Insurance market update

By Cheryl Richardson, Managing Principal, Marsh Pty Ltd

You will have read the various arguments put forward in the media as causes for the current state of the insurance market.

A number of articles have highlighted the difficulties faced by some businesses and community groups unable to buy insurance cover, citing large premium increases, and closures of sporting clubs. Blame has been apportioned to a number of factors such as September 11, the collapse of HIH, increases in damages payouts, the new APRA requirements and even the activities of your own profession.

So what are the real reasons for the present difficulties in the insurance market? Did the World Trade Centre tragedy really affect the ability to buy Public Liability insurance for the local kindergarten fete? And, importantly, what does this mean for your own insurances?

There is no doubt the September 11 terrorist attacks changed the insurance market considerably. The losses suffered by insurers, estimated between US$60 billion and US$80 billion, have transformed the worldwide insurance market for the immediate and long term future. Major insurers and reinsurers have been severely affected and are now seeking to recover some of their losses, the most common measure being by increasing premiums.

The insurance industry operates in 'soft' and 'hard' market cycles which are intrinsically linked to the investment market. Insurers will tell you that for years they have not made an 'underwriting profit' and that's why they need to increase premiums.

Historically, insurers have actually relied heavily on investment income earned on premiums for their profits. When interest rates are high, insurers seek to gain their market share by offering competitive pricing and broad cover conditions, but when the investment market is depressed, there is a return to the hard market and a greater reliance on technical underwriting processes. This brings increased premiums and cover restrictions and is where the market was heading even before the events of September 11. The investment market was further depressed after September 11, and the recent spate of corporate collapses has acted to further reduce investment returns and increase insurers exposure to substantial losses.

Locally, the collapse of HIH has impacted on the Australian market in a number of ways. There is, of course, the reduced competition following the withdrawal of such a major insurer from the market. HIH was heavily involved in Liability and Professional Indemnity insurance and its exit from the market has left a gap in this area. A number of other insurers have withdrawn from the Australian market in the past few years. St Paul, which was a key player in the Solicitor Professional Indemnity market, withdrew from the Australian market late last year, and other insurers who have previously been involved in this area of business have ceased writing Professional Indemnity insurance in the past few years.

Amidst these developments, the Australian Prudential Regulation Authority (APRA) has implemented its new Prudential Standards for general insurers in Australia. While APRA already had been considering amendment to standards prior to the HIH collapse, it has almost certainly impacted on the extent of the regulations and the requirement for immediate compliance.

The new standards require improved solvency margins for insurers, with an increase in the level of capital required compared to written premium. This is a positive move rightly intended to ensure the long term viability of insurers in Australia and to minimise the potential for another major insurer to collapse. The immediate impact however has been that some insurers who cannot access additional capital, are restricted in the amount of business they can write. This has resulted in a further reduction in available markets with a number of insurers having introduced moratoriums on any non renewal business for the remainder of 2002. Insurers are becoming more selective about risks they do write, and with the capital requirements being greater for long tail business such as Public Liability and Professional Indemnity, some insurers are reassessing their book of business in this area.

A further impact of the HIH collapse and the new APRA requirements for the introduction of safety margins on claims, is many insurers are now taking a more conservative approach to claims reserving. Some claim reserves for long tail business (such as Professional Indemnity) are now reflecting *Maximum Possible Loss* levels, irrespective of the likelihood of successful defence. The longer term benefit of this is insurers are less likely to under reserve for possible losses. However the immediate affect is that the increase in reserves affects premium negotiations as insurers rate premiums according to these increased 'expected' loss levels.

Is there light at the end of the tunnel? It is too soon to tell how long the current conditions will prevail, however if the trends follow history, we should see a softening of the market in the next couple of years. Certainly some of the initiatives introduced by Government provide greater confidence for the future.

So how does this affect the NT legal profession? Marsh is in the process of renewing the Compulsory Professional Indemnity facility for Territory lawyers, and we are negotiating with both local and international insurers to secure competitive terms. You will not be immune to premium increases this year, and there unfortunately have been some significant movement in claims over the past 12 months which directly affect our negotiations. But we are actively pursuing the market for favourable terms and are working hard to minimise any increases to your premiums this year.

In any market, soft or hard, good risks will receive preferential treatment from insurers. Now more than ever it is important to implement and maintain sound risk management practices. We are currently working with the Law Society to develop further risk management programs to assist all firms in their management of risk. We encourage you to actively become involved with these programs for the benefit of your own firm and the profession as a whole. ①