

**Allianz Australia Insurance Limited**

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Mr James Hunter  
Director  
Reinsurance Pool Taskforce  
Treasury  
Langton Crescent  
Parkes ACT 2600

**By email: reinsurancepool@treasury.gov.au**

Dear Mr Hunter

**Exposure Draft Legislation: Cyclone and Related Flood Damage Reinsurance Pool**

Allianz Australia (**Allianz**) appreciates the opportunity to comment on the exposure draft legislation to establish a cyclone and related flood damage reinsurance pool, specifically the:

- *Treasury Laws Amendment (Measures for later sitting) Exposure Draft Bill 2021: Cyclone reinsurance (the **draft Bill**)*;
- *Treasury Laws Amendment (Measures for later sitting) Exposure Draft Explanatory Materials (the **draft EM**)*;
- *Terrorism Insurance Amendment (Cyclone and Related Flood Damage Reinsurance Pool) Exposure Draft Regulations 2022 (the **draft Regulations**)*; and
- *Terrorism Insurance Amendment (Cyclone and Related Flood Damage Reinsurance Pool) Regulations 2022 Exposure Draft Explanatory Materials (the **draft Regulations EM**)*.

Allianz has appreciated the Taskforce's high level of engagement with the industry, and directly with Allianz, on this important policy initiative. Allianz is supportive of the Government's decision to establish a reinsurance pool (the **Pool**). In our view, an appropriately designed Pool, in conjunction with measures to enhance the resilience of properties to extreme weather events, is the most efficient and effective way of addressing affordability of insurance in regions exposed to cyclone risk.

While Allianz is broadly comfortable with the draft legislation as proposed, our submission raises issues and suggested amendments for your consideration.

**1. Definition of cyclone**

The draft legislation establishes the boundaries around which the Pool will respond to loss or damage caused by a cyclone. As proposed, a cyclone is defined in the draft Regulations as:

*a non-frontal low pressure system, of synoptic scale, that:*

- a) develops over warm waters; and*

- b) *has organised convection, and a maximum mean wind speed of 34 knots or greater that extends more than half-way around near the centre of the system and has persisted for at least **6 hours** (our emphasis).*

We understand that it is Treasury's intent that a cyclone will only be declared after the 6 hour period specified in the definition, and the Pool will not provide cover for damage that has already occurred within that 6 hour window. Consideration should be given to whether, once a cyclone meets the above definition, the claims period should be inclusive of the 6 hour window. Whilst losses in this period may often be minimal, the application of hours clauses in insurers' natural catastrophe reinsurance contracts are likely to be applied post downgrade, as a result, leaving this period of exposure not covered by either these reinsurance contracts or the Pool.

In addition, as proposed, "eligible cyclone loss" is defined in section 8C in the draft Bill as:

*....a loss that **arises** (our emphasis), during the claims period for a cyclone event*

Consideration should be given to whether "arises" should be replaced with "commences" to provide clarity that the Pool provides cover for initial and any subsequent losses that are eligible for coverage under the Pool. The term "commences" provides clarity as to the point of loss that determines whether the Pool responds and avoids splitting of losses between various reinsurance arrangements. This is particularly the case where losses occur over a period of time. For example, losses that Allianz suggests should be covered and which could 'arise' after commencement include situations where:

- wind damage to a roof is followed by water inundation over subsequent days; and
- business interruption, which occurs over a period of weeks or more, following initial property damage from a cyclone.

While Allianz expects that this issue could be addressed through appropriate technical drafting of insurers' reinsurance contracts with the Australian Reinsurance Pool Corporation (**ARPC**), Allianz submits that clarity in the legislation by way of amendment as we suggest is preferable.

## **2. Definition of building and incidental cover**

It is of critical importance that the type of property and consequential losses which the Pool will respond to are clear to reduce the risk of a gap between reinsurance arrangements. Within this context, Allianz makes a suggestion in relation to how "building" is defined to enhance clarity, and we seek confirmation on the intended treatment of incidental cover provided in policies.

As proposed, the Pool will provide cover for loss of, or damage to, eligible property. Section 3 of the *Terrorism Insurance Act 2003* (the **Terrorism Act**) currently defines "eligible property" to include:

- a) buildings (including fixtures) or other structures or works on, in or under land;
- b) tangible property that is located in, or on, property to which paragraph (a) applies;
- c) any other property prescribed by the regulations.

As we understand it, there is no further definition of "building" in the draft Bill, draft Regulations, or any which already exist in the *Terrorism Act* or *Terrorism Insurance Regulations 2003* (the **Terrorism Regulations**). It is unclear based on the definition of "eligible property" whether the Pool will provide cover for other insured property such as sheds and fences.

Allianz had previously suggested that the definition of “building” should be consistent with that which is used in the *Corporations Act 2001* (the **Corporations Act**), which is well understood by industry. Using the Corporations Act definition, extracted below, provides certainty that sheds and fences are included in the definition of building.

**Corporations Regulations 7.1.12(3)**

*"home building" means:*

- a) *a building used, or intended to be used, principally and primarily as a place of residence; and*
- b) *out-buildings, fixtures and structural improvements used for domestic purposes, being purposes related to the use of the principal residence;*

*on the site and, without limiting the generality of the expression, includes:*

- c) *fixed wall coverings, fixed ceiling coverings and fixed floor coverings (other than carpets); and*
- d) *services (whether underground or not) that are the property of the insured or that the insured is liable to repair or replace or pay the cost of repairing and replacing; and*
- e) *fences and gates wholly or partly on the site.*

Allianz submits that a consistent definition of “building” should be inserted into the Terrorism Regulations, which we note already contains a definition of “contents” consistent with the Corporations Act.

In addition to clarity on the types of property losses which the Pool will respond to, Allianz would also appreciate confirmation from Treasury as to the intent around how the Pool will respond to other incidental cover provided in policies. As proposed, section 8B of the draft Bill defines a “pool insurance contract” to include consequential loss arising from loss of, or damage to, or inability to use all or part of eligible property. Allianz’s interpretation of this draft provision is that the Pool will respond to incidental cover, such as removal of debris and temporary accommodation, as reflected in insurance policies purchased by consumers and small business. Insurers’ existing reinsurance arrangements closely mirror the coverage provided in product wordings, and it would be important for the Pool to also respond comprehensively to the cover provided to end consumers and small businesses.

Allianz understands that much of the detail around the types of losses the Pool will respond to will be specified in reinsurance contracts between insurers and the ARPC. Allianz’s interpretation of the draft legislation is that there is sufficient flexibility within the legislation to permit the contract entered into with ARPC to provide cover for a primary risk plus any incidental associated cover, however, Treasury’s confirmation (perhaps in the EM) would be very helpful.

### **3. Definition of small business**

As proposed, section 8B(3)(d) in the draft Bill and section 5B in the draft Regulations limit the Pool’s coverage of small business policies to policies with a sum insured of \$5 million or less. Allianz supports the use of the policy’s sum insured as a pragmatic method of defining small business.

Allianz understands Treasury is considering whether “sum insured” needs to be defined in the legislation. Clarity around what is counted towards the sum insured calculation could be done by way of a legislative definition or within contractual arrangements with the ARPC. Allianz’s preference is for the ARPC to be given sufficient flexibility to establish appropriate contractual arrangements by class of business and insurer. Allianz’s view is that the sum insured (for the

purposes of determining whether a small business policy falls within the \$5 million cap) should include the declared value of the property assets insured plus associated business interruption and also include any 'safety net' uplift (e.g. in the event of a total loss) or automatic increases to the sum insured (e.g. annual sum insured indexation to reflect increased building costs), but exclude consequential loss such as removal of debris and temporary accommodation.

#### 4. Scope of coverage for strata

As proposed, section 8B(3)(c) in the draft Bill limit the Pool's coverage of mixed use strata policies to policies where at least 80 percent of the total floor space of the units in the development is used wholly or mainly for residential purposes. Allianz understands that Treasury is considering whether an alternative test to this "80/20 rule" could be:

- an extension of the Pool's eligibility to all strata under a sum insured cap of \$5 million (in addition to applying the 80/20 rule to capture residential strata above \$5 million) ; or
- a more generous 50/50 rule.

A 50/50 rule is consistent with how the industry (based on ASIC guidance) defines "residential strata" for the purposes of determining whether a policy is a retail general insurance product. As such, for administrative simplicity, Allianz's preference is for the 50/50 rule to apply. Allianz would recommend against implementing a two-pronged test by combining the 80/20 rule with a \$5 million cap as this option is more complex to administer.

#### 5. Classification errors

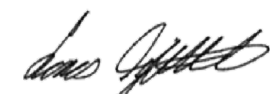
Key definitions within the proposed legislation establishes the scope of the Pool's coverage, for example, the 80/20 rule in establishing whether a strata building is captured and the \$5 million prescribed cap in determining whether a policy is a small business policy. There should be some flexibility in the regime to allow for genuine classification errors, whether due to the customer's error, insurer's error or a change in the risk post contract, so that risks ceded to the Pool in good faith are eligible for reinsurance cover. For example, an assessor may have incorrectly estimated the floor space to determine that a strata complex is predominantly residential in accordance with the legislation; in these circumstances, the reinsurance contract ARPC has entered should respond to the loss. It is expected that the ARPC would have audit rights to policy and underwriting under the contract.

#### Conclusion

Allianz appreciates the opportunity to engage with the Taskforce once again. We look forward to further collaboration, including with the ARPC, over the next few months to further progress key details around rates schedules and other operational matters.

Allianz provided a copy of this submission to the Insurance Council of Australia (ICA) and some of the matters raised herein are also included in the ICA submission. The ICA submission raises a broader range of issues, suggestions and concerns, which emanated from the cross section of its members. The only issues, suggestions or concerns that Allianz seeks to raise in relation to the draft legislation are those included in this submission.

Yours sincerely



James Fitzpatrick  
Chief Technical Officer