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Insurance Market Review Australia



– Competition nets rewards

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Report highlights

Key highlights from this report include:

- Pressure on insurance rates has continued to moderate in 2010, resulting in the prevalence of relatively favourable conditions for many insurance buyers
- The absence of major natural catastrophe loss activity last year, combined with an improvement in investment income and the continued release of loss reserves, returned most segments of the market to profitability by the end of 2009
- For property and public liability classes, there have been increases of 10% on accounts that have delivered losses to the market but, notably, reductions of 10%+ for attractive accounts
- The change in market conditions has been slower to manifest in the middle market and SME sectors as the competitive dynamic has not shifted in the way that it has in the corporate/institutional arena
- Recent loss events, when weighed against the current position of insurers, are not in themselves likely to interrupt current market trends
- Most buyers of professional liability classes of insurance are experiencing steady or improving rates, terms and conditions
- The trade credit insurance market continues to face the residual impact of the global financial crisis, although stronger economic conditions in Australia are cushioning the upward pressure on rates
- In the political risk insurance arena, market capacity has retreated somewhat in 2010 from the record levels seen in 2009 but appetite remains relatively healthy, particularly for risks within the Asia Pacific region
- A number of businesses face changes to workers' compensation conditions in various States or Territories

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Overview

Pressure on insurance rates has continued to moderate in 2010, resulting in the prevalence of relatively favourable conditions for many insurance buyers in most major economies. Importantly – and as indicated by the Marsh December Insurance Market Report – it is evident that the end of premium reductions in 2009 was not a precursor to a hardening market.

Looking back, the 2008 period proved exceptionally tough for underwriters – with rising claims and a downgrade in investment returns and performance – so relative improvement was expected in 2009. The extent of the recovery, however, surpassed general expectation, relieving much of the pressure on underwriters and quickly changing the dynamics of the market.

The absence of major natural catastrophe loss activity last year, combined with an improvement in investment income and the continued release of loss reserves, returned most segments of the market to profitability by the end of 2009. The pressure on underwriters to increase rates has, therefore, eased and the surplus of capital that has been attracted to the market has generally ensured a strong and healthy competition for client accounts.

Statistics published by the Australian Prudential Regulation Authority (APRA) for the year ended 31 December 2009 include the following key performance indicators on the local market:

- The industry returned to profitability with an annual underwriting profit of A\$3.8billion contrasting with a loss of A\$1.1billion in the previous year
- The net loss ratio (premium vs. claims) improved from 78% to 58%, on a year-on-year basis
- The combined ratio (premium vs. claims plus underwriting expenses) improved from 104% to 85% year on year
- The total industry net profit after tax was \$4billion

Many global underwriters in key marketplaces such as the United Kingdom, the United States and Europe, also produced a turnaround in their results.

Lloyd's, arguably the best barometer for the global performance of insurance markets, produced strong results for the first half of 2009, recording an increase in pre-tax profits of 39% on the previous year. Underwriting capacity has increased significantly (approximately 27%) for 2010 and, although this is partly due to movement in the US dollar against the Pound, there is a significant contribution from new entrants to the market and projected business growth from existing Lloyds syndicates.

Behind the scenes, the reinsurance market enjoyed similarly good results and, on inspection, this market also harbours a supply of capital in excess of current demand. Reinsurance rates for most lines of business reduced at the critical January 1 renewal season with MMC reinsurance specialist, Guy Carpenter, reporting that its World Catastrophe Rate On line Index decreased by 6%. Australian insurers have generally indicated favourable outcomes at their most recent treaty renewals.

The Australian market: new capacity and rating trends – implications for buyers

In the first quarter of this year there has been a perceptible shift in the attitude of insurers from the consolidation and recovery mode of 2009 to a more aggressive stance and a stated intention to grow the top line of their businesses in 2010. Market forces mean that insurers that do not expand their appetites beyond traditional comfort zones will gradually lose market share to those with a broader risk appetite.

Insurers are nonetheless largely maintaining a technical approach to their underwriting. Although they are willing to aggressively pursue new business opportunities on attractive accounts in their preferred business segments, they are still demonstrating a desire to remediate or walk away from businesses that are in loss making segments or have inadequate attitudes toward risk management and risk improvement.

The corporate/institutional space is where much of the early action has been. Allianz and Zurich both expanded their business appetites, with the latter in particular becoming active in the real estate segment for property risks and across a broad range of occupations on the liability front. CGU has continued its push to underwrite larger accounts and Chartis (formerly AIG), is looking to regain momentum in the market.

New entrants to the corporate/institutional arena are also beginning to have an impact. Lumley has recruited a number of experienced underwriters and support staff and significantly increased its capacity for both property and casualty risks – it looks set to become a genuine player at this end of the market. Axis has also expanded its underwriting capacity to the corporate property market and again, having recruited an established underwriter, has hit the ground running, providing capacity for some significant risks since commencing business in March 2010.



Other new market entrants such as WR Berkeley (Liability) and CV Starr (Property) may also have an impact in coming months.

The first quarter of the year does not contain a significant volume of renewals but there has been a wide range of renewal outcomes on corporate business. For property and public liability classes, there have been increases of 10% on accounts that have delivered losses to the market but also reductions of 10%+ in cases when accounts with a clean record, sound risk management and an attractive premium pool have generated competition between lead or primary insurers.



Accounts in the medium hazard bracket that generate an attractive premium pool and appeal to the underwriting appetites of a broad cross section of the market appear to be achieving the best results in terms of percentage reductions.

In an attempt to protect their portfolios and consolidate any new business wins, insurers are also showing a renewed willingness to enter into long term agreements whereby prices are locked in for a period of 24-36 months, subject to caveats on claims records and changes in the composition of the risk. Given that prices for many buyers are at historical lows, some are strongly considering this option.

The change in market conditions has been slower to manifest in the middle market and SME sectors as the competitive dynamic has not shifted in the way that it has in the corporate/institutional arena. An analysis of Marsh middle market property, liability and motor renewals for the first four months of the year shows a gradual change from an average outcome of a 5% increase in January to a largely flat result for April. It is anticipated that competition in this sector will increase during the heavily weighted June renewal season and that premium reductions will be on offer as competition between insurers intensifies.

Market outlook

The Marsh December 2009 Insurance Market Review contended that an over supply of risk capital could lead to "a far tougher operating environment in 2010" for insurers. On the back of that contention and the market outcomes observed in the second half of last year, the report concluded that there was "no solid basis upon which to expect an immediate hardening in the market". Our analysis at this point in 2010 confirms that, in fact, there has been a further softening of market conditions, despite the fact that buyers are still experiencing a wide range of renewal outcomes.

An assessment of the future outlook requires a close inspection of current claims activity.

On the global property front, 2010 looks likely to produce the worst ever first quarter of natural catastrophe losses. Insured losses, largely stemming from the Chilean earthquake and wind storms in Europe, look set to exceed \$US16 billion.

In the United States, respected forecasters such as Colorado State University (CSU) are predicting higher than average Atlantic hurricane activity in 2010 so global insurers may again be facing increases in catastrophe reinsurance costs by year end if this prediction comes to fruition.

Locally, insurers are facing first quarter natural catastrophe losses estimated at over A\$2 billion arising from hailstorms in Melbourne and Perth and flooding in south west Queensland. These losses appear to have had little more than a localised impact at this stage but it does make the market more sensitive to losses that may occur later in the year.

Liability insurers are also anecdotally reporting an increase in the number of litigated incidents that they are facing in Australia. This trend, coupled with the long held suspicion that risk reserve releases are disguising the true profitability of casualty portfolios, does sound a slight warning for insurers' ability to sustain pricing at current levels.

On an overall basis, these loss events, when weighed against the current position of insurers, are not in themselves likely to interrupt current market trends. Further analysis of insurer performance later in 2010 and the volume and frequency of future loss events will provide a clearer picture about the extent to which the softening of conditions is sustainable over the medium-to-long term.

Specialist classes

Professional liability

Most buyers of professional liability classes of insurance are experiencing steady or improving rates, terms and conditions – largely driven by an increase in competition in the sector. Risks associated with the engineering and construction industries, financial planners, commercial real estate and certain pockets of the financial institutions sector, however, continue to be challenging for insurers.

As the local economy continues to improve, the risk profile of clients is also likely to improve and, consequently, may increasingly put downward pressure on the professional liability rates applied by insurers. An insurance buyer's ability to demonstrate that sound risk management remains a key contributor to their performance has a positive impact on negotiating the price and breadth of insurance coverage.

Directors' and officers' (D&O) liability product offerings continue to evolve with new policy wordings being introduced on a regular basis. Conversely, there has been very little change in technical underwriting and policy wordings for professional indemnity (PI) and crime risks.

Across the D&O, PI and crime classes of insurance, competition for risk remains strong, resulting in favourable renewal results. For those larger clients with an insurance program that includes London market capacity, this softening trend is likely to continue with several new Lloyd's carriers exhibiting a strong appetite for new business. New capacity has also emerged in the Australian market. Importantly, the entrance of this new capacity is backed by experienced underwriting capabilities.

Premium rates are steady, on average, however re-marketing and re-structuring may result in a price reduction of as much as 10%.

Businesses are likely to face upward pressure on insurance ratings across the professional liability classes if they:

- Have a significant claims or notifications record
- Are involved in merger, acquisition and divestiture activity
- Face liquidity issues
- Revalue assets, write down risk or are heavily engaged in cost cutting initiatives
- Restructure debt
- Face stock performance issues

Furthermore, businesses with commercial real estate exposures – both direct (lending) and indirect (investment portfolios) – are unlikely to see reduced rates this year. Across all sectors, underwriting due diligence remains robust.

In the wake of the global financial crisis, financial institutions across the globe, including those in Australia, have been hit with larger than expected premium increases over the last 18 months. In the absence of another major financial shock or unforeseen exposures, more favourable conditions for financial institutions are likely throughout the remainder of 2010.

Purchasing trends for D&O insurance have largely remained unchanged, although buyers are purchasing larger Side A coverage limits (protection provided directly to directors and officers when their company cannot indemnify them) as rates for Side A have improved and there is greater appreciation of the security level these policies bring to the board of directors.

Insurers offering engineering and construction PI insurance continue to experience large claims across their portfolios, comprising both annual policies and also the project specific/ long-term policies. Similarly, the loss record of the financial planning and mortgage industries is forcing insurers to provide for large claims, thereby putting pressure on insurance rates.

Trade credit

The trade credit insurance market continues to face the residual impact of the global financial crisis, although stronger economic conditions in Australia are cushioning the upward pressure on rates.

The global credit insurance market continues to feel the effect of large losses. In Australia, there has been improvement in the size of claims over the last quarter, although losses continue to be higher than normal. Underwriters are now expecting claims to remain relatively steady in 2010 given the time lag between actual insolvency and the claim submission, before a general reduction in claims activity starts to take hold as the global economy improves.

There are certain industries that continue to face restrictive insurance conditions. These industries include textiles, construction, paper and printing. Underwriters are withdrawing or reducing capacity for risks in these industries or otherwise significantly increasing premium rates. For industries where claims have been limited, underwriters are providing cover with more modest premium rate increases. These rate increases are likely to ease in the absence of another contagion and if there is an across the board reduction in claims activity in 2011.

All underwriters continue to tighten risk levels by reducing indemnity levels – which had previously crept up to 95% on some policies – down to 85% or lower. Policyholders are also under pressure to absorb higher excesses in order to provide greater risk share. These tighter conditions for trade credit insurance mean that businesses are now paying more consideration to their levels of retained risk in order to obtain more favourable rates.

Political risk

According to the World Bank “political risk is a top concern for corporate foreign investors – from industrialised but also developing countries – when venturing into emerging markets”. Despite this concern, foreign direct investment into emerging markets is expected to remain healthy, particularly in light of the less certain economic outlook in Europe.

Unprecedented claims activity in 2009 cost political risk and structured credit insurers over US\$1.5 billion (which represents a multiple of the market's gross premium income). Whilst underwriters are, therefore, taking a more cautious stance, the political risk insurance market remains a viable and vital forum for risk transfer for financial institutions, corporations and trading firms.

Market capacity has retreated somewhat in 2010 from the record levels seen in 2009 but appetite remains relatively healthy, particularly for risks within the Asia Pacific region as insurers recognise both the economic strength of the region through the financial crisis and the continuing efforts of many governments in the region to attract foreign investment and trade.

A key trend within the market has been the desire of insurers to increase the proportion of political risk premium within their portfolios, as against the structured credit product which grew to dominate the portfolio of many participants over the 2007-09 period. As a result, new and existing buyers of political risk insurance have, over the past six-to-twelve months, benefited from strong competitive interest from a wide range of insurers. Direct benchmarking of premium rate movements for this class is made complicated by factors including multi-year policy periods and volatile underlying risks. Rates for political risk insurance have generally been broadly stable or reduced by up to 10% for selected risks. Appetite, pricing, terms and conditions for structured credit risks have remained firm with strong demand in the region for contract frustration and structured credit products which can support increased sales and access to working capital associated with trade in emerging markets.

Significant capacity for political risk and structured credit insurance, including terrorism and political violence coverage, is now available for corporations and financial institutions from underwriters in both Sydney and Singapore. The presence of these experienced underwriters that are familiar with key political risk trends in the region, is a positive development for buyers.

Looking forward, the current turmoil in Greece and its effect on the likes of Portugal, Ireland, Italy and Spain (together the “PIIGS”) is not expected to present direct losses to political risk insurers, which focus on ‘emerging markets’, as distinct from EU countries or members of the OECD and the like. However, concern around the potential for ‘contagion’ or consequential impacts of the harsh austerity measures being adopted in Europe will undoubtedly support a continuing cautious attitude in the underwriting market.

Workers' compensation markets

The following table outlines key changes to workers' compensation markets across Australia, including an overview of conditions, key legislative changes, expected premium outcomes and other technical changes.

State	Conditions	Key Legislative Changes	Resulting Premium Outcomes	Other Technical Changes
NSW	<p>Work Cover deficit has reduced by \$266mil as a result of increased investment values and positive investment returns.</p> <p>Lisa Hunt appointed CEO of WorkCover NSW.</p>	<p>WorkCover NSW announced 10% of policies and open claims will be reallocated between scheme agents.</p> <p>The reallocation is aimed to closely align market distribution and agent service capabilities.</p>	<p>To ensure market stability during this time of reallocation, a market freeze will be implemented affecting small to medium sized employers (tariff premium less than \$500,000) with a policy renewal date of 30 June to 31 December 2010.</p>	<p>No other changes to report.</p>
VIC	<p>Scheme is performing strongly. Funding ratio is at 109%.</p> <p>Victorian State Budget announced, businesses in Victoria will be \$240m better off over the next 4 years with a 3.5% cut to work cover premiums. This would take the average premium rate to 1.34% for 2010/11.</p>	<p>Following the Hanks review in 2008, major legislative changes have been implemented in the Victorian scheme, taking effect from the 05 April 2010.</p>	<p>With the recent implementation of the legislative changes, WorkSafe remain silent about the potential impacts to Victorian premiums.</p>	<p>Key reform changes:</p> <ul style="list-style-type: none"> — Increase in level of weekly compensation — Superannuation contributions of 9% to workers who meet the eligibility criteria — Increase to lump sum benefits — Modifications to return to work obligations — Amendments to the eligibility criteria for compensation of illnesses or disorders of the mind caused by stress
QLD	<p>WorkCover Queensland has accumulated an operating deficit of \$1.3b.</p> <p>Scheme is currently under review with a number of proposed changes forecast to be implemented.</p>	<p>Reforms package announced focusing on the followings;</p> <ul style="list-style-type: none"> — Pain & Suffering damages to be capped at \$300K — Future loss of earnings damages capped at \$176K p.a — Employer excess for wages to increase to 100% of the QOTE 	<p>Average premium rate to rise from 1.15% to 1.30% for 2010/11, the first premium rate increase in QLD for two years.</p>	<p>Effective 1 July 2010, WorkCover QLD will move to the ANZSIC 2006 classifications.</p>
SA	<p>The scheme deficit has decreased from \$1.059bn at June 2009 to \$911m at December 2009.</p> <p>Scheme is now 62.8% funded.</p> <p>Rob Thomson appointed as Work Cover SA CEO.</p>	<p>No significant change to report.</p>	<p>With the improvement of Work Cover SA financial position, the average levy rate will reduce from 3% to 2.75% for 2010-11.</p>	<p>Bonus and Penalty Incentive Levy scheme is to be abolished on 30 June 2010.</p> <p>Consultation papers have been circulated for a new incentive model to be introduced. There hasn't been any developments to date.</p>

State	Conditions	Key Legislative Changes	Resulting Premium Outcomes	Other Technical Changes
WA	Following review of the Workers Compensation and Injury Management Act 1981, The WA Government announced reductions in the average premium rates for 2010-11, and support to the recommendations to removing age limits for workers compensation.	Premium rates to reduce by 13% for 2010/11. Premium rate reductions are primarily a result of the economic recovery.	2010/11 will see the average premium rate decreased from 1.738% to 1.497%. Proposed introduction of a safety levy applicable to the resource industry.	Key recommendations following the review surround the following <ul style="list-style-type: none"> — Removal of age limits to access weekly benefits — Extending coverage for noise induced hearing loss incurred after 65 years — Greater protection for workers whose employers are uninsured
ACT	The ACT scheme remains stable.	Effective from 30 June 2010, insurers will be required to disclose the ACT Default Insurance Fund levy.	Default Insurance Levy Fund will be charged at 1.70% of premium with GST to be charged to the levy.	No significant changes.
NT	Scheme remains steady.	No changes to report.	No changes to report.	No changes to report.
TAS	Following the Claytons review in 2007, significant legislation changes will take effect from 1 July 2010.	Major reforms to the Workers Rehabilitation and Compensation Act 1988 to commence on 1 July 2010.	Anticipate premium rates to increase on average by 15% from 1.97% to 2.26%, as a result of the legislative changes.	Key legislative Changes: <ul style="list-style-type: none"> — Increase in level of weekly compensation and extended period of entitlements — Greater access to common law — Increased benefits for permanent impairment lump sums and death benefits — Introduction of the injury management programs
Comcare	Moratorium to remain in place until 2011.	No significant change to report.	No significant changes to report.	No changes to report.



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