ROYAL & SUNALLIANCE

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The Secretary
Senate Economics Legislation Committee
Room SG.64
Parliament House
Canberra
ACT 2600

Terrorism Insurance Bill 2002

Dear Dr Dermody

Thank you for your letter of 31 March 2003 and for your invitation to make a submission on the operation of the proposed terrorism insurance scheme.

At this stage, the legislation has not yet passed through all its processes and much of the finer detail has yet to be revealed in the relevant regulations. My comments are therefore based on the Bill as it stands, and the updated Guidance Notes issued by Treasury late last month, and should be considered in this light.

Royal & Sun Alliance Insurance Australia Limited (R&SAIAL) is a major general insurer, much of whose commercial portfolio (Commercial Property, Commercial Packages, Commercial Liability, Contractors All Risks, Commercial Motor) will be impacted by the proposed arrangements. Whilst we welcome the Federal government's initiative in providing a means whereby some of our policyholders can obtain terrorism cover, we do have some areas of concern. These can be summarised as:

- the inadequate time given within which to make significant necessary changes to all our mainframe and other systems
- the cost and impact of making those system changes (especially at a time when we are gearing up for other systems changes brought about by our application for an AFSL under the Corporations Law)
- the current lack of clarity around some points of detail, which will impact on our ability to scope fully the required changes to our systems and business processes

Perhaps I can elaborate:

Timeframe: mainframe systems in the general insurance industry are normally geared to a cycle which reflects the annually renewable nature of the contracts we issue, as well as the requirements of legislation such as the Insurance Contracts Act.

As such, we generally produce renewal notices and associated documentation well in advance of the renewal date of the contract. In our case, which on my understanding is no different to that of other major insurers, we need to commence the renewal cycle no later than eight weeks in advance of the actual renewal date.

In relation to the Terrorism Bill, this has the effect that we must have the necessary systems changes and relevant changes to renewal documentation in place no later than 1 August 2003 in order to meet the start date of the period from which premiums for reinsurance cover from the Pool become payable.

Our systems people have provisionally estimated a period of six months is needed within which to design, scope, implement and test the required changes, and we are therefore faced with the need to consider interim or temporary solutions, whilst also building more permanent solutions.

Cost: our project manager has discussed the required changes in detail with his systems colleagues, and preliminary indications are that the cost of implementing the permanent solution will be somewhere in the region of \$1m - \$1.5m, with additional costs associated with any temporary solution.

One significant cost driver here is that the changes will not be required across all the classes of business that R&SAIAL writes. Extreme care will therefore need to be taken by our programmers not to amend common systems functionality so as to inadvertently affect classes of business that are outside of the proposed terrorism arrangements.

R&SAIAL is currently viewing its project to obtain an AFSL as its absolute priority, largely because of its 'mission critical' nature, and is therefore extremely reluctant to divert scarce systems resources to other projects. We have long ago set an AFS licence application date of late June 2003, and arranged our systems resources accordingly.

Another, 'hidden', cost to R&SAIAL will relate to the staff time taken in explanations to our policyholders, many of whom will resent this compulsory form of insurance. This will apply especially to those policyholders operating in areas of perceived low risk, particularly when the compounding effect of other government charges and taxes (such as Fire Services Levy in some States, GST, and Stamp Duty are added to the premium for terrorism cover).

Lack of clarity: this issue revolves around a number of matters:

- defining the affected classes of business fully, so that R&SAIAL is never faced with a situation where terrorism cover could be deemed to be in place for policies where we have not paid a premium into the Pool for reinsurance cover in this respect, there is currently considerable doubt whether Commercial Motor business has been fully and completely excluded from the arrangements (as seems to be the intention). Similarly for some Marine covers
- the fashion in which the reinsurance premium rates have been expressed makes no allowance for the fact that original insurance premiums generally allow for commissions payable to insurance intermediaries. We will therefore have to gross up the reinsurance rates to allow for such commissions
- we will undoubtedly be asked by policyholders to 'spell out' the effects of the legislation in terms of additional premium cost for terrorism cover (including both the premium for our retention, and for the Pool), and expressing this in our notices presents difficult systems issues
- there are definitional issues around the terms 'urban', 'country' and 'CBD' that need urgent clarification so that they can be built into systems changes (if the definitions are not built around postcodes, they will be virtually impossible to build into systems)
- we have no understanding what data requirements the Pool managers may have of insurers, and are therefore unable to build any such requirements into our systems
- we need to build staff and agent training programs well before the commencement date, and the above issues are hindering the development of such programs
- we also need to develop explanatory material for affected policyholders and intermediaries, and again the lack of clarity is hindering the production of suitable material

In conclusion, we welcome the initiative, but have a number of misgivings about the detail of the scheme. We have particular problems with the timing of this, requiring complex systems changes at a time when we are already dealing with FSRA changes. In addition, the operation of the scheme forces us to retain a net exposure of $1m, for which reinsurance is currently unavailable. We are still waiting for confirmation that this will not have an impact on APRA solvency requirements.

Please feel free to contact me on the number above should you require clarification on any of these points.

Yours Sincerely

Duncan West

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