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MARSH

Marsh News

News for Marsh clients in Australia and the Pacific

This issue

Asset price collapse a leading risk: WEF report

According to *Global Risks 2007*, a report recently issued by the World Economic Forum, a collapse in asset prices is one of the most likely and costly risks facing our society.

The report states that "House prices have doubled in most mature markets (and in some emerging markets) in real terms over the last 10 years, putting price-to income ratios at all-time highs."

"Many experts fear a major correction, with differential impacts on consumption, economic growth and other asset prices."

The property market in Australia mirrors the global picture, with house prices increasing on average by 7.5 percent per annum over the last 20 years according to the Australian Bureau of Statistics.

Key to the concern is massive debt associated with an explosion in asset prices and the flow-on effect this has on our economy.

David Moloney, a Director at Mercer Oliver Wyman in Australia, said there are questions marks over the general level of preparedness in the community for a collapse in asset prices.

"One of the problems is that we haven't had a major downturn in asset prices for quite some time, which means there are few executives and few consumers out there with experience in managing this risk, if it were to eventuate," David said.

"For businesses, applications include dynamic stress testing and 'war-gaming' techniques to help identify relevant trigger points and action plans for this type of event.

"These tools are not unlike DRP and BCP planning exercises, where management are forced to confront scenarios in a simulated setting rather than reacting to desk-based research".

Insurance buyers in the property funds industry are also affected, said Simon Cooling of Marsh's Real Estate Practice.

"Property funds under pressure to expand their portfolios are feeling the bite of rising asset prices," Simon said.

"These funds naturally look to protect their assets with insurance to guard against loss, but insurance and risk management budgets become tighter when upfront asset purchase costs are so high.

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Asset price collapse a leading risk: WEF report

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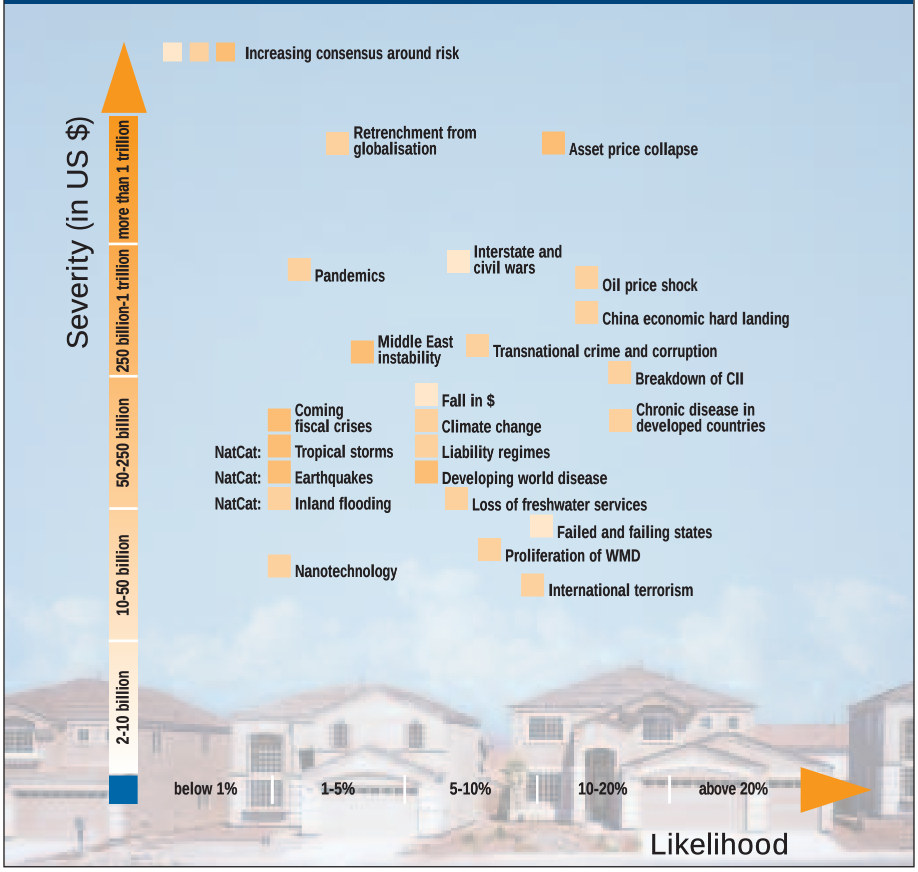
"The maturing market is also causing property funds to look offshore for expansion opportunities and this can create other insurance and risk challenges."

The *Global Risks 2007* report also rated the risk of oil price shock and a Chinese economic hard-landing as top risks, in terms of likelihood and severity.

Global Risks 2007 is a report produced by the World Economic Forum's Global Risks Network. MMC, the parent company of Marsh and Mercer, collaborated with other leading institutions to help produce the report. The report can be downloaded at http://www.weforum.org/en/initiatives/globalrisk/index.htm.

Note: Likelihood was based on actuarial principles where possible. For most risks, however, qualitative assessment was used.

The 23 Core Global Risks: Likelihood with Severity by Economic Loss



Emerging tactics for M&A players

Private equity interests in Australia have changed the merger and acquisition landscape for corporations competing for assets.

In a recent interview with *CFO Magazine*, Andrew Hunt of Marsh's Private Equity and M&A Practice, provided tips for corporations competing in the M&A space.

Tactics include:

1. Using risk and insurance due diligence to fully understand the past exposures of the target asset. This enables evaluation of any gaps in cover or incorrect pricing of historical insurance arrangements of the target. For example, the target may have inadequate past insurance through insolvency or over/under reserving of claims. This information can be used to build a more realistic pricing model.
2. Transferring certain contingent liabilities to the insurance capital markets to break a deal deadlock where a seller and buyer disagree on which party assumes the future financial consequences of a historical liability. Examples of liabilities that can be transferred include existing litigation or historical tax positions.
3. "Stapling" the conventional insurance program of an asset that is to be divested or carved out (packaging the insurance program for the asset with the deal) to ensure no hidden surprises and to prevent the deal from being held up.
4. Ring–fencing material contingent liabilities, such as environmental exposures, general commercial representations and warranties, prior to the sale of a business through the insurance market. This can assist in smoothing the deal process and pre-empt potential "chips" on the purchase price by any potential buyer.
5. Strategic use of insurance by private equity buyers to independently price risk within the target company and either use this knowledge to enhance their own bid for an asset or to extract additional concessions from the seller.

Insurance market evolving in China

Understanding the evolution of the local Chinese insurance market is becoming more important for a host of Australian companies looking to China for investment opportunities.

Australian exports to China have increased markedly in recent years, increasing from A$16.1billion in export activity in 2005 to A$20.4 billion in 2006, according to the Department of Foreign Affairs.

Paul Wilkins, Head of Marsh in Greater China, said there are important insurance-related regulations which businesses need to be aware of when developing risk management and insurance programs for their operations in China.

"Insurance must be placed with an insurance company licensed to conduct business in China for risks within Chinese territory," Paul said.

"Clients are also restricted by the geographic spread of their insurance policies because many will only provide coverage for a designated area."

Nationwide policies can only be issued for coinsurance and some master policies for large scale risks (exceeding certain asset values and premium) and, inland cargo.

"Insurer selection is particularly important in this market," Paul said.

"As an emerging market, corporate governance and under capitalisation are challenges which the insurance industry in China is increasingly addressing.

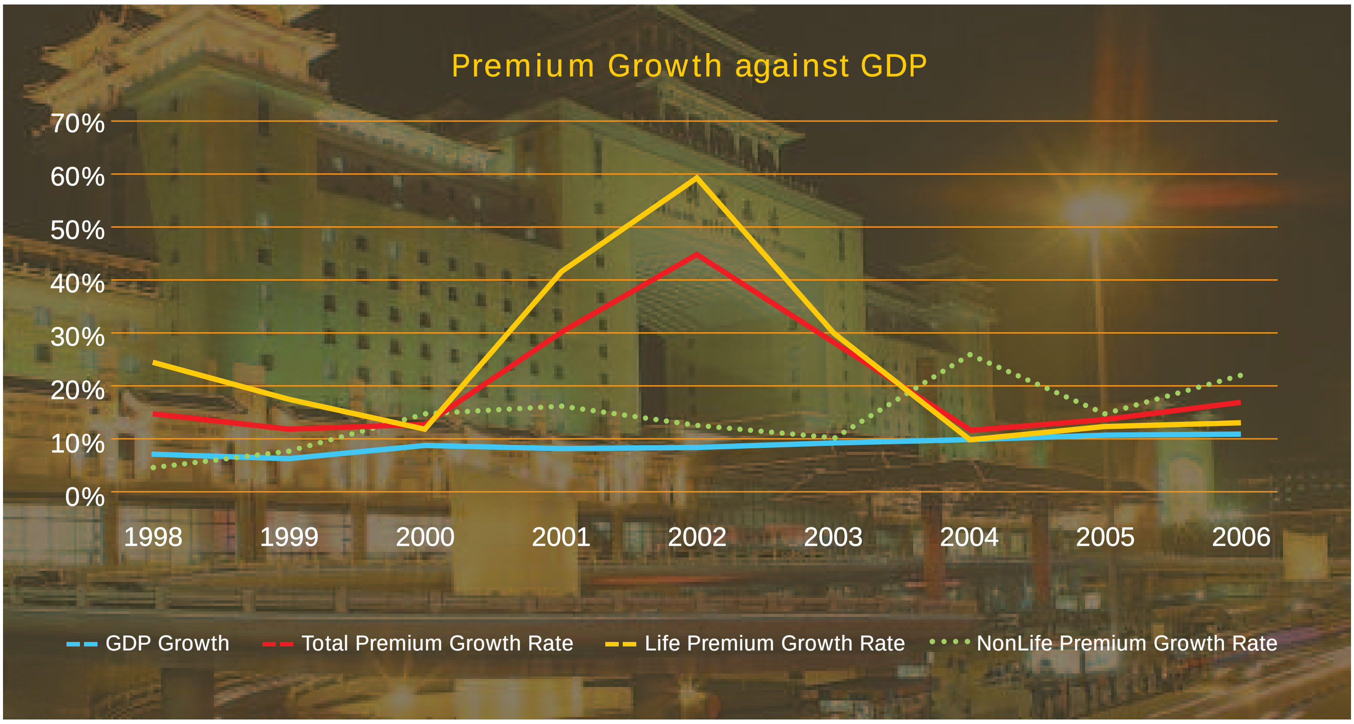
"Proactive regulatory developments and good long-term growth prospects should stabilise the industry in the medium term."

China is expected to be the second largest insurance non-life market in Asia by 2010 and the market is expected to grow by 20 to 30 percent each year, for the next few years.

The industry is also expanding in terms of the number and types of insurance companies. The top three insurers currently have a 70 percent combined market share but these shares have gradually decreased in recent times in the face of higher growth rates of other companies.

Key Points

- Insurance market fiercely competitive with rates up to 50% lower than international levels in some classes
- The industry is liberalising and insurance capacity is expanding
- Key risks include environmental liability, fraud, political risk, IP risk and risk to infrastructure



Source: S&P 2006 report

News bites

Supply chain rules getting tougher for traders

Speaking at a recent supply chain security forum at Marsh, Geoff Short, Managing Director of Tanda International, said rules affecting the supply chain of importers and exporters are getting tougher.

"Ever since 9/11, governments have moved to enhance regulation of supply-chain movements and place greater guarantees on security throughout the cycle," Geoff said.

Australian companies are likely to be subject to new requirements in the future, particularly for trade throughout Asia.

Australian Customs is currently running a pilot program with five large Australian companies to define an Authorised Economic Operator (AEO). An AEO will be a company, which - at any point in the supply chain - can satisfy Customs that it meets specified security standards relating to their premises, conveyances, IT, staff and business partners.

AEOs will be deemed 'low risk' and will receive facilitated customs clearance and other benefits, rather than facing the prospect of 100% inspections.

This process should also improve the insurance risk profile of participants.

APEC's STAR (Secure Trade in the APEC Region) Conference in Sydney in June is likely to accelerate progress towards implementation.

"The APEC economies are pushing this hard and the new rules could be in place as early as January next year," Geoff said.

"Companies which adopt the rules early will reap competitive advantages."

Soft market set to continue

The soft insurance market for corporate buyers is set to continue for the foreseeable future, but rate reductions are likely to be more modest according to the Marsh *Insurance Market Review* issued in February.

The report states that the insurance market remains cyclical and will get harder for buyers at some time in the next two-to-three years.

"Businesses must start to prepare for a harder market and should plan now for upcoming renewals," said Scott Leney, General Manager, Placement Services.

Contact your Marsh advisor for a full copy of the review

Task group to advise on carbon trading

Submissions to the task group advising the Federal Government on the potential for a workable 'global emissions trading system' in Australia have now closed.

According to the issues paper guiding the task group, the growth in the level of greenhouse gas emissions will have a "detrimental effect on the global environment and generate economic costs arising from adverse impacts on infrastructure and a range of industries, negative impacts on human amenity and degradation of ecosystems."

A recent paper issued by Marsh highlights the opportunity and risk considerations for businesses taking part in a carbon trading system:

"Any business interruption that affects carbon emissions could result in revenue gains or losses dependent upon corporate response strategy.

"Business interruption strategies and insurance programs may protect companies against potential losses, but companies will need to demonstrate to underwriters their exposure to these carbon trading risks."

Contact your Marsh advisor for a copy of the Marsh paper: Climate change – risk and opportunity

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