



Australian Government

Australian Reinsurance Pool Corporation

11 November 2022

Mr Patrick Hodder
Committee Secretary
Joint Select Committee on Northern Australia
Parliament House,
CANBERRA ACT 2600

Dear Mr Hodder,

Thank you for your letter dated 18 October 2022, inviting the Australian Reinsurance Pool Corporation (ARPC) to make a submission to the Joint Select Committee on Northern Australia (the Committee). ARPC welcomes the opportunity to provide information regarding the Committee's inquiry into the operation and implementation of the Cyclone Reinsurance Pool (the cyclone pool). This letter is that submission.

About ARPC

ARPC was established under legislation in 2003 to administer the Terrorism Reinsurance Pool (terrorism pool) following the 11 September 2001 attacks in the US. The terrorism pool was designed to provide reinsurance cover after the global withdrawal of terrorism insurance cover leaving Australia's commercial property uninsured against terrorist attacks and with reduced access to project funding and commercial refinancing. ARPC was established by the Australian Government with the support of stakeholders in the property, banking, insurance, and reinsurance sectors.

ARPC is a public financial corporation within the Treasury Portfolio. The Corporation is governed by our Accountable Authority, which is the ARPC Board. The change to legislation in March 2022, established the *Terrorism and Cyclone Insurance Act 2003*, conferring administration of a cyclone pool on ARPC in addition to the terrorism pool. ARPC began to operate the cyclone pool from 1 July 2022.

Operation of the cyclone pool

Cyclone pool coverage

The cyclone pool provides coverage for eligible risks Australia wide but targets premium reductions in medium to high risk cyclone areas, which are mainly in northern Australia. The cyclone pool covers the cost of eligible cyclone and cyclone-related flood damage claims, above the policyholder excess.

The cyclone pool will cover losses caused by cyclonic winds, cyclone related flooding and storm surge. It is estimated to cover 3.3 million households, 220,000 small businesses, and 140,000 residential strata and small commercial strata properties.

Cyclone pool funding capacity

The cyclone pool is funded by reinsurance premiums paid by insurer customers consistent with the expected claims and operating expenses for the cyclone pool. These reinsurance premiums have been determined by ARPC with consideration to its legislative obligations. The premium rates have been reviewed by the Australian Government Actuary, in their capacity as reviewing actuary.

The cyclone pool is supported by an annually reinstated \$10 billion Commonwealth guarantee, which covers any shortfalls from ARPC. If the \$10 billion guarantee is likely to be exceeded by a

single cyclone event, or series of cyclone events within a single year, there is a mechanism through which the Commonwealth can increase the guarantee to meet relevant claims.

How savings are achieved for consumers

The cyclone pool will replace insurers current approach to financing cyclone losses. This will save consumer policyholders on premiums because:

- it will not charge a margin for the risk it takes on total cyclone insurance costs;
- by setting cross-subsidised reinsurance premium rates, medium and high-risk properties pay comparatively lower premiums, while low-risk properties pay comparable cyclone premiums as the legislation intended; and
- ARPC is not APRA regulated so is not required to hold the same level of capital as private insurers.

A key advantage of the cyclone pool is that reinsurance premiums will not need to respond to international market cycles and short-term market pressures, so premiums are more stable. The cyclone pool should also lower barriers to enter the market for those insurers not currently writing business in cyclone-prone areas.

Premium rates

ARPC published initial premium rates and the Reinsurance Agreement ahead of the cyclone pool commencing operations on 1st July 2022. Following a request for further extended consultation, that resulted in additional information being provided by insurers, revised premium rates were published effective as of 1st October 2022. The revised rates resulted in a further 10% reduction in projected premiums.

ARPC's pricing formula is designed to:

- be cost-neutral to the Australian Government over the longer term;
- not make a profit thus reducing costs to policyholders and insurers;
- lower reinsurance cost for most policies with medium to high-risk exposure;
- maintain risk reduction incentives and offer discounts for properties mitigating risk; and
- encourage policyholders to mitigate cyclone and related flooding risks, while the discounts make property insurance more affordable and sustainable.

Other important considerations in the design of the pricing formula include:

- minimal disruption to insurers current pricing practice;
- all insurers pay same premium for a consistent coverage; and
- the model delivers stable long-term rates.

The pricing formula is intended to be applied at the individual risk level for all insurance policies. ARPC has designed the pricing formula to set reinsurance premiums using property-level information including:

- geography;
- building characteristics; and
- mitigation efforts.

Based on the premium rates published 30 September 2022 and the data provided to ARPC from insurers, the average premium savings by class of business have been estimated below:

Product class	Average savings (sample size)			Total sample size
	All record samples (QLD, NT, WA, Northern NSW)	Northern Australia (CRESTA 5-20)	High <i>total</i> premium band in Northern Australia ²	
Home	-6% (720,934)	-13% (143,500)	-32% (2,416)	720,934
SME ¹	-6% (34,700)	-10% (11,857)	-13% (274)	34,700
Strata	-14% (24,508)	-37% (1,905)	N/A ³	24,508

¹Policies with BLD cover

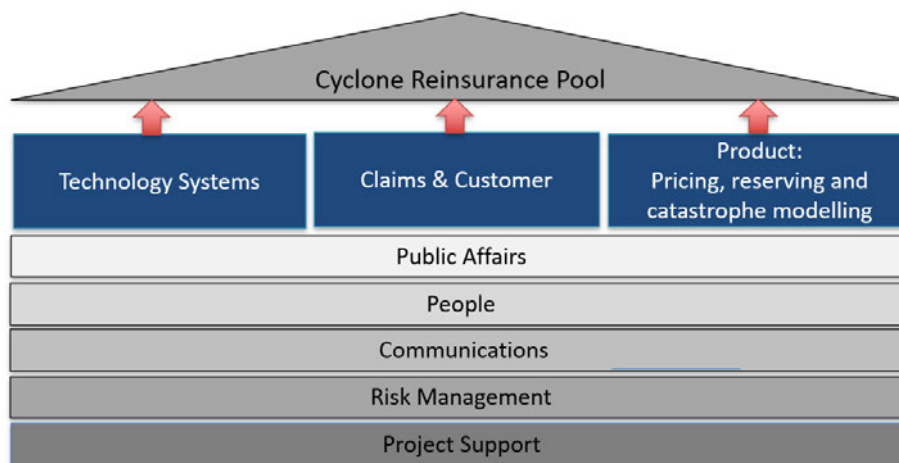
²Highest premium band defined as \$1.50+ per \$100SI for Home and SME

³Cannot be reliably estimated due to data limitations

Source: *Finity Consulting Report: Cyclone Reinsurance Pool – Premium determination applying from 1 October 2022.*

Implementation of the cyclone pool

ARPC has established a dedicated project team and work streams, with executive sponsorship, to implement the cyclone pool, oversighted by the Senior Executive and Board. The stream was supported by subject matter experts and project managers to make sure deliverables were met. This diagram shows how the program of work was managed under three streams with supporting functions.



Before the cyclone pool commenced operations on 1st July 2022, ARPC delivered:

- a reinsurance agreement;
- initial premium rates and formulas; as at 1st July 2022;
- information on ARPC's website covering onboarding, initial premium rates, and Frequently Asked Questions;
- a new reinsurance technology platform (PACE) for premium collection, with claims processing currently under development; and
- the instruments, documentation, and processes it needed to coordinate with the Bureau of Meteorology to declare a cyclone event (Declared Cyclone Event (DCE)).

Government agencies that ARPC has worked closely with to establish the cyclone pool include:

- The Treasury's Cyclone Reinsurance Pool Taskforce;
- Australian Competition and Consumer Commission (ACCC);
- Australian Government Actuary (AGA);
- Australian Government Solicitor (AGS);
- Australian Prudential Regulatory Authority (APRA); and
- The Bureau of Meteorology (BoM).

The administration of the cyclone pool

Insurer onboarding into the cyclone pool

Insurers are required to enter into reinsurance agreements with ARPC. The following table explains who is eligible, and the timing of when Insurers need to onboard into the scheme.

If & when to join...	Threshold (GWP*)	Eligible classes	Eligible regions
Exempt from joining	<=\$10m GWP	Householders/SME/Strata	Postcodes are exempt when ARPC via notifiable instrument has determined the risk in these regions is so low as to be negligible
Small (Join latest Dec 24)	< \$300m GWP	Householders	
Large (Join latest Dec 23)	> \$300m GWP	Householders	

*GWP = Gross Written Premium

ARPC's preparations to assist insurers join the cyclone pool have included:

- working with insurance industry stakeholders to develop a new cyclone pool reinsurance agreement, drafting, testing, and finalising processes to support its operation;
- development and provision of an insurer onboarding guide to assist insurers understand the process and requirements in joining the pool;
- meeting with insurers to answer operational questions and assist in onboarding requirements. Feedback from insurers on challenges in joining the pool has been considered and actioned where appropriate;
- bilateral consultations with insurers, Treasury, and the AGA, and incorporating feedback into ARPC processes;
- detailed work on the development of premium rates, with input from our consulting actuaries, key industry stakeholders, and The Treasury;
- industry briefings with Treasury, ACCC and ARPC;
- presenting at the Reinsurance Rendezvous of the Australian and New Zealand Institute of Insurance and Finance (ANZIIF) in October;
- presenting virtually to reinsurers globally (Bermuda, Singapore and London) and local reinsurers in October / November; and
- engaging with stakeholder groups such as the Local Government Association of Queensland and the Council of Queensland Insurance Brokers, and being scheduled to meet with the Australian Consumer Insurance Lobby (formerly Northern Australia Insurance Lobby) in mid-November.

Specific questions

In addition to addressing the operation and implementation of the Cyclone Reinsurance Pool, the committee requested ARPC to consider three specific questions as part of their submission. ARPC's response to each of these questions is below:

Questions 1 and 2

- What measures are taken into account when considering First Nations' engagement in the implementation of the scheme?
- How could First Nations' communities be better serviced by the Cyclone Reinsurance Pool?

ARPC Response

Our response considers both questions in relation to First Nations' communities. As appointed administrator of the cyclone pool and as a reinsurer, ARPC's response relates to how the legislation may apply to First Nations' communities in administering the cyclone pool.

There is no specific reference to "indigenous housing" in the Act, Regulations or Explanatory Memorandum (EM) that created the cyclone pool.

However, there is a reference to community housing, charities and not-for-profit organisations in the EM that appears to mean that, if a not-for-profit or charity owns indigenous housing (or other types of residences), the organisation will not have to include their residential assets when determining their policy limit, and so will be included in the scheme.

Also, home contents policies covering contents of tenants in government-owned public housing or commercial strata can be covered by the scheme. This means that the personal contents of a government-owned indigenous housing facility can be covered by the cyclone pool if the tenants take out home contents insurance.

Question 3

How does climate change, and the potential for increased frequency and intensity of cyclones, factor into the implementation and operation of the Cyclone Reinsurance Pool?

ARPC Response

ARPC released its 2022-26 corporate plan at the end of August 2022. This included a refreshed purpose, vision, and strategic priorities. A new strategic priority included in the plan was to: "develop data and insights on terrorism, cyclone, and insurance climate risk to support risk mitigation". Being the first time ARPC has included climate risk as a strategic priority, over the coming period ARPC will strategically consider its position in relation to climate risk and its role as administrator of both the terrorism and cyclone pools, plus enterprise risks associated with climate change.

Climate change is expected to impact the frequency, severity, and location of cyclones however, the specific impact is highly uncertain. The key point is that the risks faced by the cyclone pool will change over time and the pool design has settings that provide for the management of this changing risk.

The current premium rates have been based upon the best available current view of the risk. ARPC procured catastrophe modelling tools which provide credible and widely accepted views of risk. We

did not make an explicit additional adjustment for climate change as our intent was to provide premium rates appropriate for 2022.

As required under the Act, ARPC will publish a financial outlook report, the first one due to be published in 2024. The report will comment on the adequacy of the premium rates and consider the ongoing impacts of climate change on ARPC's exposure. ARPC can reflect the evolving scientific understanding of the impact of climate change within its ongoing premium rate reviews.

Conclusion

Thank you for the opportunity to make this submission to the Committee. I look forward to attending as a witness to answer the Committee's questions. If you have any further questions about this submission, please contact ARPC via

Yours sincerely

Dr Christopher Wallace
Chief Executive