insurance Policy.

As can be clearly seen, the advice on flood is in a larger font and in italics so that the reader's eye is drawn to it. This is the first of five places in the policy where it explains that flood is not a standard cover. Short of Lord Denning’s famous red flashing hand, I am not sure what more these or any of the other insurers currently being attacked, could reasonably have done to have brought the issue to their customer's attention.
Flood is the second biggest cause of building property damage in Australia. This is over a long period and is not biased by the latest events. The major perils are shown in the adjacent graph.

As already mentioned, it is a regrettable fact that the vast majority of people do not take the time to read their insurance policy. The same could be said for their mortgage documents, hire purchase agreements, credit card contracts, lease agreement or dare I say it the instructions on how to assemble a child's toy. Why this is so is the subject of a paper in its own right. The point is that if you do not take the time to understand life's risks and take out reasonable protection to cover yourself, it is not-all other things being equal-an insurance company's fault, nor the government's, nor anyone else's. If a business or home owner is not sure, then they can engage the services of a general insurance adviser at little or no cost, who will identify their needs and provide advice on what covers are available and what is best for them. Such experts have access to LMI Policy Comparison and other research tools.

So what does a typical insurance policy cover when it comes to the water perils? A brief outline of each is set out below. However, the following should only be treated as a general guide as it is not designed to be exhaustive or address any one policy. It also needs to be clearly understood that while coverage is certainly important, the financial strength rating of the underwriter, the claims service, and price all need to be considered.

**Storm & Tempest**

There are no legal or other differences between ‘storm’ and ‘tempest’. However, as ‘storm and tempest’ is such a well-known expression in the insurance industry, it remains in modern use. This peril covers violent wind, including cyclones and tornadoes, thunderstorms, and hail. Any of these may be accompanied by rain or snow.

In Australia, most household and business insurers provide storm and tempest cover as standard. The most important thing to understand is that flood, while it may be caused by a storm, is not covered by the standard insured peril of Storm & Tempest. I come back to the definition of flood later.

Storm and tempest does not cover loss or damage caused by rain, wind, hail or snow entering a building unless it enters as a result of structural damage made by the storm and tempest.

As some exclusions cover more than one water peril, I would urge the reader not to stop here, but read the exclusions section of the paper.
Rainwater

Rainwater is typically described as rain falling naturally from the sky, including rainwater run-off over the surface of the land, but excludes loss or damage:

i) to the external paintwork or other exterior coatings of the buildings;

ii) from rainwater seeping or percolating or otherwise penetrating into the buildings as a result of structural defects, faulty design of the buildings or faulty workmanship in construction, or neglect of maintenance.

There is often an overlap of the cover afforded by Storm & Tempest and Rainwater. In some areas, such as rain entering an open window, it extends the coverage afforded by the Storm & Tempest cover.

Bursting, Leaking, Discharging or Overflowing

This covers the bursting, leaking, discharging or overflowing of water tanks, pipes, gutters, drains and other water-carrying apparatus. Often, garden hoses are excluded. However, many policies now extend the cover to include other liquids, such as oil from fixed oil heating systems.

While the cost of repairing the leaking pipe is a maintenance issue and typically not covered, the cost of locating the leak and making good the damage caused in finding the leak, is covered in better quality policies, albeit to a monetary limit in some cases.

Policy Exclusions

There are a number of common exclusions that apply to the three perils discussed above. These are loss or damage:

1. by flood;

   This is typically described as the inundation of normally dry land by water escaping or released from the normal confines of any natural watercourse or lake (whether or not altered or modified), reservoir, canal or dam.

2. to gates, fences, retaining walls, textile awnings, external blinds, paths, driveways, terraces, tennis courts, boat jetties, swimming pool covers or the plastic liner of a swimming pool;

   Some policies may provide cover for some of these items, although there may be a monetary limit capping the most that will be paid for any one event.

3. directly or indirectly by the sea, which can include tidal wave, storm surge, tsunami and high tide;

   Again, policies do vary, and tsunami and storm surge can be covered by some policies, but not in others.
4. by erosion, subsidence, landslide, mudslide, shrinkage or other earth movement, but damage caused by mud, soil and other debris entering or striking a permanent building is usually covered; and

Again, some policies may provide some cover for some of these risks.

5. to buildings and their contents where the building has not been well maintained and this is known or ought to be known to the Insured.

Insurance is not designed to cover inevitable losses.

**Flood as an Insured Peril**

Flood is not typically a standard cover across the entire insurance industry. Some insurers do provide it as standard, while others provide the cover, but reserve the right not to grant cover if the risk is outside their underwriting guidelines. Others offer the cover as an optional extra cover, while some are not prepared to insure the risk at all.

The definition of flood does differ across the industry, but arguably the most common definition of flood used in the Australian market is:

"Flood means the inundation of normally dry land by water escaping or released from the normal confines of any natural watercourse or lake (whether or not altered or modified), reservoir, canal or dam."

The important words here are "escaping or released from". This includes situations as occurred in Brisbane, where the government authorities released water at the same time as the rain was falling, which only compounded the situation.

Many people who should have had flood cover elected not to take it. Examples here are business owners in particular on the upper levels of high-rise buildings. They overlooked that the electrical switchboard, backup generator, lift motors and the like are often located in the basement, and damage to this property can cause interruption losses to their business.

Similarly, a successful claim for prevention of access, or for losses arising out of damage to customers’ and suppliers’ premises, is dependent on the Insured’s policy covering flood.

**Flash Flood as an Insured Peril**

Some insurers wishing to grant some form of flood cover to their clients, have introduced a relatively new cover known as ‘flash flood’. It was introduced to domestic home and contents policies first, but now some commercial policies do offer the cover.
A typical definition of flash flood is:

“The overflow of any lake, river, creek, stormwater channel, canal or any other watercourse (whether natural, altered or mad-made), caused by a storm, where the flooding occurs within 24 consecutive hours of the storm having commenced.”

While this cover would not provide cover for the losses arising in Brisbane in 2011, it would (and indeed has) provided insurance protection to those in Toowoomba and Grantham after the tragic floods in January of this year.

Even insurers without this specific cover accepted that much of the damage in towns like Toowoomba fell within the definition of rainwater, and accepted their clients’ losses as claims.

**Motor Vehicle Insurance**

If vehicles are insured for full comprehensive cover, then flood is covered. For those with ‘fire, theft and third party’ or just ‘third party property cover only’, flood is not insured.

**Delays in Decision-making**

Perhaps the greatest criticism leveled at the insurance industry has been the delays in advising some clients if they have a valid claim. Where a client has flood cover, this is simply not an issue. If it is clearly flood, with absolutely no doubt, clients are advised immediately. Where there is a delay is where the policy does not cover flood and there is some doubt as to whether the loss was caused by flood or some other water peril. Insurers have to review each claim on a case-by-case basis using the services of a hydrologist, who will produce a report advising on his or her view of the cause.

If there were one or two claims or even a hundred or so, this could be done quickly. Here, we have losses across an area the size of Germany and France combined, involving literally tens of thousands of losses. This assessment, which has to be done accurately, takes time. It should not, and cannot, be rushed. Having said this, being out in the field myself, it is clear that everyone involved is doing their very best to complete this work as promptly as possible.

**Under-insurance**

Non-insurance is one thing. Just as important is the need to be fully insured and, if you are a business owner, to have business interruption insurance.
Conclusion

The purpose of this paper is to reinforce the fact that flood is a devastating natural disaster that can affect large numbers of homes and businesses, particularly in heavily populated areas. A flood can strike with little warning, flooding areas that have been dry for decades. The damage to property and subsequent business interruption can be financially devastating, literally destroying a lifetime’s work.

When these latest floods hit, the insurance industry-through socially responsible insurers-was providing more flood cover than it has ever done in the past. Certainly much more than at the time of the 1974 Brisbane floods.

None of us, including state governments, can afford to adopt an ‘It will never happen to me!’ attitude to risk management and insurance. Everyone needs to carefully read their insurance policy and, if they are not sure of the cover afforded, seek expert advice from an authorised general insurance adviser.

Author: Dr Allan Manning, Chief Executive of LMI Group, is one of Australia’s leading experts in insurance. He is the author of 9 books on insurance including Understanding the ISR Policy: A Comprehensive Guide. He has over 40 years’ practical experience with managing and preparing claims, drawing on this experience in developing many of the LMI Group’s online research tools such as LMI PolicyComparison, LMI BI Calculator, LMI Risk Coach and LMI Continuity Coach.

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