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Australian Reinsurance Pool Corporation

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# Cyclone Reinsurance Pool – Implementation and Pricing Structure Guide

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## Change Log

| Rate Version | Document Version | Date | Section | Change |
|---|---|---|---|---|
| v2.0 | v2.0 | 2022/10/01 | Appendix A, 2.1: Part 1 – Proposed formula; Residential Policies | Removal of combined excess relativity |
| v2.0 | v2.0 | 2022/10/01 | Appendix A, 3.3: Part 2 – Further detail; Level of Coverage; Residential Home | Further detail added on rating for Residential home when Coverage Level is unknown. |
| v2.0 | v2.0 | 2022/10/01 | Appendix A, 3.3.3: Part 2 – Further detail; Level of Coverage; Residential contents, caravan or relocatable home policies, SME, Strata | Further detail confirming that coverage level to be mapped to NA for these classes |
| v2.0 | v2.0 | 2022/10/01 | Appendix A, 3.4.3: Part 2 – Further detail; Other; Business interruption rating | Further detail added on rating for different types of business interruption coverage |
| v2.0 | v2.0 | 2022/10/01 | Appendix A, 3.4.4: Part 2 – Further detail; Other; Treatment of GST for SME Rateable Sum Insured | Section added |
| v2.0 | v2.0 | 2022/10/01 | Appendix B – Subsection 8A(7) Postcode List | Name of list changed to reference relevant subsection of legislation. List changed to postcode from suburb and updated for latest rates. |
| v2.0 | v2.0 | 2022/10/01 | Appendix C – Rater Definitions | Updated to reflect revisions to rating tables for construction year and mitigation. |
| v2.0 | v2.1 | 2022/11/23 | Section 8. Pricing Formula | Clarification on how to rate commercial strata policies. |
| v2.0 | v2.1 | 2022/11/23 | Appendix A, 3.3: Part 2 – Further detail; Level of Coverage; Residential Home | Clarification on using Uncapped allowance and small change to Coverage Level threshold. |
| v2.0 | v2.1 | 2022/11/23 | Appendix A, 3.3: Part 2 – Further detail; Missing Rating Data | Extra information added on using G-NAF data and the postcode fallback table. |

# Cyclone Reinsurance Pool – Implementation and Pricing Structure Guide

## 1. Commencement of the Reinsurance Pool

The Terrorism and Cyclone Insurance Act 2003 (the Act) was passed on 30 March 2022. The Australian Reinsurance Pool Corporation (ARPC) will operate the Cyclone Reinsurance Pool (the Pool) from 1 July 2022. The Pool will operate Australia wide, but target support to medium and high-risk cyclone-prone areas, which are mainly in northern Australia. Insurers will have until 31 December 2023 to reinsure all eligible cyclone risks with ARPC. This transition period provides the insurers with sufficient time to manage costs and address any risks associated with transitioning from existing reinsurance contracts.

## 2. Mandatory participation and transition

Participation will be mandatory for general insurers with eligible policies. Large general insurers will be required to transfer their portfolio to ARPC by 31 December 2023. Small general insurers i.e., insurers whose total gross written premiums (GWP) for household insurance are less than $300 million for the financial year before 31 December 2022, will be required to transfer their portfolio to ARPC by 31 December 2024. All insurers can voluntarily sign up from 1 July 2022.

During the transition period, insurers can progressively transfer their eligible cyclone policies into the Pool, or cede in the whole through a portfolio transfer, or a combination of both.

Lloyd's syndicates are not required to participate in the Cyclone Reinsurance Pool, however, if they choose to participate in the Pool then they must reinsure on a 'one-in-all-in' basis.

## 3. Civil penalty

The Act creates a Civil penalty for insurers whose participation in the Pool is mandatory but are in breach of the legislation. An insurer will be in breach of the Civil penalty provision if it does not reinsure all eligible cyclone risks with the Pool. ARPC will assess compliance with ceding eligible risks during ARPC's routine insurance audit (cedant review) process.

The Civil penalty will be applied every calendar year that the insurer fails to reinsure all eligible cyclone risks with ARPC. The penalties will be administered by APRA and come into effect at the end of the relevant transition periods.

## 4. Declaration of Cyclone events and claims period

If the Bureau of Meteorology (Bureau) observes that a cyclone exists and is likely to affect any part of Australia, it must notify ARPC regarding the cyclone within 24 hours of first making this observation.

ARPC must declare the start of a cyclone event within 24 hours of receiving the Bureau's advice. The declaration must state when a cyclone begins based on the Bureau's advice and must be published on ARPC's website as soon as practicable, within the 24-hour period, and register a notifiable instrument on the Federal Register of Legislation. ARPC will make a subsequent declaration to note the end of a cyclone event, similarly, relying on the Bureau's advice that the cyclone has ended. The cyclone event, and with it the claims period, will then conclude 48 hours after the cyclone ends.

ARPC must declare a further cyclone event for the same named cyclone if the cyclone was declared to have ended, but then, based on the Bureau's advice, the relevant cyclone re-intensified.

## 5. Coverage of claims

For a period of three years from 1 July 2022, the Pool will cover the cost of eligible cyclone and related flood damage claims above the policyholder excess to support insurer transition and maximise the potential premium reductions through the Pool.

Following this period, the Pool will operate on a risk sharing arrangement with insurers where the Pool will continue to cover a significant proportion of eligible cyclone and related flood damage claims.

## 6. Backing from a $10 billion Commonwealth guarantee

The Cyclone Reinsurance Pool will be supported by an annually reinstated $10 billion Commonwealth guarantee. Any shortfall in reserves built up over time will be paid for through the Commonwealth guarantee.

If the $10 billion guarantee is likely to be exceeded by a single cyclone event, or series of cyclone events within a single year, the Government will increase the guarantee if needed to support the pool to meet all its obligations.

## 7. Underlying core principles of the pricing formula

The Pool will be funded by charging reinsurance premiums to insurers that are consistent with the expected claims and operating expenses for the Pool. Premium amounts for the Cyclone Reinsurance Pool will be determined and set by ARPC and reviewed by the reviewing actuary.

The pricing formula designed by ARPC to set premiums uses property-level data such as: geography, building characteristics, and mitigation. It has been developed in line with the Government's policy intent that the Pool will:

1. be cost-neutral to Government over the longer term;
   - The premiums charged cover the long term costs of insured risk in addition to ARPC's administration expenses. The Pool does not seek to make a profit, thereby achieving savings that are available to policyholders and insurers compared to the profit margin charged by commercial reinsurers.
2. lower the reinsurance cost for most policies with medium to high exposure to cyclone risk;
   - The Pool would provide targeted reinsurance premium reductions based on each property's risk profile, where higher risk properties receive higher discounts.
3. seek to ensure that premiums are kept at levels comparable to what would be charged by other reinsurers for insurance contracts involving lower levels of exposure to eligible cyclone losses; and
4. maintain incentives for risk reduction and offer discounts for properties that undertake mitigation.
   - The premiums encourage policyholders to engage in strategies to mitigate cyclone and related flooding risks. The discounts will assist in improving the affordability and sustainability of property insurance over time

## 8. Pricing formula

In addition to the core underlying principles mentioned above, the pricing formula has been designed to ensure that:

- it causes minimal disruption to insurers' current pricing practices;
- the premium paid is the same across insurers for a consistent level of coverage; and
- the model delivers stable rates over the long term.

The pricing formula is intended to be applied at the individual risk level for all policies.

The pricing will use a different rating for each hazard or peril. The pricing structure for residential, small to medium enterprise (SME), and strata will be largely similar with some differences in the rating for different hazards and zones. The pricing will take into account various rate modifiers for building characteristics.

ARPC recognises that there are different levels of coverage provided by insurers including the level of cover for removal of debris and temporary accommodation. This has been dealt with through a rating coverage factor in the pricing formula.

Where a property is eligible and classified as strata as defined in the Act, insurers should apply the strata rates and strata definition of rateable sum insured to calculate the ARPC reinsurance premium, regardless of whether it is considered to be 'residential' or 'commercial'.

The detailed pricing structure for each of Residential, SME and Strata properties is provided at Appendix A.

## 9. Definition of sum insured

The Act does not include a definition of sum insured. ARPC has provided a definition for sum insured in the reinsurance agreement. ARPC is aware that different definitions of sum insured are used by insurance providers and has taken into consideration these definitions in preparing a standard definition for premium rating, referred to as the 'rateable sum insured'.

## 10. The 'rateable sum insured' will also be used for the purposes of determining whether SME and commercial strata (where there is more than 50% commercial usage) policies fall within or above the sum insured threshold, and whether they are eligible for cover under the Pool. The 'rateable sum insured' definition must be used by all insurers for the purposes of calculating the reinsurance premium payable to ARPC and to determine whether policies are within the relevant sum insured threshold. Catastrophe Models

ARPC has sought assistance from a range of catastrophe model vendors with respect to modelling losses that will be used to support setting the reinsurance premiums.

The use of multiple models will provide ARPC with a range of views of the risk. ARPC will be able to tap into the thinking of catastrophe model teams at the relevant vendors to help with quantifying risk and understanding the models to assist with pricing.

ARPC will review its choice of vendors and number of models used in the future to ensure they remain fit for purpose.

## 11. Reinsurance Agreement

As mentioned above, insurers will be able to enter into agreements with ARPC once the Pool has commenced and will be expected to have entered into an agreement with ARPC prior to the end of the relevant transition periods.

The Reinsurance Agreement will cover, amongst other things, the following:

- Definition of sum insured – The agreement includes a standard definition of sum insured for the purposes of determining premiums and determining eligibility of SME policies.
- Premiums – The Reinsurance Premium payable to the ARPC by the Reinsured as calculated by applying the relevant Cyclone Reinsurance Premium Rates.
- Reporting – The reinsured must provide key data on premiums, policies, and claims to ARPC, in a form specified by ARPC.

# Appendix A – Proposed Pricing Structure

## 1. Objective

This document sets out the proposed rate formula that would be used by insurers to calculate the Pool premium to be paid to ARPC for residential, SME, and Strata scheme policies. The formula is intended to be calculated at the individual risk level.

The first part of the document sets out the proposed formula. The second part provides additional detail on specific issues linked to the calculation. The Third Part of this section sets out expectations around how insurer premium rates would be adjusted for the introduction of the Pool.

It is intended that the reinsurance premium will be consistent regardless of which insurer is underwriting the risk.

## 2. Part 1 - Proposed formula

At a high level, the Pool premium formula has the following structure when calculated in respect of each eligible policy:

$$CRP\ premium_{product\ type,peril} = Policy\ sum\ insured \times CRP\ base\ rate_{location,peril}$$

$$\times [risk\ rating\ factor_1 \times risk\ rating\ factor_2 \times risk\ rating\ factor_3 \times \ldots] / 100$$

A separate formula applies to each of Wind (including surface flooding and water ingress), Riverine Flood, and Storm Surge. The Riverine Flood and Storm Surge calculations only apply where these coverages are included in the policy.

The sum insured risk relativity is determined such that there is a monotonic shape to the calculated Pool premiums as the sum insured increases.

The sum insured risk relativity is calculated using the formula below:

$$\frac{\text{Start of SI band} \times \text{Relativity}_{start\ of\ SI\ band} + (\text{SI} - \text{Start of SI band}) \times \text{Relativity}_{marginal\ for\ the\ SI\ band}}{\text{SI}}$$

*SI refers to sum insured in the above formula.*

For example, for a home building with sum insured of $790,000, the start of the sum insured band would be $700,000, which has a relativity of 0.97. The marginal additional $90,000 sum insured has a relativity of 0.90. The sum insured relativity applying to this policy is the weighted average of these amounts, which is 0.96.

Instead of applying the above formula, insurers may instead calculate the implied relativity for each sum insured value resulting in a large look up table.

### 2.1. Residential policies

**Wind**

- A rate times $100 sum insured, with the rate based on the following:
  - Cover (Buildings/Contents)
  - Suburb (Lookup key is G-NAF and rates are flat within Suburb)
- Modifiers
  - Sum insured (marginal rate table)
  - Level of coverage
  - Type of building (e.g., house vs townhouse)
  - Construction type (loading would vary by region)
  - Roof type
  - Excess
  - Landlords (Y/N)

  - Year of construction (loading varies by region)
  - Mitigation actions undertaken to property:
    - Window protection to all windows
    - Roof tied down
    - New roof
    - Roller door braced or installed after 2012

**Riverine Flood**

- Only payable if the policy includes riverine flood cover
- A rate times $100 sum insured, with the rate based on the following:
  - Cover (Buildings/Contents)
  - Risk band: Each address would be assigned a riverine flood risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High, and Maximum). Hence in effect there are eight riverine flood premium rate levels.
    - For most properties, the risk group would be nil, and the rate would be nil.
- Modifiers
  - Level of coverage
  - Number of storeys (including house on stilts)
  - Construction Type
  - Excess
  - Landlords (Y/N)
  - Year of construction

**Storm Surge**

- Only payable if the policy includes storm surge cover
- A rate times $100 sum insured, with the rate based on the following:
  - Cover (Buildings/Contents)
  - Risk band: Each address would be assigned a storm surge risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High, and Maximum). Hence in effect there are eight storm surge premium rate levels.
    - For most properties, the risk group would be nil, and the rate would be nil.
- Modifiers
  - Level of coverage
  - Number of storeys (including house on stilts)
  - Construction Type
  - Excess
  - Landlords (Y/N)
  - Year of construction

**Note:** Where valuables are expressed as an additional sum insured, then the valuables sum insured should be added to the base contents sum insured, for the purposes of the above calculations.

### 2.2. Strata Scheme policies

**Wind**

- A rate times $100 sum insured (sum insured includes common property contents), with the rate based on:
  - Suburb (Lookup key is G-NAF and rates are flat within Suburb)
- Modifiers
  - Sum insured (marginal rate table)
  - Level of coverage (not active at Pool commencement)
  - Number of storeys
  - Construction Type (loading would vary by region)
  - Roof Type
  - Excess
  - Year of construction (loading would vary by region)

**Riverine Flood**

- Only payable if the policy includes riverine flood coverage
- A rate times $100 sum insured (sum insured includes common property contents), with the rate based on:
    - Risk band: Each address would be assigned a riverine flood risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High and Maximum). Hence in effect there are eight riverine flood premium rate levels.
        - For most properties, the risk group would be nil, and the rate would be nil.
- Modifiers
    - Level of coverage (not active at Pool commencement)
    - Flood policy sublimit (relativity depends on total sum insured and sublimit as a proportion of sum insured)
    - Number of storeys
    - Construction Type
    - Number of basement levels
    - Excess
    - Year of construction.

**Storm Surge**

- Only payable if the policy includes storm surge coverage
- A rate times $100 sum insured (sum insured includes common property contents), with the rate based on:
    - Risk band: Each address would be assigned a storm surge risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High, and Maximum). Hence in effect there are eight storm surge premium rate levels.
        - For most properties, the risk group would be nil, and the rate would be nil.
- Modifiers
    - Level of coverage (not active at the Pool commencement)
    - Surge policy sublimit (relativity depends on total sum insured as sublimit as a proportion of sum insured)
    - Number of storeys
    - Construction Type
    - Number of basement levels
    - Excess
    - Year of construction.

## 2.3. SME policies

**Wind - Property Damage**

- A rate times $100 sum insured, with the rate based on:
    - Cover (Buildings, Contents including machinery and stock)
    - Suburb (Lookup key is G-NAF and rates are flat within Suburb)
- Modifiers
    - Sum insured (marginal rate table)
    - Level of coverage (not active at Pool commencement)
    - Industry group
    - Construction type (loading would vary by region)
    - Roof type
    - Excess
    - Year of construction (loading would vary by region)

**Riverine Flood – Property Damage**

- Only payable if the policy includes riverine flood coverage
- Rate times $100 sum insured, with the rate based on:
    - Cover (Buildings, Contents including machinery and stock)

  - Risk band: Each address would be assigned a riverine flood risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High and Maximum). Hence in effect there are eight riverine flood premium rate levels.
    - For most properties, the risk group would be nil, and the rate would be nil.
- Modifiers
  - Level of coverage (not active at Pool commencement)
  - Number of storeys
  - Construction Type
  - Excess
  - Year of construction

**Storm Surge – Property Damage**

- Only payable if the policy includes storm surge coverage
- Rate times $100 sum insured, with the rate based on:
  - Cover (Buildings, Contents including machinery and stock)
  - Risk band: Each address would be assigned a storm surge risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High and Maximum). Hence in effect there are eight storm surge premium rate levels.
    - For most properties, the risk group would be nil, and the rate would be nil.
  - Modifiers
  - Level of coverage (not active at pool commencement)
  - Number of storeys
  - Construction Type
  - Excess
  - Year of construction

**Business Interruption**

- Rate times $100 sum insured for each of Wind, Riverine Flood and Storm Surge where policy includes coverage for that component, with the rate based on:
  - Suburb Rating for Wind and address assigned risk band (Nil, Minimum, Very Low, Low, Medium, High, Very High, and Maximum) for Riverine Flood and Storm Surge
- Modifiers
  - Sum insured (marginal rate table)
  - Factor that depends on how sum insured is expressed (Gross Revenue vs Gross Profits)
  - Industry group
  - Construction Type (loading varies by region for Wind only)
  - Roof type (Wind only)
  - Year of construction (loading varies by region for Wind only)
  - Number of storeys (Riverine Flood and Storm Surge only)
  - Duration of cover
  - Indicator for whether Additional Increased Cost of Working is covered
  - Level of coverage (not 'active' at Pool commencement)

# 3. Part 2 – Further detail

## 3.1. Missing Rating Data

In some cases, an insurer may not collect all the input rating data required in the proposed rating formula. It is acceptable for insurers to use external data to supplement data (e.g. satellite imagery or industry datasets) collected directly from the policyholder for the purposes of rating. However, where an insurer has used a modelling approach to approximate missing data, this should not be used for the purposes of ARPC rating formula.

Where an insurer is unable to provide data for a modifier or map data to a provided option, an "Unknown" option will be available in each rating table.

Similarly, where an insurer does not collect G-NAF, a fallback table with a postcode lookup will be provided. G-NAF data must be used where available to calculate premiums. New G-NAFs will be added to the table via annual updates, and older or superseded G-NAFs will be removed. Only where the insurer does not know the G-NAF or is using a G-NAF that is not in the ARPC G-NAF table should insurers calculate the premium using the postcode lookup table.

The rates for the "Unknown" option and the fallback postcode table will not unduly penalise insurers who do not collect this rating information at the commencement of the Pool (Year of Construction is an exception as it is collected as common industry practice). However, the rates for Unknowns are likely to be revised upwards in the future after insurers have had sufficient time to collect this data.

## 3.2. Definition of sum insured

It is recognised that sum insured is not calculated consistently across all insurers. In the absence of any other controls, this could lead to instances where the reinsurance premium would vary according to which insurer underwrites the risk. To avoid this occurring, ARPC will set out a standard definition of what is to be included in the sum insured for the purposes of calculating the reinsurance premium. To the extent possible, this definition will be aligned with the most common insurer practices.

The standard definition must be used by all insurers for the purposes of calculating the reinsurance premium payable to ARPC. To the extent that an insurer uses a different definition internally, that insurer will be required to make adjustments to the sum insured they use for rating purposes.

In some cases, insurers write insurance where there is no sum insured (for example, some complete replacement cover policies available in the market). In these cases, the insurer will be required to estimate the sum insured using a definition that is consistent with ARPC sum insured definition.

The proposed sum insured definition is described below:

### 3.2.1. Residential buildings

For residential buildings, the rateable sum insured is the replacement cost of the building. It includes all elements of the construction that are included in the coverage.  Specific examples of elements of the construction that may be covered by the policy that would be included in the rateable sum insured include:

- Sheds
- Decks, pergolas
- Swimming pools
- Gates, fences
- Driveways, retaining walls

Where additional benefits are provided to the customer that are not part of the property itself, these should be excluded from the rateable sum insured.

Some examples of additional benefits that would be excluded from the rateable sum insured are:

- Demolition and debris removal
- Additional living expenses
- Council fees, architect's fees and related construction expenses costs
- Sum insured event buffers, build back better allowances

The rateable sum insured should be gross of GST. It should exclude any adjustments that may be made for underinsurance, unless these adjustments have been agreed with the customer and reflected in the sum insured provided to them as part of the policy.

For total replacement policies (where there is no sum insured provided to the customer) insurers must use, and provide to ARPC, an estimate of sum insured that is consistent with the above definition.

#### 3.2.2. Residential contents

For residential contents, the rateable sum insured is the insured value of the contents consistent with basis of cover provided (new for old vs indemnity). Where valuables/specified items are captured as a separate item, then the sum insured should include the value of these items at their agreed sub-limit. Portable item coverages that provide cover for damage that occurs outside the premises are not required to be included within the contents sum insured.

The rateable sum insured should be gross of GST.

#### 3.2.3. SME buildings

For small business buildings, the rateable sum insured is the replacement cost of the building. It should include all elements of the construction that are included in the coverage. Specific examples of elements of the construction that may be covered by the policy, and that would be included in the rateable sum insured include:

- Sheds
- Gates, fences
- Driveways, retaining walls

Where additional benefits are provided to the customer, that are not part of the property itself, should be excluded from the rateable sum insured. Some examples of additional benefits that would be excluded are:

- Demolition and debris removal
- Council fees, architects' fees, and related construction expenses costs
- Sum insured event buffers, build back better allowances

For policyholders that are registered for GST the Rateable Sum Insured should be net of GST (or pro-rated where partially registered for GST). For other policyholders, the Rateable Sum Insured should be gross of GST. The Rateable Sum Insured should exclude any adjustments that may be made for underinsurance unless these adjustments have been agreed with the customer and reflected in the sum insured provided to them as part of the policy.

#### 3.2.4. SME contents

For Small Business contents, the rateable sum insured is the insured value of the contents consistent with basis of cover provided (new for old vs indemnity). Contents includes stock, where covered by the insurer.

For policyholders that are registered for GST the rateable sum insured should be net of GST (or pro-rated where partially registered for GST). For other policyholders, the rateable sum insured should be gross of GST.

#### 3.2.5. SME business interruption

For Small Business 'Business Interruption', the rateable sum insured is the annualised Gross Revenue or Gross Profits, depending on the rating basis used by the insurer. For example, $50,000 total gross revenue of Business Interruption cover for a 6-month period will be reported to ARPC annualised at $100,000. Where the cover includes Additional Increased Cost of Working (AICOW) then this should be provided separately.

#### 3.2.6. Strata

For strata, the rateable sum insured is the replacement cost of the building plus the sum insured for common property contents. The rateable sum insured should include allowance for the costs of:

- Lifts
- Common property equipment such as gyms and BBQ areas
- Fences
- Swimming pools
- Retaining walls
- Driveways

- Demolition and debris removal
- Rebuild costs (council fees etc)

The rateable sum insured should be gross of GST. It should exclude any adjustments that may be made for underinsurance, unless these adjustments have been agreed with the customer and reflected in the sum insured provided to them as part of the policy.

## 3.3. Level of Coverage

It is recognised that there can be differences in the coverage provided by insurers, including the level of cover for removal of debris and temporary accommodation and buffers provided to the sum insured. A simple design is proposed when the Pool commences that focuses on a small number of additional product coverages to classify policies into a coverage category. This approach is simplistic by design to enable ease of implementation and is commensurate with the fact that the expected impact on risk from these benefits is relatively small. The design has been tested against current market products and may be revised to be more sophisticated if market products change over time.

The proposed rating approach for product coverage is described below:

### 3.3.1. Residential buildings (non-landlords)

For non-landlords' residential buildings, each policy will be rated for product coverage based on four categories of additional sum insured benefits. Insurers should sum up the total additional benefits across the four categories as a percentage of the 'rateable sum insured'. Where a product provides uncapped coverage for a category (e.g. replacement cover policies providing unlimited underinsurance protection), ARPC has specified the additional benefit to be used for the calculation.

The four categories and the allowance for uncapped coverage (as a % of rateable sum insured) are:

| Category | Uncapped allowance |
|---|---|
| 1. Demolition and Debris Removal | 30% |
| 2. Temporary accommodation (sometimes referred to as Alternative accommodation or Emergency accommodation) | 10% per year of cover |
| 3. Professional services fees, such as architects or surveyors for redesign work | 20% |
| 4. Underinsurance protection (sometimes referred to as Safety Net or Gap Cover) | 20% |

Where the percentage coverage offered for a category is greater than the uncapped allowance specified in the table above, insurers should use the uncapped allowance as the allowance for that category in the coverage level calculation.

The coverage level for rating is derived from the sum of the total additional benefits across the four (4) categories. The lookup table is shown below:

| Sum of additional benefits | Coverage Level |
|---|---|
| Less than 41% of rateable sum insured | C |
| 41% to 65% of rateable sum insured | B |

| | |
|---|---|
| 66% + of rateable sum insured | A |

Where level of coverage is unknown or unable to be derived, insurers should map to Coverage Level A.

#### 3.3.2. Residential buildings (landlords)

For landlords' residential buildings, a similar approach will apply but there will be three (3) categories of additional benefits. These are:

| Category | Uncapped allowance |
|---|---|
| 1. Demolition and Debris Removal | 30% |
| 2. Professional services fees, such as architects or surveyors for redesign work | 20% |
| 3. Underinsurance protection (sometimes referred to as Safety Net or Gap Cover) | 20% |

The coverage level for rating is derived from the sum of the total additional benefits across the three (3) categories. The lookup table is shown below:

| Sum of additional benefits | Coverage Level |
|---|---|
| Less than 26% of rateable sum insured | C |
| 26% to 45% of rateable sum insured | B |
| 46% + of rateable sum insured | A |

Where level of coverage is unknown or unable to be derived, insurers should map to Coverage Level A.

#### 3.3.3. Residential contents, caravan or relocatable home policies, SME, Strata

No product coverage rating is proposed when the Pool commences. Considerations for this approach include time constraints, complexity, and impact on risk. Insurers should initially map all policies to Not Applicable for these classes. This may be revisited in the future and introduced into the formula later.

### 3.4. Other

#### 3.4.1. Loyalty, NCB, and multi-product discounts for Residential policies

Some insurers currently offer premium discounts for no claim bonus, multi-product, and loyalty and may decide to continue to do so. However, the reinsurance premium paid to ARPC will not vary according to these elements, so that the reinsurance premium will be the same regardless of which insurer underwrites the risk.

#### 3.4.2. Mitigation for Strata Scheme policies

Ideally, the rating formula would explicitly recognise assessments of building resilience such as those undertaken under the North Queensland Strata Title Inspection Program. However, this adds some complexity compared to existing insurer practices and this will be explored in the early years of the Pool, rather than on day 1.

#### 3.4.3. Business interruption rating

ARPC recognises that for business interruption, it is not always industry practice to collect rating information for all locations covered by a policy. For business interruption rating only, where an insurer only collects rating information for a single location (e.g. head office or largest exposure site), it is acceptable to use this single location for rating purposes. The exposure data (Gross profits or Gross revenue) should be reflective of all covered locations.

Where an insurer collects the BI sum insured as Gross Rentals, this should be mapped to Gross Revenue for premium calculation purposes. Where the sum insured is collected as Gross Income or Weekly Income, these should be annualised and mapped to Gross Profit for premium calculation purposes.

If an insurance policy includes a combination of Gross Revenue and Gross Profit for rating, the sum insured relating to Gross Profit should be converted to Gross Revenue using the factors provided in the 'Sum Insured Type' relativity table. I.e. multiply the sum insured by the factor in the table corresponding to the policyholder's primary industry group. The sum insured can then be added to the Gross Revenue sum insured, and the total can be used to calculate the aggregate Business Interruption premium.

The cyclone pool premium formula allows for Additional Increased Cost of Working (AICOW) coverage using a multiplicative loading on the base premium. For policies that offer standalone AICOW cover only, the loss will be covered by the Pool but no premium will be payable. Insurers should report the AICOW sum insured separately to ARPC in all cases where this coverage is provided as specified in the ARPC reporting templates.

Any optional benefits other than AICOW offered by an insurer, such as Accounts Receivable coverage, are not part of the rateable sum insured or rated for in the cyclone pool premium formula but are covered by the cyclone pool to the extent they are covered in the insurer's Product Disclosure Statement.

#### 3.4.4. Treatment of GST for SME Rateable Sum Insured

For SME, the rateable sum insured definition requires insurers to quote sum insured inclusive or exclusive of GST depending on whether the policyholder is registered for GST. The intention of this requirement is to align with wording within insurer PDS documents and common market practice undertaken by intermediaries. ARPC understands common market practice to have an expectation that the policyholder will nominate an appropriate sum insured based on their tax status. Insurers do not need to verify the tax status for individual policies, and reliance can be placed on the information provided by the policyholder or intermediary.

#### 3.4.5. Update cycle for G-NAF table

The risk band applying for riverine flooding and storm surge has been provided for each unique Geoscape Geocoded National Address File (G-NAF). G-NAF is Australia's authoritative, geocoded address file, and is maintained using government data.

ARPC will update the G-NAF table annually. The update will include new and changes to G-NAF addresses.

#### 3.4.6. Future enhancements to the formula

ARPC recognises that it is desirable to have a reasonable level of stability in the design. However, given implementation and time constraints, some aspects of the formula may be determined in the future.

## 4. Part 3 – Guidance for Implementation of rates

Guidance for implementation of the Pool premium rates. This section sets out expectations around how insurer premium rates would be adjusted for the introduction of the Pool.

The following is a list of considerations for insurers that is not intended to be exhaustive:

- To the extent that these perils are covered by the Pool, it is expected that all existing cyclone and related flood and storm surge costs would be removed from existing premiums for risks covered by the Pool. This includes both retained and reinsured components of cost.
- For the Pool reinsured component, it is expected that existing reinsurance would be removed, and revised reinsurance (for non-CRP perils) would be allocated to policies in proportion to the expected claims that the revised reinsurance would cover (i.e. allocated less to high cyclone areas).

- Any other reinsurance on the Pool covered risks (e.g. facultative, property per risk, etc.) should be adjusted to remove coverage for cyclone as the Pool will now be the primary cover. This should recognise that the Pool will provide uncapped, ground-up cover with unlimited reinstatements.
- All margins on the expected claims and expenses covered by the Pool should also be removed from premiums. We do not expect insurers to load in risk margins where the Pool reinsurance has removed the risk.
- Proportionate expenses (such as commissions) would be adjusted in line with the change in premium. It is expected that any commissions paid will be consistent with the insurer's general practices and will not be inflated as a result of the Pool.
- We recognise that insurers have long standing practices on discounts for supporting business, longevity, etc., which we do not expect to be changed due to the introduction of the Pool. These adjustments are separate to the underlying expected claims costs on policies. Consistent with existing XoL reinsurance, Pool premiums do not reflect these commercial adjustments.

By design, there is no requirement for insurers to pass on the CRP premium to policyholders at an individual risk level. We expect insurers will use the flexibility provided through a reinsurance rate structure to help deal with unintended consequences, for example where the shape of insurers rates is not the same as the CRP rates. It is expected that overall premiums will be reduced to reflect savings from the CRP and that the insurer will be able to demonstrate this.

## 4.1. Comparing CRP premium to existing rates

This section describes two (2) potential approaches for insurers to estimate the impact of the Pool on their portfolio and some considerations for insurers with each approach.

### 4.1.1. Risk level Premium comparison

At an individual policy level, insurers could compare the following two items:

1. Existing premium rates for cyclone, storm surge, and cyclone related flood - Insurers may have cyclone and flood premium components readily available where they have separate rating for these perils within their rating engine or where the split of these costs is available from analysis underlying their premium rates. An allowance would need to be made for Pool claims coverage to the extent that not all the cyclone cost would be allowed for, but this should be minor for most risks. Estimates of the proportion of riverine flood costs that are cyclone-related will need to be made by insurers. ARPC has provided to insurers analysis relating to flooding caused by cyclones that could be used to support their estimates.
2. The Pool premium rates – the premium emulators provided could be used to calculate the Pool premium on individual risks (directly or indirectly). It will be important to ensure the sum insureds used in the calculation align with the 'rateable sum insured' definition provided by ARPC. It should also be noted that if an insurer does not have required coding (and thus needs to revert to an "unknown" factor) rating differences should be expected.

The two components could be compared to give an indication of the level of premium movements that could result from the Pool. This calculation would be undertaken at the risk level and could be rolled up on a region or portfolio basis.

### 4.1.2. Impact on Reinsurance Program

This approach compares the total Pool premium to the expected reduction in the insurer's non-ARPC reinsurance program and retained costs. The process involves comparing the following two items:

1. Total Pool premium – This can be calculated on an 'in-force' portfolio by applying the Pool premium formula provided by ARPC.
2. Estimated reduction in non-ARPC reinsurance plus retained loss cost - The process for insurers would involve examining the AALs by peril (usually available in the market information packages which were prepared by the broker in support of Cat XoL reinsurance placement). Insurers should have an established process for

blending this information with working loss data to project total peril losses from ground up (noting reinsured cyclone and flood costs in the reinsurance program will not be proportional to the AAL).

Along with an assumption for the proportion of current flood premium that is cyclone related, this could be used to estimate the reduction in the Cat XoL program premium as a result of the introduction of the Pool.

Some additional adjustments would be required for effects like:

- the top layers of reinsurance programs are typically subject to minimum rates online and may not reduce as expected
- the removal of cyclone risk may lead to some loss of the diversification benefits, which will offset some of the savings in reinsurance cost that may otherwise have been achieved
- actual changes to reinsurance rates are an outcome of possibly complex negotiations with reinsurers
- reinsurance costs may be affected by recent experience which has been largely driven by non-cyclone peril.

To support reinsurance engagement, ARPC will make available reports on the catastrophe modelling process that has been used to inform the Pool rates and the underlying assumptions for the cyclonic proportion of flood

### 4.2. Adjusting Insurer Premium Rates

Once insurers have analysed the impact of the Pool rates on their portfolio, it is expected that any calculated savings be passed onto policyholders. The Pool has been designed as a reinsurance premium to allow insurers to smooth impacts to policyholders. It may be reasonable (particularly in lower risk areas) for insurers to calculate impacts from the Pool at a region level (e.g. CRESTA zone) and apply adjustments to their premium rates at this level.

For example, insurers may calculate that there is no impact from the Pool in low-risk areas (e.g. Brisbane) and initially leave their premium rates unchanged in these regions. In higher risk regions insurers may consider more granular groupings based on risk profile and level of savings expected (e.g. properties with an elevated ground floor, mitigation measures in place and in postcodes within 50km of the coast in Townsville). It may then be reasonable to pass on savings to policyholders based on these risk profiles.

It is expected that insurers will be able to demonstrate how they have passed on premium savings from the Pool. To facilitate this, a separation of premium rate changes due to the introduction from the Pool from rate changes due to other factors (e.g. claims inflation, claims experience, commercial decisions) would be required.

## Appendix B – Subsection 8A(7) Postcode List

The Act provides an exception to mandatory joining of the Pool for a calendar year where an insurer's premium income is below a prescribed threshold in the previous financial year. This threshold amount is set at $10 million in the regulations.

For the purposes of applying the exception, the insurer should calculate the total Gross Written Premium (GWP) in respect of policies located in the list of postcodes in the spreadsheets provided. The premium for all eligible policies should be included in the calculation (i.e. eligible home, SME businesses, and strata insurance policies).

For postcodes not in this list, ARPC intends to issue a notifiable instrument determining that the risk of eligible cyclone losses arising is so small as to be negligible.

Where the total premium income for policies located in the prescribed list of postcodes is below $10 million in the previous financial year, then the insurer may apply the exception and therefore not be required to participate in the pool. Insurers should notify ARPC of their intention to apply the exception.

**ARPC - Implementation and Pricing Structure Guide - Appendix B - Subsection 8A(7) Postcode List v2_0 as at 01 October 2022**

# Appendix C – Rating Definitions

**ARPC - Implementation and Pricing Structure Guide - Appendix C - Rating Definitions v2_1 - as at 23 November 2022**