

The State of the Australian Insurance Market

APRIL 2009



Soft and hard market cycles

Insurance companies, brokers and many buyers are familiar with the cyclical nature of the Australian Insurance Market (figure 1).

In recent years, the industry experienced a highly competitive or 'soft' market, typified by strong capacity from many companies to write business in what has been, until recently, a profitable environment.

In a soft market, insurance premiums are typically low as a result of competition, with buyers enjoying reduced premiums year on year. Since 2004, the commercial insurance market has experienced a soft cycle where premium rates generally dropped each year and competition became more intense.



Figure 1. The Australian Insurance Cycle - Source: Public Liability Insurance: Analysis for Meeting of Ministers 27 March 2002 (Trowbridge Consulting) www.treasury.gov.au/documents/269/PDF/trowbridge.pdf

Entering the hard market

A number of recent factors, including a period of large weather event losses and falling investment returns have brought the soft cycle to an end. Figure 2 illustrates the number and the high costs associated with weather-related claims over the last 24 months, including storms and bushfires.

Event	Date	Estimated costs
Victorian Bushfires	February 2009	\$1.12B
North Qld Mackay Floods	February 2008	\$342M
South East QLD Storms	November 2008	\$310M
NSW December hail storms	December 2007	\$415M
NSW Queen's Birthday Storms	June 2007	\$1.5B
North QLD Cyclone Larry	March 2006	\$540M

Figure 2. Australian natural catastrophes Source – The Insurance Council of Australia - Current as at 30 March 2009.

These significant events have resulted in substantial losses to insurers and reinsurers and as a result insurers are facing higher reinsurance costs.

The effect of the change in the global economic environment and in financial markets will also impact insurers who will need to ensure their profitability and protect their capital and credit ratings.

Insurance companies supplement premiums through investment income to help fund the cost of claims and expenses.

As a result, insurance companies need to take insurance and financial market conditions and other factors into account in their pricing decisions.

Factors affecting pricing decisions

While large spikes in rates are not expected, it is anticipated that the market will experience hardening conditions as insurers take various factors into account, including:

1. Investment income on capital and future technical reserves will reduce significantly as a result of the free fall in interest rates;
2. Higher exchange rates for imported goods resulting in inflationary pressures on claims costs ;
3. The ability to buoy profits through reserve releases have diminished as these benefits have largely been factored into company results over the last three years;
4. Increased insolvency and bankruptcy of businesses;
5. Increased underwriting discipline;
6. The impact of recent weather-related losses leading to future increases in reinsurance costs; and
7. Likely increases in fraudulent activity as a result of depressed financial conditions.

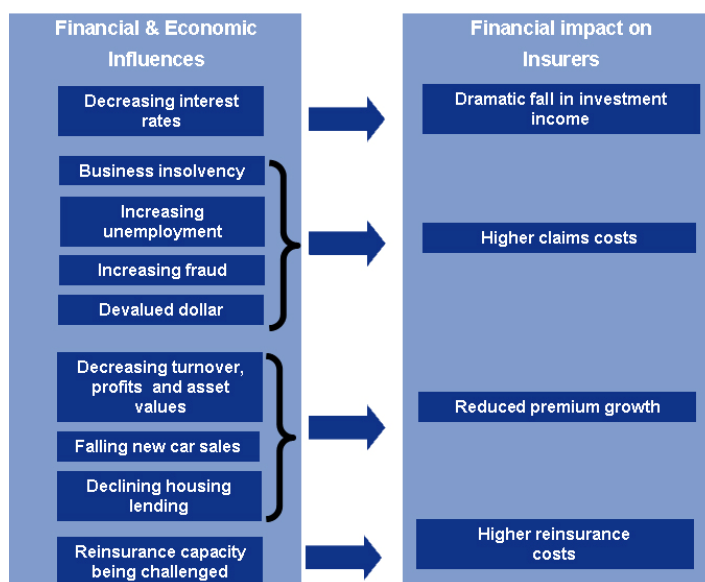


Figure 3. Financial and economic influencers on the insurance market

Beyond the short term, price levels will depend on the economic factors that affect the capital base and profitability of insurers. Figure 4 below illustrates the trend on both loss ratio and combined ratio that is emerging.

What those requiring insurance need to consider

In the current cycle, insurers are better placed than they were at the beginning of the previous market hardening, so it is hoped that the upswing will be less severe. That said rate rises are already taking place in some classes of business, particularly in personal lines and short-tail commercial.

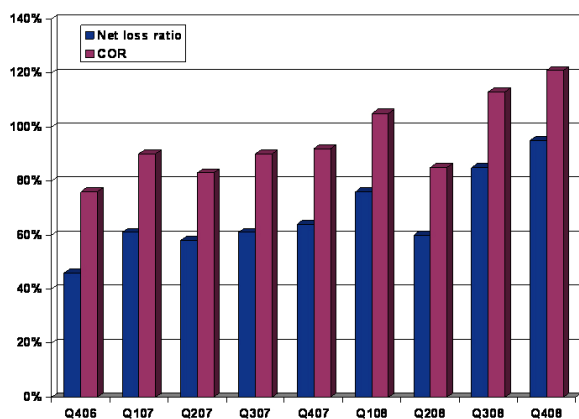


Figure 4. Quarterly Combined Operating Ratios for the Australian General Insurance Market - Source: APRA Quarterly Statistics Bulletins March 2009.

In such a market environment it will be important for insurance buyers to work closely with their brokers to ensure that their organisation's risk profile is optimised and that the level and scope of cover is reviewed for cost effectiveness. Insurers will continue to recognise better risk-managed businesses through the review of the following factors:

1. Sums insured should reflect current values;
2. Turnover and revenue declarations should reflect current business prospects in this economic climate;
3. Consideration of risk retentions/deductibles to mitigate rate increases; and
4. Continual improvement of the quality of risk through risk management disciplines.

In the current market, clients should focus on the longevity and resilience of the security provided by an insurance company.

In January 2009, Standard and Poor's (S&P) confirmed Allianz Australia Insurance Limited's Financial Strength Rating at AA-/Stable.

For further information please contact General Manager - Commercial, Broker and Agency Denis Morrissey on (02) 8258 5382 or denis.morrissey@allianz.com.au