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# Media Release

## FOR IMMEDIATE RELEASE

# Insurance industry profitability unchanged in 2008 but increased claims expected to pressure '09 profits

**20 January 2009:** The J.P. Morgan Deloitte 2008 General Insurance Industry Survey released today highlighted that profitability in the industry remained unchanged from 2007 with an overall combined ratio of 94%. "However there was a noted difference between classes, with participants expecting sharp improvements in combined ratios in personal lines, coupled with significant deterioration in long tail commercial lines," said Siddharth Parameswaran, J.P. Morgan Senior Insurance Analyst.

"Whilst combined ratios may hold up, we believe there will be added pressure on profits at least in the short term from the effects of the financial crisis on both claims and falling yields," he said.

Deloitte partner, Stuart Alexander who co-launched the survey, pointed to the weaker economic outlook saying it is expected to have an adverse impact on claims. "A number of respondents indicated that the poor economic outlook for 2009 was a concern," he said.

"Generally speaking, the number of fraudulent claims and litigation tends to increase during weak economic conditions, which can then have an impact on Professional Indemnity, Director's and Officers, Workers' Compensation and Commercial Property insurance," Alexander said.

Parameswaran noted that some classes such as motor and householders' could actually face lower claims costs as in adverse economic conditions, there is often reduced vehicle usage and lower building costs.

In 2008 claims frequency did increase in a number of classes primarily due to one off events such as storms which impacted personal lines (motor and home) in particular. Claims frequency in the long tail liability classes (such as professional indemnity and directors and officers) also increased a little. In this instance respondents indicated that weakening economic and financial market conditions may have resulted in increased claims.

"Industry participants are expecting rates to rise and storm costs to normalise," Parameswaran said. "I think the direction forecast for loss ratios is right and that rates are rising and reinsurers will pick up a large part of any storm damage costs in 2009. Also public and product liability will tick up. The extent to which they do is contingent on the state of the economy and financial markets."

Parameswaran added: "We think there will be more pressure on profits this year before an uptick in 2010." He also commented that in his view "general insurance companies are likely to face less financial pressure stemming from the financial crisis than life insurers and banks."

“However, we expect there will be some pain for insurers and reinsurers that have exposure to commercial, long tail insurance lines in particular. How insurers deal with these stresses depends ultimately on how quickly they move to increase rates.

We believe the classes where rates are likely to rise the fastest are those where capacity is constrained and there are significant barriers to new entrants. Also where there has been significant consolidation, there is a more rational, less competitive environment. In addition losses are always a good excuse for rate increases.

“We suspect that it will take a few months at least before adequate rate increases flow through, implying some short term pain to insurance margins.”

**Rates in 2008**

The survey revealed that in 2008 premium rates in commercial classes continued to fall with long tail rates down by an average of 7% on top of the 10% reduction in 2007. Short tail rates however, bottomed out in 2008, picking up 1% compared to a 7% fall last year.

“We do expect commercial rates to turn in 2009 given the deterioration in profitability in some lines, coupled with expectations for higher claims costs and falling yields as a result of tougher economic conditions. Survey respondents also expect to see commercial rates bottom in 2009 and increase in 2010,” Parameswaran said.

Premium rates in the personal lines increased in 2008 and are expected to continue to rise. “Rates in personal lines increased 3% on average in 2008, compared to no movement in 2007. This was due to accumulated storm losses in 2007 and 2008 encouraging increases,” he explained.

Parameswaran said: “We expect rates to continue to rise in the coming year given falling investment yields, the fact that the Australian market is dominated by a few large players, and their consensus that rates in personal lines need to increase.”

## Top five issues for the industry in 2008

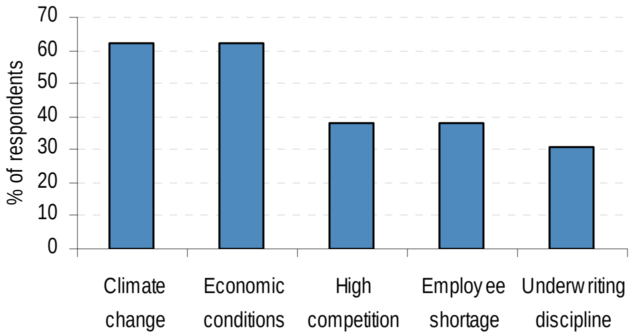
For the third consecutive year the J.P. Morgan Deloitte General Insurance Industry Survey asked respondents to nominate and rank the five most important issues impacting their business.

Stuart Alexander said: “In 2008 economic conditions became the most important issue along with climate change for underwriters (60%) and as the standout issue for brokers (71%).

“Economic conditions were not mentioned in the top five in 2007 for either group. Climate change moved from fourth place in 2007 and 2006 to equal first with economic environment for underwriters,” he said.

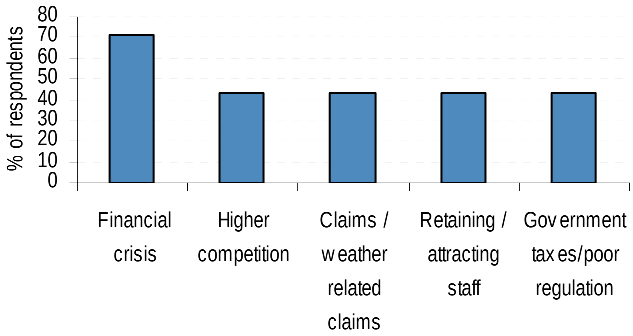
**Market environment:** Underwriters noted that increased claim costs caused inflation in some long tail classes and most short tail classes. Underwriting discipline was also a critical factor in maintaining profitability.

Figure 1: Top issues facing the underwriters in 2008




Source: 2008 General Insurance Survey

Figure 2: Top issues facing the brokers in 2008

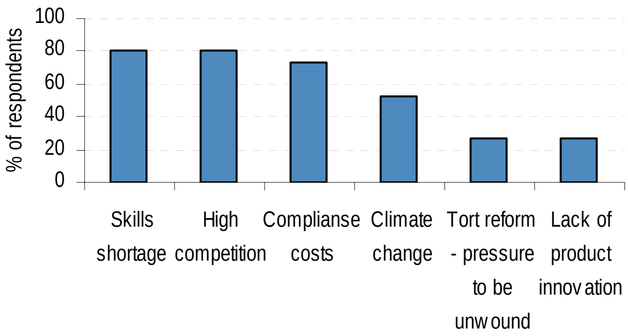



Source: 2008 General Insurance Survey

**Competition:** Competition continued to be an issue for the industry as a whole although it slipped from being No 1 in 2007 to third place in 2008, on a par with skill shortages. For brokers, competition was equal second along with skill shortage, claims & weather related claims, and regulation & taxes.

Underwriters expect the soft market of 2008 to harden in 2009/10 in line with credit concerns, identifying the construction and SME markets as some of the most competitive. Motor insurance was singled out for mention, and participants pointed to increasingly sophisticated pricing models as the cause of even more intense competition. Brokers pointed casualty classes which are also the most profitable as also most competitive. They also identified the fact that larger “international players” were attempting to carve out a niche in the SME space where they have not traditionally entered.

Figure 3: Top issues facing the industry in 2007




Source: 2008 General Insurance Survey

**Skill shortage:** The fall out from the credit crunch should open up the talent market in 2009/2010 making the short supply of more experienced staff and the high turnover of junior staff of less concern to the industry than it has been to date.

**Regulation:** Most underwriters expressed their comfort with the proposed APRA refinements to the General Insurance Framework.

Comments included: “To have a viable industry, changed regulatory requirements must be ongoing and therefore we will wait and see how these refinements will impact us.”

“The positives of a "principles" based approach are that insurers are able to create a compliance framework that suits the size and complexity of the enterprise. The negatives are that different insurers have a different interpretation and level of activity required to meet the principles which may create an uneven playing field. Insurers will be required to constantly examine and refine practices to ensure compliance with the principles.”

**The J.P. Morgan/Deloitte 2008 General Insurance Survey outlook in summary**

1. **Industry profitability unchanged in 2008 and will modestly deteriorate in 2009 –** The industry's overall combined ratio remained at 94% in 2008 and 2007 with 2009 forecast at 96%. Respondents noted high storm activity, couple with reserve releases as responsible – also noting that they expected both to reduce in the future. There was a significant difference between classes with participants expecting sharp improvements in personal lines and significant deterioration in long tail commercial lines.

2. **Premium rate in the commercial classes are stabilising –** Rates in the long tail classes fell further during 2008, although the trajectory of rate reductions slowed. Long tail rates fell 7% on average compared with 10% in 2007. Rates in short tail commercial classes bottomed in 2008, with, short tail commercial rates increasing by 1% this year compared to a 7% fall in 2007. Commercial rates are expected to bottom or turn in 2009 given the deterioration in profitability in some lines, coupled with expectations for higher claims costs and falling yields as a result of tougher economic conditions. Survey respondents expect commercial rates to increase in 2010.

3. **Premium rates in the personal lines increased, and are expected to continue to rise.** Rates in the personal lines increased 3% on average this year, compared to a 0% move in rates last year (mainly as a result of 2007 rate reductions in CTP after regulatory change). We expect rates to continue to rise in the coming year. Lack of profitability in NSW CTP, and changes in profitability in QLD CTP were a major concern and large rate rises would be needed to restore former margins.

4. **Weaker economic outlook could have adverse impact on claims.** A number of respondents indicated that a poor economic outlook for the coming year was a concern. Generally speaking, the number of fraudulent claims and litigation increases during weak economic conditions, which can have an impact on Professional Indemnity, Director's and Officers, Workers' Compensation and Commercial Property.

**For more information:**

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## About the J.P. Morgan Deloitte General Industry Insurance Survey:

The J.P. Morgan Deloitte General insurance Survey has for the past 16 years provided a detailed overview of the current state of the Australian general insurance industry, by the industry, for the industry and covers the industry's expectations of the way ahead.

The report delivers critical information on the key elements of the industry from direct underwriters, reinsurers and brokers, including:

- detailed product information for the current period and industry expectations for the next two years covering issues such as premium rate trends, capacity changes, claims inflation, loss and expense ratios
- perceptions of product profitability
- distribution trends
- broker's perceptions of underwriters.

This year the Survey also gauges the industry's view of the impact of regulation and insight into those areas which insurers expect to obtain operating efficiency gains. Survey participants were also asked to comment on coverage of minimum regulatory capital requirements.

The Survey also provides editorial comments from J.P. Morgan and Deloitte on key industry issues as a commentary on industry developments to compliment the survey results and respondent feedback.

## Sources of Information

All of the information in the report is sourced from a survey of the major underwriters, reinsurers and brokers in the Australian general insurance industry. J.P. Morgan and Deloitte estimate that the survey's participants account for more than 75% of the total industry, thus making the document a comprehensive review of the industry's expectations.

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