AUSTRALIA — TERRORISM RISK INSURANCE PROGRAMME
May 2016

Name of programme

Australian Reinsurance Pool Corporation (ARPC)

Date of establishment

ARPC was established in 2003 after the Commonwealth Parliament passed the *Terrorism Insurance Act 2003* (Cth). This Act set out the structure of the scheme and any limitations upon its operation.

Basic structure

The structure of the regime relies upon a public/private partnership. Central to ARPCs operation is ensuring co-operation with the private insurance industry. Under the current structure the ARPC acts as a reinsurer with the private insurers drafting eligible insurance contracts with consumers and businesses.

Any terrorism exclusion clauses in certain insurance contracts (eligible contracts) are inoperative if a terrorism incident is declared by the Minister. Therefore, insurers providing cover for eligible contracts must cover against terrorism risk. Insurers have the opportunity of purchasing terrorism reinsurance through the ARPC or can use an alternate reinsurance mechanism if they remove any terrorism exclusions from the policies.

There was a change to the structure of the ARPC in 2006 after its first review was undertaken to determine the need for a continued scheme. The review required the ARPC to continue to charge premiums for reinsurance. The structural change occurred in the expanded scope of the ARPCs operations whereby it was to provide terrorism risk insurance for public authorities. There were additional capital requirements where upon reaching $300 million the ARPC can use premium income for the pool or buy reinsurance elsewhere.

OECD

World Forum OF CATASTROPHE PROGRAMMES

The OECD International Platform on Terrorism Risk Insurance shares information and identifies–good practices on terrorism risk financing to contribute to more rapid economic recovery in the event of attacks.

This country profile is regularly updated. It is the product of joint work between national terrorism insurance schemes, the OECD and the World Forum of Catastrophe Programmes.

www.oecd.org/daf/fin/insurance/terrorism-risk-insurance.htm

Australian Reinsurance Pool Corporation

History and Purpose

The Australian Reinsurance Pool Corporation (ARPC) is a corporate Commonwealth entity established under the *Terrorism Insurance Act 2003* (Cth). The ARPC's establishment was a direct outcome of the global repercussions that 11 September 2001 had on the insurance industry. Prior to the events of 11 September 2001, terrorism insurance was readily incorporated into standard insurance policies. In Australia after 11 September 2001 and prior to ARPC coming into existence, insurers would limit their liability in relation to terrorist events. This was done because Australian insurers could not find affordable reinsurance cover for terrorism risk. There was a market failure.

The Commonwealth Government felt that it was necessary for the functioning of the national economy to maintain cover against terrorism risk. The Commonwealth Government was however worried about being over exposed and thus capped their ultimate liability at A$10 billion. If an event were to occur where the government guarantee was exhausted, the payment made to each of the insureds would be reduced. The Minister who is declaring that a terrorist act has occurred should also declare the reduction percentage based upon the estimated costs of a particular incident. The benefit of utilising the reduction percentage limits the exposure of the Commonwealth Government whereby if it looks like the Commonwealth Government's guarantee may be exceeded; each insured will get a lesser amount reducing the insurance pay-out received by an insured.

In Australia, the Australian insurance and regulatory regime is largely premised upon the autonomy of the individual insurer. Therefore, ARPC maintains the autonomy of the individual insurer as central to the effective workability of the regime. In line with facilitating autonomy of individual insurance firms, an insurer has the option of purchasing reinsurance cover for terrorism risk from the ARPC at an affordable rate or utilising other reinsurance mechanisms.

Definitions

Eligible insurance contracts have a starting point definition of insurance for loss of or damage to eligible property located in Australia, and associated business interruption and public liability cover. Eligible insurance contracts must contain a terrorism exclusion clause.

Eligible property is defined as buildings or other structures or works on, in or under land; and their contents.

In order for reinsurance coverage to be provided by ARPC, it is necessary that the event is a declared terrorist incident. The Minister must make the formal declaration in the *Gazette* once they are satisfied that one or more terrorist incidents have occurred in Australia. When making this declaration if the relevant Minister believes it is likely that the losses will exceed A$10 billion there can be a declaration made regarding the need to reduce the amount payable to insureds in light of the upper limit of the Commonwealth Government.

A terrorist act is defined in section 100.1 of the Australian Criminal Code as one which involves an action or threat made to advance a political, religious or ideological cause. A terrorist act requires the perpetrator/s to have intent to coerce or influence by intimidation the government of the Commonwealth or one of the Australian States or Territories or a foreign country or to intimidate the public or a sector of the public.

Operation, Extent, Lines Covered & Perils Covered

Operation:
The ARPC currently operates under the guidance of a corporate board that consists of a non-executive Chair and six other non-executive Members appointed by the Minister. The current CEO is Dr Chris Wallace.

Lines Covered:
ARPC provides reinsurance coverage for commercial risks, industrial risks, constructions risks and for interruption to farming (where the farm has business interruption insurance). The extent of ARPC's cover follows the original eligible insurance contract's terms and conditions, ignoring the terrorism exclusion clause. The total funds available to the pool are currently A$13.3 billion. The Commonwealth Government has a maximum liability of A$10 billion.

Modelling:
In determining the best mechanism to deal with risk the ARPC has developed both 2D and 3D modelling for bomb blasts and 3D modelling for chemical attacks, chem-bio plumes, and radiological plumes. ARPC has utilised the expertise of both government experts and subject matter experts.

Exclusions

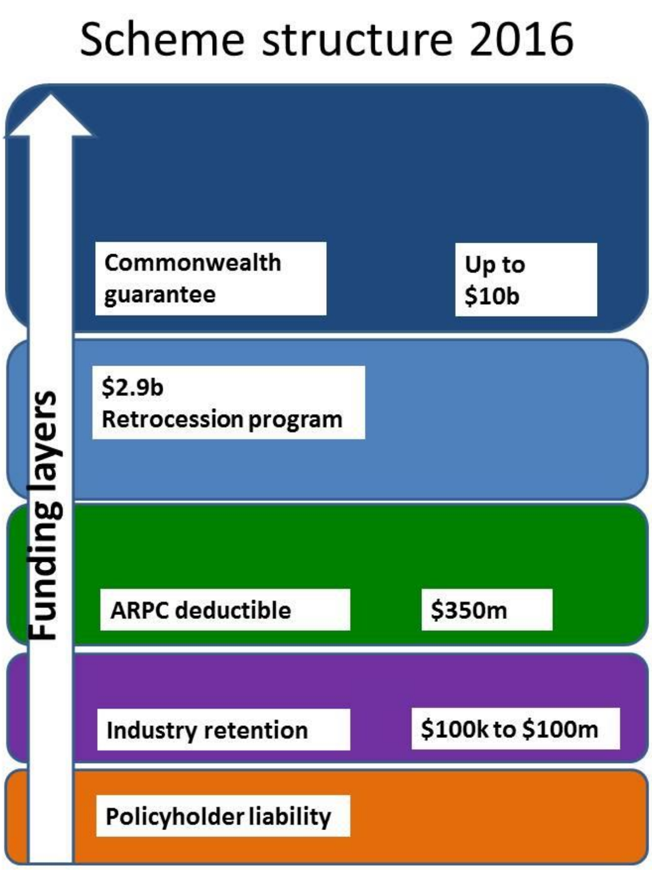
The following principal exclusions apply:

- Nuclear Risks;
- Radiological Risks;
- Residential property;
- Commonwealth assets;
- Marine Insurance;
- Motor Insurance;
- Worker's Compensation Insurance;
- Loss associated with travel (including damage to personal belongings, cancellation, sickness, injury or disease);
- Farming insurance (where there is no business interruption cover);
- Professional Indemnity Insurance;
- Life Insurance;
- Aviation Insurance;
- Prime movers, trailers, railway stock and tram stock;
- Financial products;
- Cyber-crime.

State Involvement & Layers of Cover

The terrorism reinsurance scheme provides a multi-layer model that will spread the cost of any claims. Claims will be met first by ARPCs accumulated pool of premium and investment income. The pool is supplemented by a $3 billion retrocession program and a further $10 billion Commonwealth guarantee, giving a total scheme value of $13.3 billion. The diagram below illustrates the breakdown.

Diagram: scheme structure



Layer 6	Possible liability for some risk by policyholder, through the operation of the reduction percentage or policy limits
Layer 5	Commonwealth guarantee
Layer 4	Retrocession program funded from premium income
Layer 3	ARPC's deductible under its retrocession program
Layer 2	Retention of some risk by insurers

Layer 1	Policyholder's liability for some risk through a possible excess or deductible

If the responsible Minister considers that the amount paid or payable under the Commonwealth guarantee will exceed $10 billion, the Minister must also announce a reduction percentage. This will have the effect of limiting the level of cover, by reducing the amount payable by the insurer to the policy holder.

Non-State Reinsurance/Retrocession

In 2016 the ARPC purchased $2.9 billion of retrocession cover at a slight discount on prior years' pricing. The retrocession scheme was introduced in 2009 and has increased since. The retrocession program has helped to increase the overall capacity of the scheme whilst reducing the potential exposure of the Commonwealth and relies heavily on transparency in underwriting procedure and exposure modelling.

Extent of Compulsion & Choice

Although insurers who are covering eligible property must provide cover against terrorism risk, they do have the option to utilise the reinsurance coverage offered by ARPC if the insurance contract contains a terrorism exclusion clause or they can choose to utilise the commercial reinsurance market.

Period of Operation

The Australian Reinsurance Pool Corporation was established in 2003. After its establishment the ARPC has been subject to review every three years. In order for the ARPC to continue to operate, the relevant Minister (Minister for Financial Services and Superannuation) must create a report outlining the need for the continued operation of the ARPC. Reviews have been conducted in 2006, 2009, 2012 and 2015. These all showed a need for the ARPC to continue its operations and has recommended that the scheme should expect to cover small gaps in coverage. The next review of ARPC will occur in 2018.

Main features

Layers of coverage	Insurer will need to retain a proportion of the risk. The Minister will determine the retention amount. • First- A$350 million (ARPC Retention) • Second- A$3 billion (Retrocession Program) • Third- A$10 billion (Government Guarantee)
Limitation of exposure of private sector	The retention rate is determined annually but applies to each insurer (even if part of a corporate group). In 2015/16 financial year the retention rate or limited exposure was 4% of Australian fire and industrial special risk (ISR) premiums held by an insurer with a minimum retention rate of A$100,000 and a maximum retention of $10 million.
Temporary /permanent	The ARPC is subject to review every three years in order to sustain its operation. The last report in 2015 cited the need for the continuation of ARPC

government participation	until 2018 (when it is subject to another review).
Gratuity of government coverage	ARPC charges for the reinsurance coverage provided. Rates were increased in 2016 to: Tier A 16% of gross base policy premium (was 12%) Tier B 5.3% (was 4%) Tier C 2.6% (was 2%) The Australian government commenced taking fees and dividends from ARPC in 2013.
Voluntary / mandatory	Voluntary Insurers operating in Australia can decide if they want to obtain reinsurance coverage for terrorism from ARPC or obtain such coverage through a different mechanism.
Minimum sum insured	As per the original contract of insurance.
Coverage of NCBR terrorist attacks	Nuclear and Radiological risks are not covered by ARPC.
Lines covered	• Commercial risks • Industrial risks • Constructions risks • Farming (where the farmer has business interruption insurance covering their farm).
Pricing mechanism	Premium rates are charged based upon the locality of the property insured (postcode system is utilised).
Other public sector victims compensation schemes	Victims of Crime Compensation Scheme (state based regimes in existence in every Australian state)