THE BIG WIND BLOWS - ON NORTHERN AUSTRALIA

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The Australian Reinsurance Pool Corporation's Cyclone and Related Flood Damage Reinsurance Pool: Part 2A of the Terrorism and Cyclone Insurance Act 2003 (Cth):

- whence does it apply?
- to which insurers does it apply?
- to what classes of business does it apply?
- to what categories of loss does it apply?
- how does it work?

When did it take effect?

- From 1 July 2022:
  - "large insurers have until 31 December 2023 to join the scheme, at which point they must have obtained reinsurance for all their eligible cyclone risks with the ARPC" - Treasury Laws Amendment (Cyclone and Flood Damage Reinsurance Pool Bill 2022 Explanatory Memorandum 1.13;
  - small insurers have until 31 December 2024.

To what business classes does it apply?

- if a general insurer carries on business that includes undertaking liability, under pool insurance contracts, in respect of eligible cyclone losses, the insurer must maintain contracts of reinsurance with the Corporation that:
  - cover the insurer's liability, under all pool insurance contracts that it enters into, in respect of all eligible cyclone losses; and
  - insure against 100% of the insurer's liability, under each of those pool insurance contracts, in respect of all eligible cyclone losses. Terrorism and Cyclone Insurance Act 2003 (Cth) s 8A(1)

So the scheme applies to 100% of an authorised general insurer's liability under pool insurance contracts in respect of eligible cyclone losses:

- subject to any direction from the Minister to the ARPC under sub-section 38(2)(e) regarding risk retention by re-insureds;
- irrespective of whether there is other reinsurance applicable to the policy in question;
- unless the insurer's Gross Written Premium for such policies in the prior financial year falls below the threshold prescribed by regulation: sub-sections 8(5) and 8(6) (an exempt general insurer).

Exempt general insurers, Lloyds Underwriters authorised under the Insurance Act 1973 (Cth) and Direct Offshore Foreign Insurers do not have to participate.

- But if they choose to do so, they must reinsure 100% of their liabilities under pool contracts in respect of all eligible cyclone losses.

The principle of "one in, all in" applies:

- to avoid negative selection; and
- to achieve the largest possible reductions in insurance premiums for cyclone-prone areas, by accumulating the largest possible premium pool;
- but does not preclude private reinsurance of risks other than cyclone and related flood, that may be covered under the same policies.

What is a "pool insurance contract"? (s 8B (1) - (4))

- Type of risk:
  - loss of or damage to "eligible property" owned by the insured;
  - business interruption and consequential loss arising from loss of, damage to or inability to use eligible property owned or occupied by the insured.

What is a "pool insurance contract"? (s 8B (1) - (4))

- Type of cover:
  - home building and/or home building contents cover;
  - including for bodies corporate of strata or community title developments where 50% or more of the floor space is "mainly residential";
  - other insurance "in respect of" a building and/or its contents where the sum insured does not exceed the amount provided by regulation: s 8B(3)(d)(ii);

What is a "pool insurance contract"? (s 8B (1) - (4))

- "building", "contents" and "home building" are all defined in the regulations;
  - but mean pretty much what you would expect them to and are consistent with other relevant legislation viz. Insurance Contracts Act 1984 (Cth).

What's <u>not</u> a "pool insurance contract"? (s 8B (5) - (8))

- A contract of insurance covering buildings and/or contents owned and managed by government entities - Federal, State, Territory or Local;
- one to which sub-section 8B(3)(d) would apply, except for the maximum sum insured cut off in sub-section 8B(3)(d)(ii);
- a contract of reinsurance;
- farm insurance, except for home building and contents;
- other insurances excluded by regulation;
- State insurance, not extending beyond the limits of the State concerned.

The Commonwealth guarantees all the ARPC's cyclone loss liabilities and related commitments - ss 35 and 35A:

- notionally capped at AUD10 billion for cyclone loss liabilities:
  - but the guarantee must be revised UPWARD if insufficient: s 35A(4);
- contrast that with the "reduction percentage" provided for with respect to terrorism losses, by section 6(7):
  - the effect of which is to revise cedants' policy liabilities toward their original insureds DOWNWARD, ensuring that the ARPC's reinsurance liabilities do not exceed the amount of the applicable guarantee.

There is, accordingly, a total transfer of the cyclone and related flood loss risk from the original insureds and the private insurance market, to the State.

And what's an "eligible cyclone loss"? (s 8C)

- Essentially, a loss which arises:
  - from a weather system which is declared by the Bureau of Meteorology to be a "cyclone event"; or
  - from wind, rain, rainwater, rainwater run-off, storm surge or flood caused by that weather system;

and commences during the claims period for that cyclone event.

And what's an "eligible cyclone loss"? (s 8C)

- The ARPC "declares" the commencement and termination of the claims period for the cyclone event.
  - Again the relevant terms are defined by regulation but are consistent with insurance practice and the Insurance Contracts Act.

And what's an "eligible cyclone loss"? (s 8C)

- The BOM decides when a cyclone event has commenced, ended and/or re-intensified:
  - and must "notify the ARPC specifying date and time" - section 8E;
  - the ARPC then makes a declaration under section 8F:
    - as soon as practicable and in any event within 24 hours;
    - by notifiable instrument, which cannot be varied or revoked;
    - published on the ARPC's website, again as soon as practicable and in any case within 24 hours.

And how are the reinsurance premiums to be set? (s 8D)

- Well, basically the same way porcupines are said to have sex - very carefully:
  - the object is for the scheme to be cost-neutral to the taxpayers "over the longer term" (s 8D(a));
- For "medium to high" levels of exposure to eligible cyclone losses, the ARPC is:
  - "to keep the premiums as low as possible while maintaining incentives to reduce and mitigate the risk of eligible cyclone losses" (s 8D(b));
- For lower levels of exposure - "to keep the premiums at levels comparable to what would be charged by other reinsurers" (s 8D(c)).

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