INSURANCE COUNCIL OF AUSTRALIA

Insurance Markets Unit
The Treasury
Langton Crescent
PARKES ACT 2600
By email: claudio.damiani@treasury.gov.au
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Dear Mr Damiani,

The Insurance Council of Australia (ICA) appreciates the opportunity to comment on the need for, and effectiveness, efficiency and impact on competition of the *Terrorism Insurance Act 2003.*

Need for the Act to Continue

The ICA submits that there is an ongoing need to continue the operation of the Terrorism Insurance Act (2003).

Discussion with key reinsurers has confirmed that whilst global reinsurance capacity to address this particular risk has continued to grow, access to consolidated capacity in Australia has been enabled solely by the operation of the Act. The capacity of the Australian Reinsurance Pool Corporation (ARPC) to amalgamate risk assessment, rating and insurer access to guaranteed reinsurance for the terrorism risk continues to be necessary in order to deliver commercial terrorism cover.

In considering if there is a need for the Act to continue it is useful to return to the original point of market failure to determine if the causative reasons still remain. Several insurers have submitted that the reason why terrorism is considered a largely uninsurable risk, is the inability to predict and therefore price for an event - Determining the amount of capacity required would be nearly impossible.

Catastrophe reinsurance programs provide a useful analogy. In these programs there are predictive models, weather patterns and building vulnerability standards that can measured, understood and priced over time. With terrorism insurance the ability to predict the probability of the event or the impacts is impossible. Insurers could not be certain that sufficient cover had been purchased if buying reinsurance on an excess of loss basis.

Several reinsurers have reiterated that the pool managed through the ARPC remains the most efficient way for global reinsurers to manage commercial lines exposure to terrorism in Australia. Through the ARPC, global reinsurers are able to centrally support the Australian market with specific reinsurance/retrocession capacity. Without the capacity of the ARPC to funnel the risks into a central pool, it is unlikely that reinsurance capacity would be made available by reinsurers and the situation would revert back to the 'market failure' position post Sept 2011.

Without the operation of the ARPC it is presently not possible for individual insurers to access reinsurance cover for this risk and as a consequence it could be expected that without the ARPC in operation the cover would not be offered by general insurer.

ARPC Pricing

The ICA submits that, based upon present understanding and feedback from insurers and reinsurers, the ARPC's pricing of terrorism reinsurance suitably reflects the risk. Further, the ICA supports the position that premiums should continue to be charged, at present rates, by the ARPC to allow growth in the pool to accommodate increasing property values.

ARPC Retrocession

The ICA holds the view that the purchase of retrocession by the ARPC remains a prudent use of ARPC funds.

Retention by Insurers

Feedback from insurers has indicated that the current structure and level of retention applied to insurers remains appropriate.
The ICA would not support changes to the retention levels that came into effect in 2009 and draws attention to the recent increases in reinsurance rates in Australia as evidence of ongoing reinsurance capacity and cost demands on insurers - it is unlikely that a change to retention rates, in order to drive development of the private market, would bear any fruit for the foreseeable future. ICA submits that the issue of retention rates should be revisited at the next review of the Act.

Payment of a dividend to the Commonwealth

The ICA supports the concept of the payment of a reasonable dividend by the ARPC to the Commonwealth as consideration for the current Commonwealth funding guarantee. Such a dividend payment should take into consideration the 'public good' nature of the ARPC function and consequently should not be viewed as revenue, only as compensation for costs incurred by the Commonwealth in providing the guarantee.

The quantum of the dividend should also reflect the fact that the Commonwealth guarantee is not capital that has been sequestered by government, preventing the use of this capital elsewhere. The 'costs' associated with providing a promise for future contingency funding, without actually having allocated capital to a fund, would naturally be significantly lower than capital costs associated with providing actual funding.

Additional Issue: Cover for residential property

The Insurance Council continues to be concerned with the lack of provision in the scheme to provide cover for high-rise residential property. Most insurers do not include terrorism cover in their residential policies due to an absence of reinsurance cover for the risk.

In the 2009 Review of the Act, the Insurance Council highlighted an anomaly in the scheme where high rise apartment buildings and cluster developments are excluded from the scheme purely on the basis of their occupancy being either for commercial or residential purposes. This anomaly continues to exist and the Insurance Council remains of the view that the Act should be amended, so that restrictions on buildings predominantly and primarily used for residential purposes are removed.

The ICA would be pleased to coordinate technical input and discussion on this matter through a suitable industry/government working group to examine the matter in detail.

Please feel free to contact Karl Sullivan, General Manager Risk and Disaster Directorate on (02) 9353 5155 or ksullivan@insurancecouncil.com.au if you require any further information.

Yours sincerely,

Robert Whelan
Executive Director & CEO