Focus on Australia

Intense competition among insurers in Australia means the market has not hardened, despite a number of natural disasters and growing pressure from climate change. By **Kate Tilley**

Risk management is an established part of the landscape in Australia

ROBERT HARDING PHOTOGRAPHY

Australia has weathered the global financial crisis better than many countries, but has been unable to shelter fully from the storm. As a resources-rich nation, the impact of the global financial crisis on commodity prices has affected Australia, with some major private-sector projects being mothballed. Finance Minister Lindsay Tanner has warned that Australia "still has many economic challenges ahead and is dependent on recovery in the USA, Europe and China".

The crisis has prompted insurers to talk up premium rate rises, according to Richard van Velzen, Jardine Lloyd Thompson Australia's Executive Director of Natural Resources and Construction and Business Development. Insurers are saying that the rise in premium is needed to counter the diminution in investment returns that have bolstered their overall results for the past five years or more. But he has seen "little evidence of a wholesale upward movement", apart from some specialist market segments, for example, trade credit.

Trade credit is hardening significantly with a lack of capacity, as insurers try to reduce their exposure in vulnerable industry sectors. Van Velzen says: "There's a low appetite for trade credit new business. Premium rates and deductibles are increasing, while indemnities are falling." Vulnerable sectors include mining, resources and construction and, to a lesser extent, retail. In the rural sector, the wool industry is finding it "particularly tough" to get credit risk cover.

Where traditional trade credit insurance is unavailable, there has been a focus on alternative risk transfer solutions. John Tippett, Jardine Lloyd Thompson's General Manager, Queensland, says organisations have to "go back to the basics of good risk management. The ultimate goal is to reduce the cost of insurable risk."

Competitive rates remain

Aside from these areas, the market remains soft. Van Velzen says while insurers are seeking rate hikes in property and liability classes, they are "not always successful", particularly given the Australian market's intense competition. Exceptions are property risks like sandwich panelling and offshore energy risk, which have seen substantial local and global losses in the last 12 months, heightening underwriter awareness. In both of these areas, insurers' risk appetite has diminished, reflected in reduced capacities and an increase in rates and deductibles.

But other property/casualty lines are still very competitive. Larger risks that demand greater capacity are more vulnerable, but it is only in sectors with insufficient capacity to drive competition that rate hikes are achievable.

Many companies have downsized as a result of the global economic conditions, with the result that less risk and premium is being transferred to insurers. With the pressure for further cost reductions, Clinton Wright, a Jardine Lloyd Thompson Business Analyst, says many organisations have utilised financial modelling expertise to investigate correlations between increased retentions and premium reductions.

They are also looking to manage risk more effectively within the business. Eddie Stewart, Governance and Risk Manager at Newcastle City Council for over 20 years and now a Senior Risk Consultant with Echelon Australia, a risk consulting firm, says members of the NSW-based Statewide Mutual fund for local authorities, introduced a number of risk management practices, including use of best practice manuals and guidance notes on specific risks, a web-based system for risk identification and regional risk managers.

Wright stresses there is a gulf between a stated policy of risk management and a cultural commitment to it. He says: "It's no good having it at board and upper management level only. Sometimes risk management frameworks are built on sand. In the midst of a global financial crisis is not the time to discover that." He suggests now is the time to revisit the risk management framework to ensure it is sufficiently robust.

> "It's no good having risk management at board level only. Sometimes risk management frameworks are built on sand. In the midst of a global financial crisis is not the time to discover that."
>
> Clinton Wright, Jardine Lloyd Thompson

This needs to be part of a broad enterprise risk management strategy. Australia and New Zealand were early adopters of ERM. They developed a risk management standard, AS/NZS 4360, a decade ago, which was a global first, and Australia is currently spearheading the transition to a global standard, ISO 31000. Australia has a very risk aware culture and greater CEO/board level awareness of the cost of risk. The Australian Securities Exchange requires mandatory risk management reporting by listed companies.

This will stand companies in good stead when rates harden as the impact of Australia's natural catastrophes and overseas insurers' results "wash through". Even organisations with good loss records will be impacted by events that influence the global market.

Australia has witnessed a spate of natural disasters in 2008-09 – fatal fires in Victoria, which have so far generated $A1.07 billion in insured losses, and floods in Queensland and northern New South Wales, with insured losses of about $A413 million. While the losses are significant, they have impacted predominately on domestic portfolios. However, van Velzen says potential litigation for utilities following the fires could "send shock waves through the London market". Specialist liability underwriters for the energy market would be "looking at whether they've got the pricing right". The continent is at the brunt of climate change and risk will increasingly be priced accordingly.

The energy market was also impacted by the 3 June 2008 gas explosion on Varanus Island, off the West Australian coast. Gas supply to WA was reduced for several months. Claims so far have reached $A230 million. As a consequence,

»»

Fires in Victoria are one symptom of the problems caused by climate change

CLIMATE CHANGE

In Australia about 80 per cent of the population lives within 50km of the coast. Scientific evidence shows the country will experience more intense storms, more frequent bushfires, higher sea levels and higher temperatures due to climate change.

The Australian insurance market is acutely aware of the impact of climate change, but that has not yet translated into premium rate changes. Brokers are in the process of information gathering and scenario testing. Ron Barnes, General Manager of Echelon Australia, says the mindset has been forced to change: organisations now need to make decisions based "not on the past but on what's predicted for the future".

Australia has already experienced increased storms and bushfires, which have impacted on self-insured layers in local authority insurance pools.

Directors need to examine their exposure. Jardine Lloyd Thompson Executive Director André Louw says companies exposed to carbon risk need to consider the level of disclosure required before entering into D&O policies and how they minimise risk through compliance and risk management programmes. Companies that can differentiate their carbon risk management will be viewed more favourably by financial risk insurers.

Alice Cahill, Corporate Responsibility Manager at Zurich Financial Services Australia, says the insurer is working with clients to build community resilience. It sees brokers as being at the front line, and hosts education programmes to help brokers understand climate change's ramifications.

> "Potential litigation for utilities following fires could send shock waves through the London market. Underwriters will look at whether they've got the pricing right."
>
> Richard van Velzen, Jardine Lloyd Thompson

van Velzen says that insurers will more closely examine their exposure to cumulative 'contingent' business interruption losses from such incidents.

But while prices may yet harden, the market remains aggressively competitive. Van Velzen says the growth of international insurers and reinsurers in Asia, including Lloyd's syndicates, is putting more pressure on the already competitive Australian market.

Deregulation and liberalisation in Asia, as well as relatively low insurance penetration rates, have proven attractive for insurers. Growth of the market is phenomenal. According to Swiss Re sigma research, in 2008 Japan was ranked second in the world for the value of life and nonlife direct premiums written, at $473 billion, and 20 per cent higher than a year earlier. China, meanwhile, was sixth, with £141 billion, but that constitutes a dramatic 52 per cent rise from the previous year. Compare this to the US where premiums rose 0.22 per cent and the UK where they fell 15.56 per cent in that time.

While Asian expansion seems attractive, van Velzen warns it creates multiple access points for brokers and their clients. If undisciplined or left wanting in the use of global systems or practices, underwriters risk cannibalising their own portfolios by trying to gain market share through their Asian offices at the expense of their more mature London operations. Giving Australian brokers more touch points could simply be another way of creating more competition, he says.

i Richard.vanVelzen@jlta.com.au

Kate Tilley is based in Australia and has been writing on risk for over 20 years. She is contributing editor to *Cover Note* and *The Risk Report*.

Australia's risk rating

Relatively benign is the easiest way to explain Australia's position in the World Risk Review™. Each of the nine perils in the review rates risk at one, two or three out of ten. The only peril for which it rates at three is the assessment for the nation's country economic risk. By comparison, Canada ranks two for this, the United Kingdom three and the United States four.

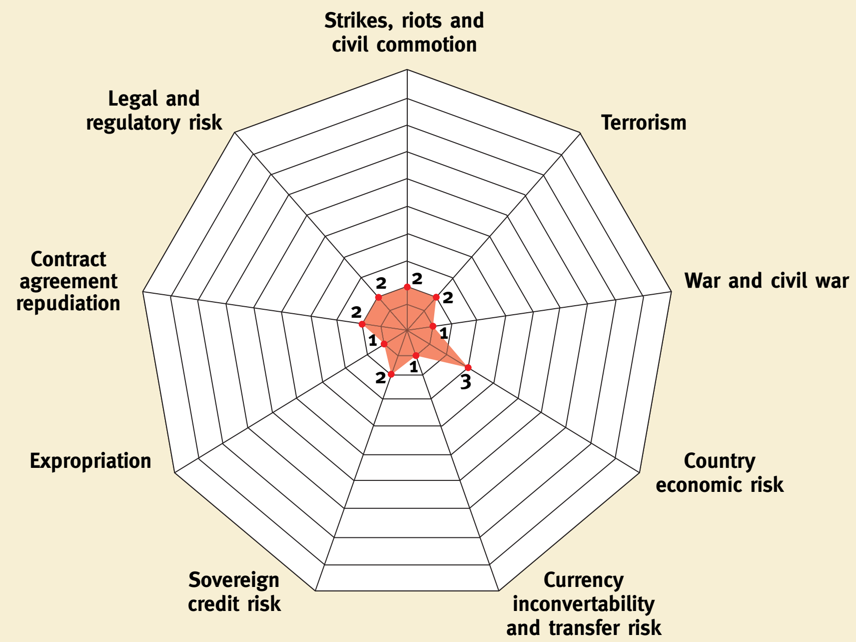
The country economic risk rating is "the most detailed, taking about 20 factors into consideration, including a country's banks' exposure to the credit crunch, GDP, inflation, interest rates, the current account balance, foreign exchange rates, banking sector capitalisation and short-term foreign debt," according to Dr Elizabeth Stephens, Head of Credit & Political Risk Analysis with Jardine Lloyd Thompson in London.

These risks are arguably being tackled by the authorities. The Reserve Bank has dropped interest rates aggressively, and the Federal Government has introduced an economic stimulus package to encourage spending, including embarking on massive infrastructure projects.

Australia's heavily regulated banking sector is "well insulated" against the global financial crisis's impact, particularly compared with some western European nations, and there is less sub-prime mortgage market exposure, according to Stephens. However, as the United States is a major trading partner, the advent of the crisis has impacted Australia's country economic risk.

Mining is a significant contributor to the Australian economy so, with commodity prices sliding, the effect on balance sheet stability has to be considered.

The Australian Government intends to legislate to implement a carbon emission trading scheme. Major greenhouse emitters like the coal industry have said any scheme would be unaffordable in the current climate. It would certainly make the economy less competitive in the short term. "Any moves to reduce emissions will be negative for the mining sector and make it less competitive against mines in Africa, many of which are operated by the Chinese," Stephens says.



World Risk Review™ ratings for Australia

She adds that some Australian companies may also be more reticent about doing business in China, given the Australian Rio Tinto executive who was held on allegations of spying. But she says it is still "an appealing place to invest. The West will tolerate these risks to do business with China." The blurred boundary between the Chinese Government and Chinese corporations is not new. "China is becoming more capitalist, but some things haven't changed, and that's one of them," Stephens says.

She adds that Australian organisations' difficulties in obtaining credit risk insurance have been factored into the calculations for the World Risk Review ratings, but other countries are finding it much harder to obtain coverage. "Some countries are virtually off limits for the credit risk market." RS

World Risk Review™

The World Risk Review™ provides short- to medium-term assessments of the level of risk associated with a range of political and economic perils that may impact upon business.

The risk review rates nine perils in 197 countries and territories, captured under the broad categories of political violence, the trading environment and the investment environment.

The model is designed to enable companies to effectively identify the perils that may impact on their business and deliver an understanding of the relative level of risk associated with each peril, using a scale of 1 (low) to 10 (high).

The model incorporates independently verifiable data from 53 international sources, drawn from Europe, North America, Australia, Asia and the Middle East.

The diversity and breadth of the data sources is intended to reduce, to the greatest extent possible, cultural bias, political influence and personal interpretation.

This approach contributes significantly to the robustness and integrity of the model and recognises that most country risk ratings available to the business have traditionally been heavily influenced by western bias reflecting the historical dominance of western foreign investors and trading businesses.

For more details and to register for this free service go to www.jltgroup.com/worldriskreview