Australian Government

Australian Reinsurance Pool Corporation

ARPC MARKET UPDATE

22 MAY 2014

Background

Australian Reinsurance Pool Corporation (ARPC) protects Australia from economic losses to eligible commercial property caused by terrorism catastrophe. ARPC was established as a temporary measure to ensure that Australia's commercial property continued to have access to terrorism insurance in the wake of the 11 September 2001 terrorist attacks.

The National Commission of Audit in its report to the Australian Government released on 1 May 2014 recommended that "with continued recovery in the insurance markets, there is scope for a gradual Commonwealth exit over the coming years" and "suggests the next review of the scheme will provide an appropriate vehicle for abolishing the Corporation".

The Australian Government in its Federal Budget released on 13 May 2014 announced that "ARPC will pay the Government a fee totalling $450 million over four years for the $10 billion guarantee provided by the Australian Government to the ARPC. The fee will replace the current requirement for the ARPC to provide a dividend to Government, and is more aligned to the substance of the guarantee provided by the Government to the ARPC. In addition the Government will provide $1.2 million in 2014-15 to the Department of the Treasury to develop options on the future of the Terrorism Insurance Act 2003, including the future role of the ARPC."

ARPC Operations

The threat of a terrorist attack remains real. The National Terrorism Public Alert System communicates an assessed risk of terrorist threat to Australia. ARPC's website provides a link to the threat level, currently rated as Medium alert, which is that a terrorist attack could occur.

ARPC delivers significant capacity to the Australian market. ARPC currently provides its insurer clients with a tailored solution of $13.4 billion in reinsurance capacity in the event of a declared terrorist incident. Total capacity comprises ARPC assets, retrocession reinsurance and Commonwealth Guarantee. ARPC purchases $3 billion in capacity through its retrocession reinsurance program placed with 57 reinsurers from within Australia and globally. ARPC currently purchases almost all the global capacity that is available for Australian risks through S&P A- or better rated reinsurers. However, this private sector capacity is insufficient to cover a probable maximum loss, and therefore ARPC has access to the $10 billion Commonwealth Guarantee. ARPC's total capacity covers 99% of possible maximum loss scenarios from a conventional blast in CBD locations.

ARPC assists the sharing of risk between the private sector and Government. To date, ARPC has paid the Government fees through dividends of $325 million to reimburse Government for the provision of the $10 billion Commonwealth Guarantee. ARPC will continue to pay fees to Government in total of $450 million over the next four years.

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ARPC offers value for money. The average price of cover to insurers is currently 3.5% of eligible policy premiums, which is at a level very favourable with other international terrorism reinsurance pools. Levels of retention held by insurers are also low, with insurers holding retention on average of $1 million and up to a maximum of $10 million. Insurers covered by ARPC also benefit from the capping of liability under the Terrorism Insurance Act 2003 which limits insurer's liabilities through the legislated reduction percentage for a loss exceeding ARPC's capacity, which means our insurer client's capital is fully protected.

Cover with ARPC is voluntary. The Terrorism Insurance Act 2003 mandates insurers to issue cover for terrorism events. However, it is voluntary for insurers to purchase reinsurance cover from ARPC. ARPC currently covers almost all commercial property in Australia with aggregate sum insured of over $3 trillion. Insurers are able to choose to purchase cover with ARPC, or offer cover under their own capacity, or purchase alternative reinsurance.

There is currently insufficient terrorism reinsurance capacity to cover all commercial property risks in Australia. Some market commentators believe that the private reinsurance market has both capacity and appetite to provide cover at the level required. ARPC's recent experience in testing the market availability demonstrates that this is not yet the case for the whole market, and only limited capacity exists for individual risks. However, an independent expert analysis will take place later in 2014 as part of ARPC's Triennial Review to test the current appetite for a return of the private market at the capacity level required to cover a possible maximum loss. One of ARPC's goals is to encourage the return of a commercial private reinsurance market and we continue to work with the market to fulfil that goal. It is one of the reasons why ARPC purchases retrocession reinsurance.

Terrorism reinsurance pools and schemes operate in all major western economies. Pooling of risk for terrorism catastrophe is an efficient response when capacity is limited and prices are high. As global capacity has slowly increased ARPC has transferred risk to the reinsurance market and reduced reliance on the Commonwealth Guarantee in the event of a terrorism catastrophe.

Triennial Review Process

The Terrorism Insurance Act 2003 requires a review to be conducted at least once every three years that reviews the needs for the Act to continue in operation. Reports for three previous Triennial Reviews are available on ARPC's website.

Conclusion

ARPC's Chair, Ms Joan Fitzpatrick, said "ARPC continues to address significant market failure in the reinsurance industry for the provision of cost effective terrorism insurance cover. ARPC plays an important role in making Australia resilient to the economic losses of a terrorism event."

For more information on ARPC please visit www.arpc.gov.au. For any enquiries about this market update, please contact Dr Christopher Wallace, Chief Executive Officer, on + 61 2 6279 2100 or at christopher.wallace@arpc.gov.au.