Property Council of Australia

Submission to the Senate Economics Legislation Committee

Terrorism Insurance Bill 2003

April 17, 2003

The Voice of Leadership

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The Property Council of Australia represents the non residential property sector in Australia.

Its members own the majority of Australia's office, hotel and leisure, shopping centre and industrial real estate assets in the country. They are also investing more heavily in residential, aged care, health and major engineering infrastructure.

The Property Council is a strong supporter of the proposed Australian Reinsurance Pool (ARP).

It contends that ARP remedies a major market failure in a manner superior to models developed in most international jurisdictions.

This submission outlines the basis of the market failure and specifically addresses the need for a compulsory surcharge on commercial all risks policy premiums.

Proof of Market Failure

There is no adequate terrorism insurance available even eighteen months after the September 11 attack on the World Trade Centre.

The Claytons cover that is on offer:

- is massively expensive;
- contains significant exclusions;
- does not cover biological or chemical attack;
- does not cover public liability of business interruption risks; and,
- contains ambiguous definitions of `terrorism' and `event'.

In addition, it is highly likely that further terrorist acts will take place in the future; thereby undermining any recovering of reinsurance markets.

Finally, Australia's critical infrastructure is at risk to an extent that has only previously existed at times of war. That heightened state of risk looks likely to exist for several years.

The Property Council contends that a rigorous terrorism pool reinsurance scheme that specifically addresses these risks is required.

The ARP model fulfills this goal.

The Case for a Compulsory Scheme

The Property Council submits that there are eight main reasons for supporting a compulsory model for the proposed ARP scheme.

1. Terrorism Risk Is Shared by Everyone

As terrorism risks are shared by everyone, we should all bear the cost of capitalizing ARP.

While the risks of terrorist attack are relative, they are faced by all businesses (and ultimately, all Australians).

Although not an act of political terrorism, the massacre at Port Arthur shows that the location and manner of tragic events are unpredictable.

Terrorism is not necessarily confined to CBD or urban areas.

As terrorism is an issue for all Australians, the Property Council contends that businesses should make a fair contribution to the insurance pool which covers that risk, as proposed by Trowbridge Consulting.

2. The Proposed ARP Premiums are Modest

The ARP scheme recognizes relative risk. The surcharge on premiums ranges from 2% to 12%.

Under a compulsory scheme everyone would contribute their fair share, thus ensuring premiums remain low.

The Insurance Council is quoted as putting the contribution for small businesses at around $15 to $35 per annum.

Under the ARP model, SMEs and regional businesses will pay a small percentage of a low premium, whereas CBD owners will pay a higher surcharge (six times more) on a much larger premium.

3. A Voluntary Scheme Will Penalise Superannuants

Nearly 70% of Australia's prime real estate assets in CBDs are collectively owned through super funds. In short, they are owned by ordinary Australians who rely on those assets to generate their retirement wealth.

Prime CBD assets are no longer the preserve of the big end of town and so it's not fair that they should bear the brunt of capitalizing ARP.

4. An Act of Terrorism Has Implications for Everyone

A terrorist act could be directed at any piece of infrastructure.

Whether it's an office block that houses financial services tenants, an airport, an energy plant or a harbour tunnel, the dislocation of services caused by a terrorist act will spread to all businesses and all parts of the community.

The Property Council believes this another reason why the burden of capitalizing ARP should be spread widely – we are all part of a higher risk environment.

5. ARP Covers More Than Real Estate

ARP not only covers the cost of reconstructing the built environment, it also addresses public liability and business interruption costs.

The broad scope of ARP is one if its great virtues and a further argument for spreading the burden.

6. The Period of Financial Pain is Brief

According to Trowbridge Consulting, it will take only three to four years to capitalize the necessary $300 million that constitutes the base pool of ARP.

Given the low level of premiums for SMEs and regional businesses, their participation in the scheme does not provide them with an additional burden for long.

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However, if the scheme was to be voluntary, ARP will take longer to capitalize or the surcharge would need to increase for those who are left in the pool, particularly super funds.

7. The Australian Insurance Market Is Not Deep Enough

As Trowbridge noted in their reports to the Commonwealth Government, the Australian insurance market is small.

ARP cannot effectively capitalize unless everyone chips in. This would be a huge pity as the Trowbridge model is superior to those existing in other countries.

8. Nobody Will Be Forced to Take Out a Policy

The proposed ARP scheme is only compulsory for those with property related cover. It does not mandate participation from those that do not wish to insure their properties.

Given the modest size of the surcharge for small and regional businesses and the benefits of insurance generally, the Property Council does not believe that compulsory involvement in ARP would provide an incentive for businesses to exit their existing insurance arrangements.

The Property Council looks forward to making a verbal presentation to the Senate Economics Legislation Committee on this matter.

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