

J.P.Morgan

Australia Equity Research

21 January 2010

## 2009 General Insurance Industry Survey

Direct Underwriters, Reinsurers and Brokers



---

### Insurance

**Siddharth Parameswaran**<sup>AC</sup>

(61-2) 9220 1596

siddharth.x.parameswaran@jpmorgan.com

**Paul Mobilio**

(61-2) 9220-1920

paul.d.mobilio@jpmorgan.com

J.P. Morgan Securities Australia Limited

---

### Deloitte

**Elaine Collins**

(61-2) 9322-7533

elcollins@deloitte.com.au

**Stuart Alexander**

(61-2) 9322-7155

stalexander@deloitte.com.au

---

This is the result of a joint research effort between J.P. Morgan and Deloitte

J.P.Morgan

**Deloitte.**

**See page 143 for analyst certification and important disclosures, including non-US analyst disclosures.**

J.P. Morgan does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

[www.morganmarkets.com](http://www.morganmarkets.com)

## Table of Contents

<b>Executive Summary .....</b>	<b>3</b>
<b>Survey Description.....</b>	<b>4</b>
<b>Rate rises come through; 2009 a poor year .....</b>	<b>6</b>
<b>Economy turnaround- positives for insurers.....</b>	<b>15</b>
<b>Capacity &amp; competition provide problems.....</b>	<b>24</b>
<b>The challenge of claims management: forecasting the 20% .....</b>	<b>34</b>
<b>Capital and enterprise risk management linkages: adds up to performance .....</b>	<b>39</b>
<b>Lessons learned: and the changing global regulatory landscape for insurers .....</b>	<b>44</b>
<b>Issues Confronting the Underwriters .....</b>	<b>48</b>
<b>Issues confronting the Brokers.....</b>	<b>49</b>
<b>Issues Confronting the Reinsurers.....</b>	<b>50</b>
<b>Survey Participants .....</b>	<b>51</b>

## Executive Summary

We highlight here the key themes to emerge from the 2009 survey and our analysis:

- 1. Profitability collapsed in 2009; but it should be the nadir for returns.** The 2009 financial year was a bad one for insurance reported profits. Our survey respondents reported an industry combined ratio of 101%, compared to 94% in 2008, worse than their forecast in the previous survey of 96%. The trends were affected by catastrophe activity, adverse discount rate movements, and reserve releases. The trends were worst for personal /domestic lines with a combined ratio of 102%, compared to commercial lines at 95%. The industry forecasts the combined ratios to improve to 95% in 2010, driven by sharp improvements in ratios in personal lines, coupled with flat trends in commercial lines. Participants expressed most concern with the CTP and Workers' Compensation classes (combined ratios 100 or higher in 2009). Reserve releases in those classes are reducing, and in the latter, premium rates continue to fall.
- 2. Premium rates increasing almost everywhere in response.** Premium rates in 2009 rose in all classes, except workers' compensation. Personal lines rates showed the strongest increases (8% overall, driven by householders' and CTP increases). Commercial classes showed more moderate increases (4% in total, the greatest increases were at the SME end). The rises in personal lines represents the industry trying to restore profitability after sustained large claims activity above allowances for the last 2 -3 years. The increases in the commercial markets reflects some financial discipline in the industry, willing to respond to the impact of the financial crisis and reducing reserve releases before they are reflected in poor reported combined ratios. Survey respondents expect to see the strong premium rate increases continue into 2010. We believe these are likely to be tempered somewhat by increased competition in personal lines, and a continued weakness in the global commercial insurance rates cycle.
- 3. Claims trends.** There was some concern amongst participants about superimposed inflation emerging in CTP (11% inflation in total), workers' compensation and professional indemnity. There were also considerable reserve releases evident in long tail lines, with this trend masking some of the reported results in CTP and workers' compensation, in particular. superimposed inflation trends in general liability appear limited at the moment. In the short tail lines, claims trends in motor were impacted by the low Australian dollar leading to increased inflation. The 2009 bushfires hurt trends in home and Fire / ISR.
- 4. The modest downturn in the economy a concern.** A number of respondents indicated risks on the economic outlook as a cause for concern. Generally speaking, the number of fraudulent claims and litigation increases during weak economic conditions, which can have an impact on Professional Indemnity, Directors and Officers, Workers' Compensation and Commercial Property. Although no doubt the concerns here are less than feared in March 2009, we still have doubts whether the full impacts of losses, in particular for Directors and Officers, have been factored into the 2009 combined ratios. Yields are still lower than in 2008 and as such running investment yields are likely to still be somewhat depressed relative to their long-run levels.

## Survey Description

This is the seventeenth edition of the J.P. Morgan Deloitte General Insurance Survey.

The 2009 J.P. Morgan Deloitte General Insurance Survey provides a detailed overview of the current state of the Australian general insurance industry and the industry's expectations. The report conveys analyses on the key elements of the industry from the perspective of 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 trends, loss and expense ratios
- perceptions of product profitability
- distribution trends
- practitioner views on key issues affecting the industry and particular classes
- broker's perceptions of underwriters.

**As has been our longstanding custom, we have also provided editorial comments from J.P. Morgan and Deloitte on key industry issues which serve as a commentary on industry developments to complement the survey results and respondent feedback.**

### Sources of Information

All of the information in this report is sourced from a survey of the major underwriters, reinsurers and brokers in the Australian general insurance industry. A complete list of the participating companies is contained at the end of this report.

The survey is the seventeenth consecutive data collection and accordingly there is now a substantial body of trend data available and many of the comments and observations in the body of the report have been drawn from this information.

### Acknowledgments

This report has been produced with the support of the Australian insurance industry. The insurance industry's support has been generous and is greatly appreciated.

The J.P. Morgan and Deloitte teams hope you find this a valuable reference.

# Part 1: Editorial Comments

## Rate rises come through; 2009 a poor year

Siddharth Parameswaran and Paul Mobilio, J.P. Morgan

### Rates in 2009 increased - as expected

Rates in commercial lines finally turned in 2009 – rising 4%.

They had fallen 2% in 2008, having been on a downward trend since 2004.

Personal lines rates rose 8%, led by CTP and home classes

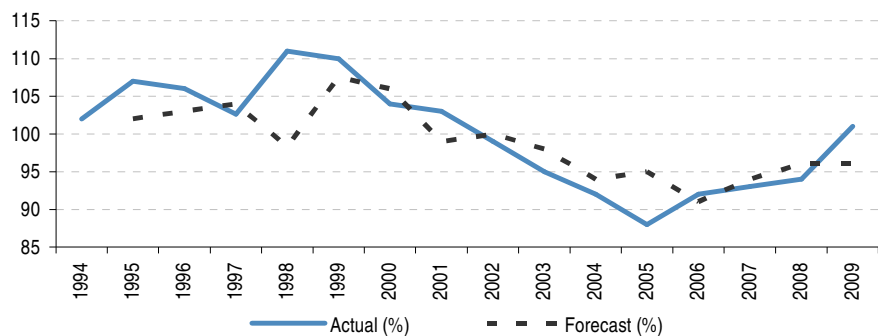
Last study, the insurance industry and ourselves predicted a turn in the insurance cycle in 2009 (commercial lines in particular, which had been falling since 2004). This appears to have borne out according to this year's survey. Premium rates increased across both domestic / personal lines and commercial lines – despite continued comments that competitive pressures were evident from both domestic and offshore players. No doubt much of the impetus for rate rises was triggered by the continued above average large event activity affecting short tail lines, and concerns on the impact of the financial crisis on claims and investment returns of long tail lines. **For the year to June 2009, domestic /personal lines rates increased on average by 8%, while commercial rates increased for the first time by 4%.** Of most concern is workers' compensation (all states) where premium rates are continuing to decline, driven by excessive competition in the search for top-line growth. The industry overall is forecasting further rate increases in 2010 for both personal and commercial lines.

### Combined ratios in 2009 were poor

The premium rate increases are needed given tough combined ratio trends in 2009

Combined ratios<sup>1</sup> in the industry in 2009 jumped up sharply, to 101%, impacted by bush fires affecting home and property classes, and the effects of falling government bond yields on long tail lines (from greater valuations on discounted outstanding claims). The trends were worse than the industry was expecting in the 2008 survey, largely in our view due to an underestimation of the impacts of the financial crisis (particularly on yields).

Figure 1: Combined Ratio Trends Time-series (Actual vs. Expected from preceding survey)



Source: 2009 and prior General Insurance Surveys

<sup>1</sup> Combined Ratios are (Claims costs incurred net of reinsurance as + all other expenses)/(net earned premium)

Table 1: Actual Historical Combined ratios by Class

(%)	2007A	2008A	2009A
<b>Domestic classes</b>			
Domestic motor	89	93	91
Householders	96	91	108
CTP (NSW)	100	112	125
CTP (QLD)	86	103	101
<b>Commercial classes</b>			
Fire & ISR (Commercial property)	92	99	99
Commercial motor	103	103	98
Public & Product Liability	88	84	88
Workers' compensation (WA only)	90	94	100
Workers' compensation (TAS, NT & ACT)	93	95	91
Professional indemnity	92	86	84
Directors & officers	76	88	109
<b>Total</b>	<b>94</b>	<b>94</b>	<b>101</b>

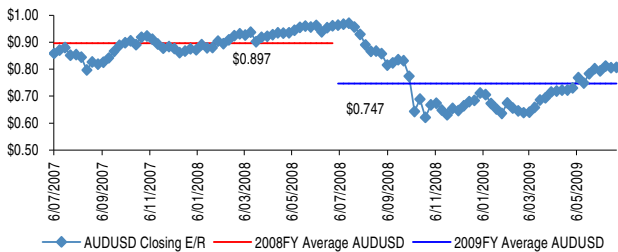
Source: General Insurance Surveys (2007-2009)

The trends by class shown above indicated that CTP, Householders, WA Workers' Compensation and Directors & Officers prima facie showed the most concerning trend in combined ratios.

**Claims inflation moderate – some concerns in CTP**

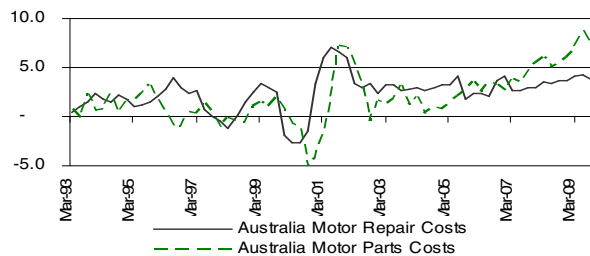
Claims inflation for the year remained at similar levels to 2008 in all classes except CTP and Professional Indemnity. Claims inflation in the motor classes in 2009FY was 4% (CPI 3%), which was in part inflated by the weaker A\$ through large parts of 2009.

Figure 2: Exchange Rate 2009FY vs 2008FY



Source: Iress

Figure 3: Inflation in Motor Vehicle Parts across Australia



Source: ABS

**Motor inflation hurt by weak exchange rates, home hurt by bushfires.**

**Inflation concerns are greatest for CTP, followed by Professional Indemnity.**

**Liability showed inflation – but from a very low base**

**Frequency trends are of most concern in CTP and professional indemnity.**

Home insurance was affected by the bush fires – with inflation at 5%. CTP showed quite adverse trends, with respondents suggesting 11% inflation in both NSW and QLD.

Short tail commercial lines were in check with inflation of only 3%. However, some of the commercial long tail lines showed some inflation seeping through, with inflation in Workers' Compensation at 7%, Liability at 6% and Professional Indemnity at 8%. These levels would be a concern if they were sustained for a few years. The recent inflation experience of these commercial classes has been very favourable.

**Frequency rose for CTP and Professional Indemnity as well**

Claims frequency trends also appeared adverse in CTP classes (+4% NSW, +9% QLD) and Professional Indemnity (+10%). Respondents indicated that weakening economic and financial market conditions may have resulted in an increase in claims

in Professional Indemnity, whilst it appears that in the CTP classes there was increased success in claiming compensation on smaller claims. There are mixed views on the likelihood of this continuing in the CTP classes. We are also concerned about Directors and Officers class where there still remains the risk of notifications turning into full blown claims.

Table 2: Selected data from 2009 survey – Changes over the year

2009 (%)	Premium rates	Claims Inflation	Claims frequency
Domestic classes			
Domestic motor	5	4	1
Householders	10	5	0
CTP (NSW)	10	11	4
CTP (QLD)	14	11	9
<b>Weighted average</b>	<b>8</b>	<b>6</b>	<b>1</b>
Commercial classes			
Fire & ISR (Commercial property)	5	3	2
Commercial motor	10	4	0
Public & Product Liability	1	6	2
Workers' compensation (WA only)	-6	7	-8
Workers' compensation (TAS, NT & ACT)	-5	5	-9
Professional indemnity	4	8	10
Directors & officers	6	3	1
<b>Weighted average</b>	<b>4</b>	<b>5</b>	<b>1</b>

Source: 2009 General Insurance Survey

### Normalising results suggests CTP & WA Workers' concerns

We have for the first time asked industry participants to try and strip out the impacts of one-off factors such as event costs differing from their expectations, the impact of reserve releases and the impact of interest rates. In 2009 there were considerable one-off impacts from all these factors. These adjustments are shown in the following table.

Of most concern are the NSW / QLD CTP and WA Workers' Compensation classes, where the normalised combined ratios are well over 100% (131%, 116% and 109% respectively). If these are the true underlying starting points, considerable remediation is needed in these classes to meet reasonable return on equity targets.

The householders' and Fire / ISR class returns appear modest after adjusting for events (as opposed to prima facie weak trends). We would caution however that recent trends have been poor for some time and there appears to have been a re-estimation in the industry of the expected costs of events.

**2009 Normalised combined ratios in CTP and WA Workers' Comp are very high.**

Table 3: Normalising the 2009 Actual Combined Ratio for Reserve Releases and other One-offs

(%)	Reported CoR (2009)	less Abnormal reserve (releases) / additions	less Abnormal event activity above / (below) 'normal' allowances	less Impact on loss ratio from 'real' moves in interest	Normalised CoR (2009)
<b>Domestic classes</b>					
Domestic motor	91	0	4	0	87
Householders	108	0	10	1	97
CTP (NSW)	125	(19)	na	14	131
CTP (QLD)	101	(23)	na	8	116
<b>Commercial classes</b>					
Fire & ISR (Commercial property)	99	(1)	3	0	97
Commercial motor	98	(1)	2	0	97
Public & Product Liability	88	(11)	na	9	90
Workers' compensation (WA)	100	(15)	na	6	109
Workers' compensation (TAS, NT & ACT)	91	(15)	na	6	100
Professional indemnity	84	(8)	na	6	86
Directors & officers	109	(7)	na	7	109

Source: J.P. Morgan estimates, 2009 General Insurance Survey

### Looking forward: Rate increases to continue

Clear signs that the industry is starting to raise commercial rates – but only modestly...

Personal lines rate increases may continue.

The industry has in 2009 shown that it is willing to respond to weaker levels of profitability through action on prices. Whilst there were increases across the board, we saw particularly strong rate increases in CTP of up to 14% (Queensland), and 10% again in commercial motor. The only concerning class is Workers' compensation in WA, where rates continue to decline, despite legislation changes that were expected to increase benefit costs.

For 2010, the industry in personal lines is forecasting weighted average rate increases of 7%, a reasonably healthy increase given rising yields on investments. We have our doubts on the ability of the industry to achieve the quantum of increases sought due to increased competition in some classes, and regulatory pressures in the CTP classes keeping a lid on premium rates.

In commercial classes, the industry is seeking greater price rises in 2010 than was achieved in 2009. Many have commented however that there remains considerable capacity in the industry at the moment – and we suspect that this may place an upper limit on the ability of the industry to achieve these increases.

Table 4: Historical premium rate movements and expected rate movements

(%)	2007A	2008A	2009A	2010F	2011F
<b>Domestic classes</b>					
Domestic motor	2	3	5	5	4
Householders	4	4	10	9	7
CTP (NSW)	-12	-3	10	9	7
CTP (QLD)	-1	3	14	15	7
<b>Weighted average</b>	<b>0</b>	<b>3</b>	<b>8</b>	<b>7</b>	<b>6</b>
<b>Commercial classes</b>					
Fire & ISR (Commercial property)	-9	-3	5	6	5
Commercial motor	-2	9	10	6	5
Public & Product Liability	-10	-6	1	4	4
Workers' compensation (WA only)	-14	-12	-6	8	5
Workers' compensation (TAS, NT & ACT)	-11	-8	-5	6	4
Professional indemnity	-9	-7	4	8	6
Directors & officers	-8	-6	6	9	7
<b>Weighted average</b>	<b>-8</b>	<b>-2</b>	<b>4</b>	<b>6</b>	<b>5</b>

Source: 2009 General Insurance Survey

Rate rises expected to be strongest in personal lines (seeking +7% in personal lines, +6% in commercial lines)

### 2009 should be nadir for returns... recovery on the way.

Overall, we believe that 2009 should be the nadir for insurance returns. The rising premium rates, along with rising investment yields, a relatively benign inflation outlook and a positive economic outlook should help restore some level of profitability to the industry. We suspect however that 2010 will not summon a return to levels of profitability seen through the mid parts of the decade. There are still (1) some concerning classes that will weigh on profitability including CTP NSW, CTP QLD, WA Workers' Compensation and Director's and Officers & (2) the impact of reducing reserve releases. Whilst premium rates are forecast to continue to rise according to the industry, we suspect that the extent of increases may be kept in check by surplus capacity globally.

Rate increases should result in some turnaround in profitability.

The industry's actual combined ratios (based on our survey of respondents), and their forecasts going forward are shown below.

Table 5: Combined ratios

(%)	2007A	2008A	2009A	2010F	2011F
<b>Domestic classes</b>					
Domestic motor	89	93	91	85	85
Householders	96	91	108	90	89
CTP (NSW)	100	112	125	110	109
CTP (QLD)	86	103	101	118	109
<b>Weighted average sub total</b>	<b>92</b>	<b>95</b>	<b>102</b>	<b>92</b>	<b>91</b>
<b>Commercial classes</b>					
Fire & ISR (Commercial property)	92	99	99	96	95
Commercial motor	103	103	98	94	95
Public & Product Liability	88	84	88	90	89
Workers' compensation (WA only)	90	94	100	100	99
Workers' compensation (TAS, NT & ACT)	93	95	91	95	95
Professional indemnity	92	86	84	91	88
Directors & officers	76	88	109	87	86
<b>Weighted average sub total</b>	<b>94</b>	<b>95</b>	<b>95</b>	<b>94</b>	<b>93</b>
<b>WEIGHTED AVERAGE TOTAL</b>	<b>94</b>	<b>94</b>	<b>101</b>	<b>95</b>	<b>94</b>

Source: General Insurance Surveys (2007-2009)

Table 6: Change in the combined ratio

(%)	2008A	2009A	2010F	2011F
<b>Domestic classes</b>				
Domestic motor	4	-2	-6	0
Householders	-5	17	-18	-1
CTP (NSW)	12	14	-16	0
CTP (QLD)	17	-2	17	-8
<b>Weighted average sub total</b>	<b>3</b>	<b>6</b>	<b>-10</b>	<b>-1</b>
<b>Commercial classes</b>				
Fire & ISR (Commercial property)	6	0	-2	-2
Commercial motor	0	-5	-3	0
Liability	-8	3	3	-2
Workers' compensation (WA only)	4	7	0	-1
Workers' compensation (TAS, NT & ACT)	2	-5	4	0
Professional indemnity	-6	-2	6	-3
Directors & officers	12	20	-22	-1
<b>Weighted average sub total</b>	<b>1</b>	<b>0</b>	<b>-1</b>	<b>-1</b>
<b>WEIGHTED AVERAGE TOTAL</b>	<b>0</b>	<b>7</b>	<b>-6</b>	<b>-1</b>

Source: 2009 General Insurance Survey

**Industry combined ratios in FY09 deteriorated substantially on the previous period due to householders' and CTP (NSW)**

The industry has reported an overall combined ratio of 101% in FY09, considerably worse than the 94% in FY08. They are forecasting an improvement overall back to 95% in FY10.

**Forecasts for the future appear optimistic to us in both commercial and personal lines.**

Domestic classes had poor trends in FY09 (worsening 6 pts – due to home losses from events such as the bushfires and NSW CTP from inflation, inadequate pricing and the impact of yield curve moves). Commercial lines meanwhile showed combined ratios that were largely flat in total.

The improvement in combined ratios going forward according to the industry is expected to be strongest in domestic classes in 2010 (10pts). Whilst we are not surprised with the direction, we are sceptical about the industry's ability to achieve the extent of improvement forecast, particularly given some of the concerns in profitability in the CTP classes. We suspect home insurance combined ratios will improve substantially on the back of premium rate increases.

Commercial classes are forecast by the industry to recover modestly, with the short tail classes showing the strongest improvements. Directors and Officers ratios are expected to improve dramatically (22 pts). This may hold if current reserving levels on the class are adequate. We however believe that there remains a risk of adverse development on claims if some of the reports of a very large increase in lodgements by litigation-funders prove to be well founded. Combined ratios in liability and professional indemnity are likely to deteriorate in our view (as forecast by the industry) on the back of declining reserve releases.

## Changes in Capacity

The change in capacity can be seen as a measure for the change in the level of appetite to write business in a particular line (which reflects the level of competition in the market place). This year (for the first time) – we restricted this question to brokers only as they would be in a better position to analyse capacity than underwriters.

In the domestic classes, the level of capacity has increased in both home and motor. The industry is forecasting the increase in personal lines capacity to continue in the following year, particularly in householder. The increase in personal lines capacity is interesting as it was not predicted in the last survey, despite the increase in

advertising noticeable in 2009 from the likes of Youi and Real Insurance. The increase in home insurance capacity we suspect reflects expansion of coverage (e.g. through different players offering flood insurance). In our view, the personal lines market is essentially an oligopoly market dominated by three large underwriters. As a result, the personal lines market should not experience the level of price-based competition seen in the commercial markets. In addition, the oligopoly structure of the market gives us some level of comfort that rates in the personal lines will continue to increase in the short run. Large personal lines underwriters have publicly indicated that rates need to increase in personal lines in order to offset previous large weather-related claims.

In commercial lines, capacity has increased in some classes but at a lower rate than in previous years. Some respondents noted this year that competition from offshore participants increased in a few of the long tail, liability and professional indemnity classes. In a worrying sign, the market now expects capacity to continue to increase in some commercial lines - which is opposite to the view expressed in the previous survey. This we suspect may continue to place a dampener on premium rates going forward.

**Some increase in capacity in professional indemnity and directors and officers in commercial lines.**

**Capacity is forecast to continue to increase into the future – which may place a dampener on premium rate increases going forward.**

**Table 7: Changes in capacity**

(%)	2007A	2008A	2009A	2010F	2011F
<b>Domestic classes</b>					
Domestic motor	4	0	3	1	1
Householders	1	1	4	4	4
CTP (NSW)	1	0	0	0	0
CTP (QLD)	2	0	0	0	0
<b>Commercial classes</b>					
Fire & ISR (Commercial property)	4	6	1	0	1
Commercial motor	4	2	0	0	0
Public & Product Liability	13	-1	0	5	5
Workers' compensation (WA only)	2	0	1	1	1
Workers' compensation (TAS, NT & ACT)	2	0	0	0	0
Professional indemnity	11	9	2	0	0
Directors & officers	10	7	3	2	2

Source: General Insurance Survey (2007-2009) - responses from brokers only

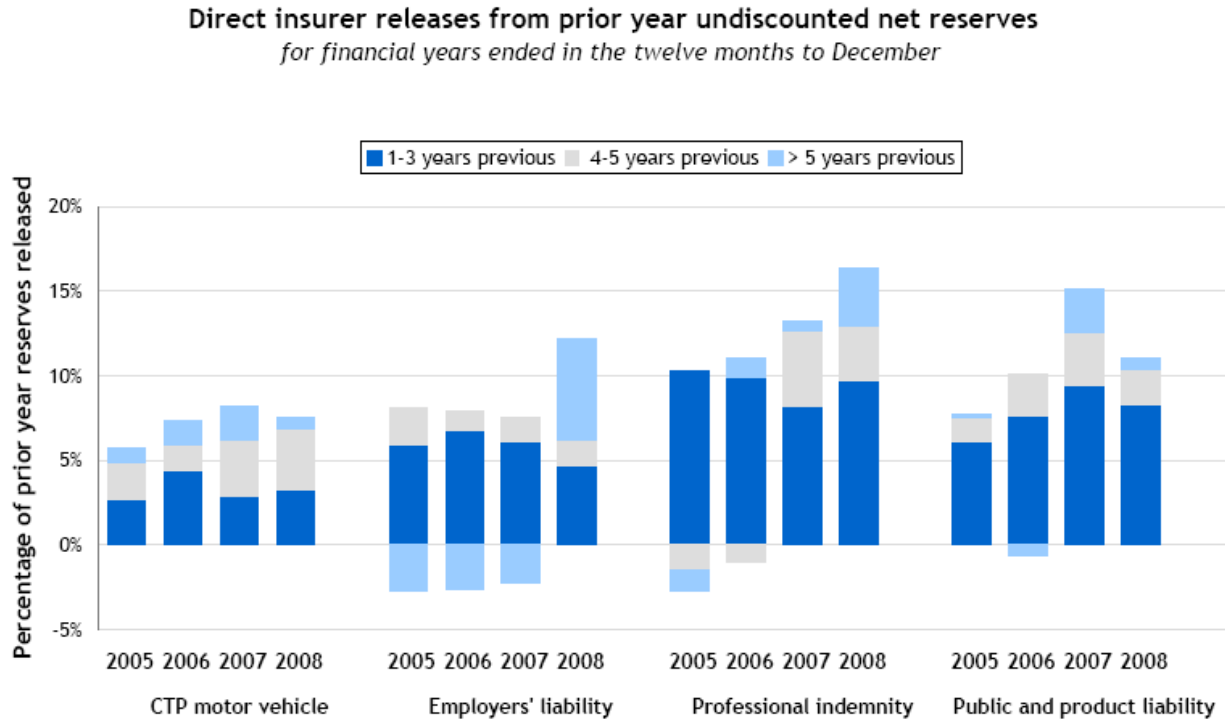
**The reserving cycle**

Reserve releases have been a feature of insurance results for a number of years. The impact of tort reforms has had a beneficial impact on long tail claims, allowing underwriters to release redundant reserves to support profitability. Reserve releases were once again a feature of insurance results in the year to June 2009 (Table 3). However, we believe that reserve releases have slowed. A few listed insurers have in fact indicated that reserve releases in the coming periods will be substantially lower than in prior years. We show below some graphs from APRA that indicate just how substantial a proportion of recent insurer profits they have been.

**Reserve releases were such a major part of previous results and must now be slowing.**

**Long tail lines will face the greatest threat to their margins from this...**

Figure 4: Prior Year Reserve Releases as % of Prior Year Reserves



Source: APRA

Whilst the reserve releases have been substantial in 2009 again in the long tail classes – there are signs that they are reducing. In CTP, the 2008 reserve releases reduced compared to 2007. In Employers liability, reserve releases on the more recent accident periods have started to reduce. The same trends are evident in professional indemnity and public liability. We expect the reserve releases in the CTP class to be negligible in coming years. Survey participants have indicated there remains concern on those classes (some expressed concerns about NSW, others about QLD). We are also keen to see how the reserving trends in directors and officers will trend going forward particularly if there are some large losses relating to Side C covers.

### The impact of the economy

There have been a number of comments in this year’s survey about continued concerns about the impact of possible deterioration in the economy. **We are much less concerned this year than when we were last year, as the economic downturn appears to be much more benign than was forecast by us and others.** We discuss these issues in much more detail in the next article. Key points to note are:

- Investment returns on a run- rate basis (i.e. excluding capital gains or losses from yield curve moves) are likely to be greater in 2010 than was envisaged in 2009.
- Economic growth forecasts remain reasonably robust for 2010, and considerably higher than 2009. Unemployment forecasts are also improving – from what are already quite low levels. This should aid economically linked lines.

- A strong Australian dollar should assist classes such as motor which rely to a large extent on imported parts. Partially offsetting this, a stronger economy is often associated with increased miles driven.
- Inflation in general appears to be in check. This should assist claims cost more generally. We believe that the professional indemnity and directors and officers classes are still classes to watch, as litigation may appear with a lag relating to the impacts of the financial crisis.

## Economy turnaround- positives for insurers

Siddharth Parameswaran and Paul Mobilio, J.P. Morgan

The recent “financial crisis” (2008 / 2009) has proved to be far more benign than most commentators (including J.P. Morgan as a house) were expecting. The impact of a co-ordinated series of fiscal stimulus measures and monetary policy injections through very low interest rates appears to have been very effective at averting what many thought would be a protracted economic downturn in Australia.

The financial crisis’ impact has proved to be more benign on the economy than many were predicting.

Last year we said that whilst we believed general insurance companies were largely better placed than life insurers and banks to deal with the crisis, we were particularly concerned about long tail lines’ margins being affected by the dual impacts of reduced investment income and increased claims costs (see below).

Table 8: Ranking of Impact from Financial Crisis by Class of Business –from 2008 survey

Classes	Possible Impact on Margins from Claims	Rank -Claims	Possible Impact on Margins from Yields (-2.0%)	Rank - Yields	Possible Impact on Margins - Total	Total Impact - Rank
Directors and Officers	-25%	1	-7%	1	-32%	1
Professional Indemnity	-7%	2	-7%	1	-14%	2
CTP	-3%	4	-7%	1	-10%	3
Public Liability	-2%	5	-7%	1	-9%	4
Workers’ Compensation	-4%	3	-4%	5	-8%	5
Fire and ISR (Property)	-2%	5	-1%	6	-3%	6
Motor	0%	7	-1%	6	-1%	7
Householders & Other	2%	8	-1%	6	2%	8

Source: J.P. Morgan Views. Yields are assumed to reduce 2%

The recovery, in both sentiment and in real economic indicators, has been quite spectacular. This has necessitated a re-evaluation of the concerns we had, both in terms of some of the key indicators and how well placed the insurers are to benefit from some of these changes:

Equity markets are recovering

GDP growth is proving resilient in Australia.

Yields are still lower than previously but are slowly rising.

The A\$ has strengthened.

- Whilst **equity markets** in Australia fell 40% between June 2008 and March 2009, they have recovered quite spectacularly since then (up 52% from March 2009 to December 2009). *This affects insurance company valuations in the listed space as well as the investment allocation of insurers. Some classes covering equity market related risks may still feel the impact on claims from the volatility in equity prices.*
- The **economic indicators** such as GDP and unemployment appear relatively positive. Inflation also appears to be under control. *Some classes (especially long tail) are particularly exposed to downside risks from any deterioration here, as downturns can trigger an increased incidence of claims along with claims inflation. On the other hand, classes such as motor insurance can have frequency of claims rising during an improving economic climate. Low CPI inflation is a positive for all short tail classes. Growth in the economy should benefit volumes in all classes of business.*
- **Fixed Income returns.** These are still lower than 2008 levels – but are better than early 2009. *Higher investment yields are a positive for those insurers with greater investment assets.*

- **The Australian dollar** fell 34% between June 2008 and March 2009 vs. the US\$. It has since recovered 40% from March 2009 to December 2009. *This could be a negative for insurers with significant incomes from off-shore, but could be a positive for motor insurers.*

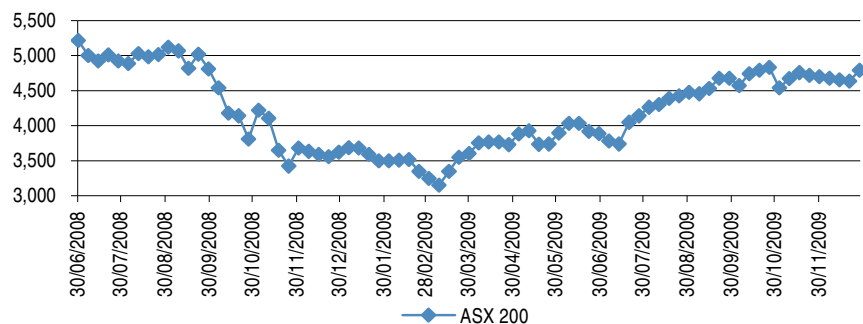
We discuss these factors and the implications on insurer returns in more detail below.

### Market recovery – GI lagged on way down, lags on way up

Whilst equity markets in Australia fell 40% between Jun 2008 and March 2009, they have recovered quite spectacularly since then (up 52% from March 2009 to Dec 2009).

**General insurers have low leverage to the economic cycle. Hence in an economic upswing they are not as attractive as other financial stocks, all other things being equal**

Figure 5: ASX 200



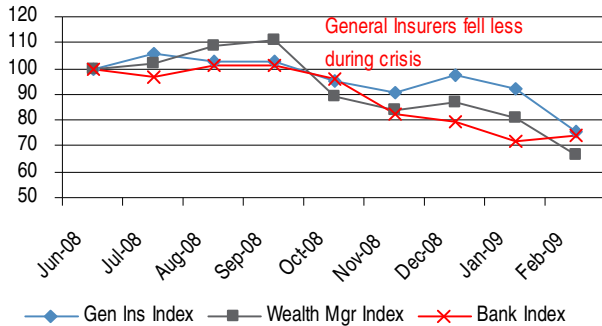
Source: Iress

This affects insurance companies in 3 ways:

1. **General Insurance seen as low beta:** In the listed space, general insurance companies were seen as relative safe havens in the financial space vs. banks or wealth managers.
  - When compared to banks, they only face modest credit risk (through their investments), and do not face liquidity risk (as consistent premium income means they are cashflow positive).
  - When compared to life insurers / wealth managers, they do not write guaranteed investment product liabilities, do not have fixed costs and do not receive revenue that is levied as a proportion of assets under management.

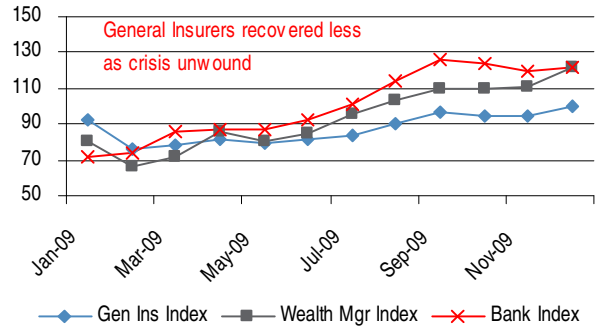
**Given the rapid recovery (or more rather a lack of decline) in economic fundamentals in the country, general insurance companies are not as levered to benefit from the recovery, *ceteris paribus*.** This to some extent has been reflected in the performance of the listed general insurance stocks in the ASX 200.

Figure 6: Performance of Listed General Insurers vs. Financial Peers (Fin Crisis)



Source: J.P. Morgan calculations, Bloomberg

Figure 7: Performance of Listed General Insurers vs. Financial Peers (Post Fin Crisis)

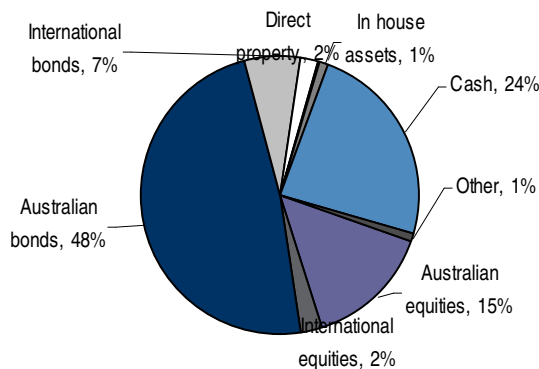


Source: J.P. Morgan calculations, Bloomberg

The industry may increase exposure to equities in their investments.

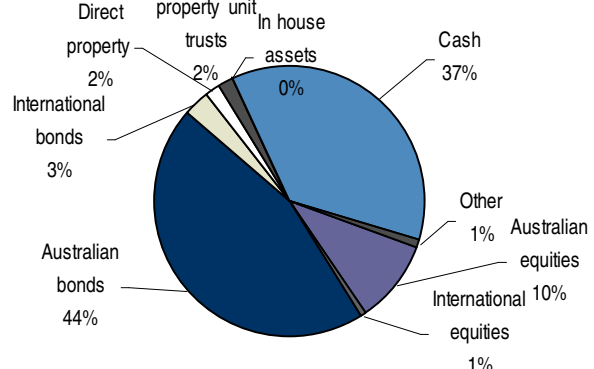
2. **Investment asset exposure changes:** Some companies (e.g. IAG) have publicly signaled a desire to increase their exposure to equities in their shareholders funds, having previously reduced their exposure. The industry in total appears to have a lower exposure to equities for shareholders funds in June 2009 than was held in June 2008 (11% vs. 17%). We suspect that there will be a general trend to increase exposure to risky classes across the board, capital permitting.

Figure 8: Investment Allocation Shareholders' Funds 2008 Survey



Source: J.P. Morgan Deloitte 2008 General Insurance Survey

Figure 9: Investment Allocation Shareholders' Funds 2009 Survey



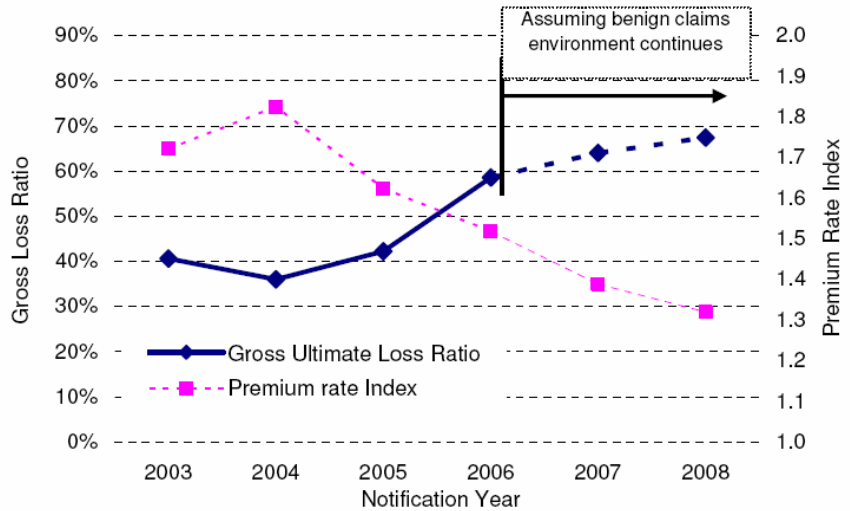
Source: J.P. Morgan Deloitte 2009 General Insurance Survey

Professional Indemnity and Directors and Officers Losses from the financial crisis may still come through...in much greater amounts than the industry thinks

3. **Past big market falls still exposes Professional Indemnity and D&O:** The falls seen in equity markets expose some classes such as professional indemnity and directors and officers to increased claim numbers. Due to the long lead time in claims being reported, these classes are typically written on a claims-made basis, with considerable uncertainty on the extent of the losses possible on the class. Risks remain that the costs of these classes could increase substantially as the claims get reported and develop. We believe that the full impact of possible losses is yet to be felt. We have anecdotally heard from some actuaries that they would not be surprised if loss ratios reached 150% on this class. The sting may yet be in the tail (see following chart for increasing claims ratio trends).

Figure 10: Professional Indemnity Loss Ratios in Australia -by accident / notification year

Figure 2.4 – Ultimate Loss Ratios by notification year



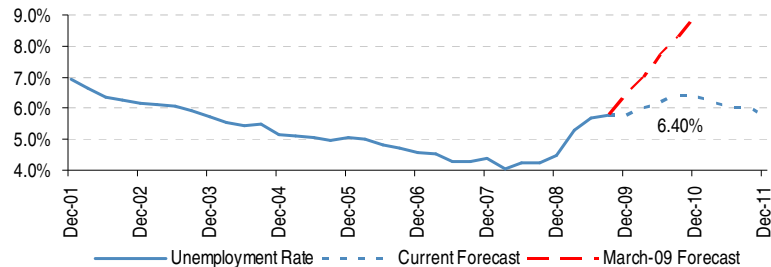
*“incorporating expenses and an allowance for profit margin this suggests that in aggregate premiums were at borderline adequacy for a benign economic environment. Given the deteriorating financial and claims environment – it seems likely that current premiums are inadequate in aggregate”... “PIDO challenges for the actuary” - Tim Andrews, Susie Bowden ... presented at 16th IAAust General Insurance Seminar.*

Source: “PIDO – Challenges for the Actuary” IAAust General insurance Seminar 2008. Tim Andrews, Susie Bowden, Robert Cameron, Pravesh Ponna.

**More favourable economic indicators a positive:**

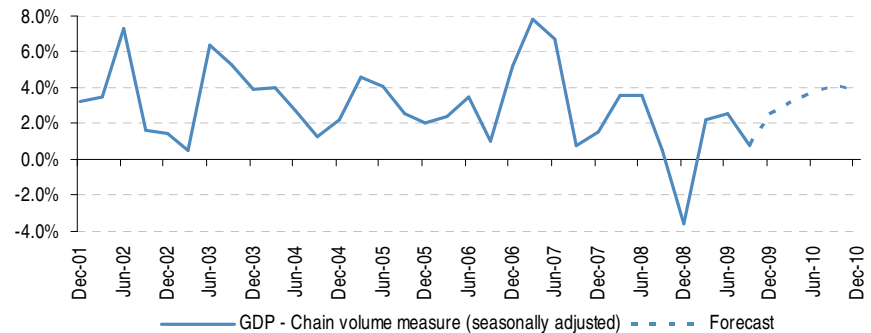
Economic forecasts appear much more favourable on GDP growth and unemployment than many had previously forecast.

Figure 11: Unemployment Forecast (much lower than before) –J.P. Morgan



Source: J.P. Morgan

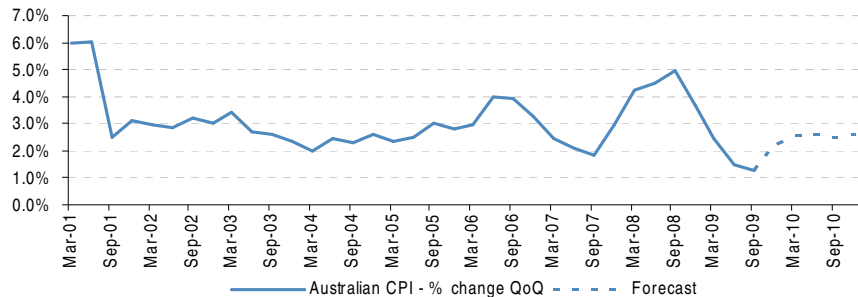
Figure 12: GDP Forecasts – J.P. Morgan



Source: J.P. Morgan

Coupled with this however, the forecasts on inflation are also quite benign.

Figure 13: CPI Forecasts – J.P. Morgan



Source: J.P. Morgan

All this spells positives for the insurance industry:

- Economically linked classes unlikely to face an increase in costs:** We had previously written that classes such as workers' compensation and liability may have economic links. The lack of worsening trends here should provide respite on the claims line to these classes:

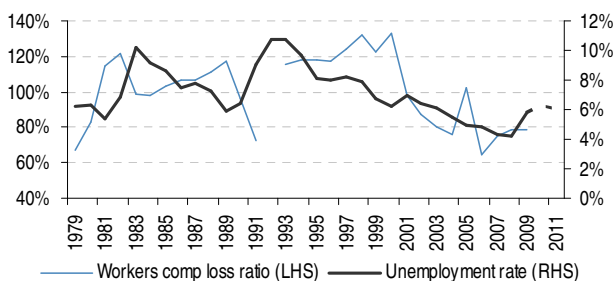
A strong economy means:

- fewer economically linked claims; good for commercial loss ratios.

- Volume growth should be resurgent

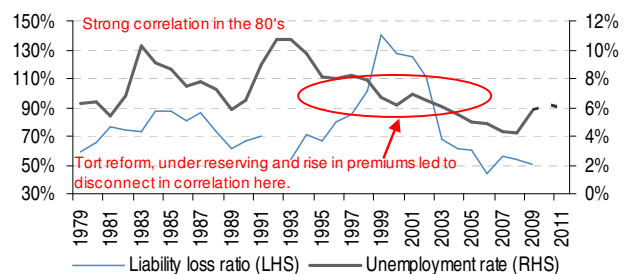
- Whilst we did not expect workers' compensation claim numbers to increase as a result of the sub-prime crisis, - we suspected that "return-to-work" rates would decline as injured workers faced difficulties in finding jobs to go back to if unemployment rose. Historically there has been a reasonable correlation between unemployment and loss ratios as can be seen in Figure 14.
- Historically liability had also demonstrated a very strong correlation between loss ratio and unemployment (see Figure 15). However, this broke down due to bouts of superimposed inflation coupled with under-reserving in the mid 1990s and due to the liability crisis in 2001 onwards triggering rate rises and tort reforms. Conceptually one would expect fraudulent claims to rise during weaker economic times and hence the link between loss ratios and unemployment could be expected to continue.

Figure 14: Workers' Compensation loss ratio vs. unemployment



Source: J.P. Morgan, APRA, ISC

Figure 15: Liability loss ratio vs. unemployment

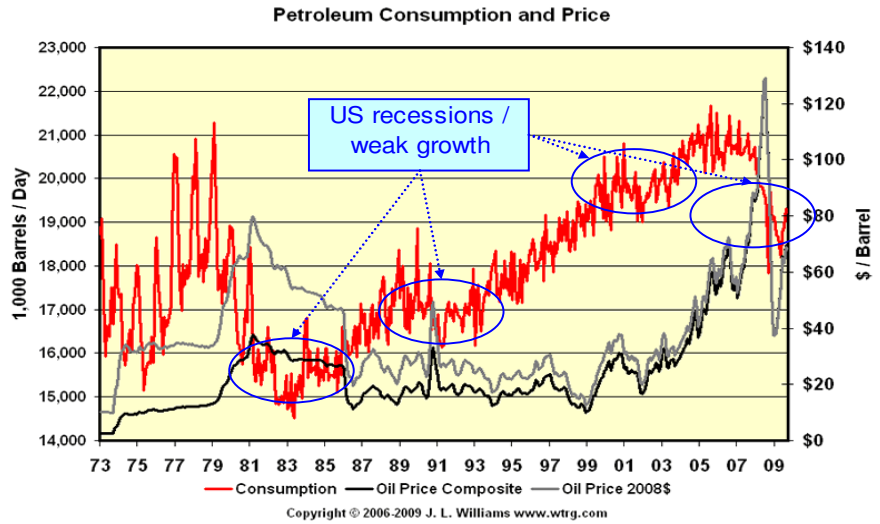


Source: J.P. Morgan, APRA, ISC

Short tail personal lines likely to be much better insulated than commercial long tail lines in an economic downturn...

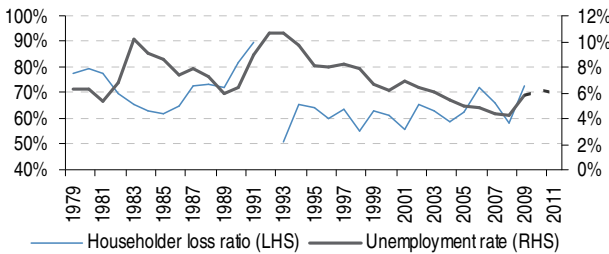
- There appears to have been much less of a link in short tail personal lines as can be seen from the following charts. In motor, tougher economic times usually are correlated with reduced driving (and hence less frequent collisions), but this effect is offset by increased thefts. In home, the link is similar with tougher economic times associated with lower repair costs, but also coupled with rising thefts.

Figure 16: US consumption of petrol – linked with economic activity and the oil price



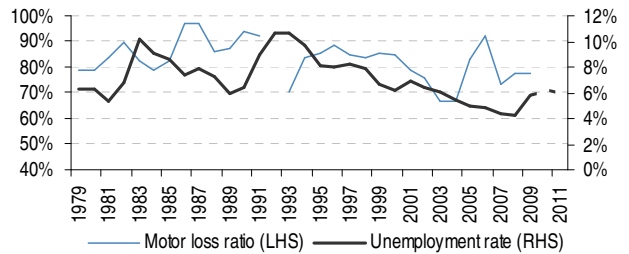
Source: J.L. Williams

Figure 17: Householders' loss ratio vs. unemployment



Source: J.P. Morgan, APRA, ISC

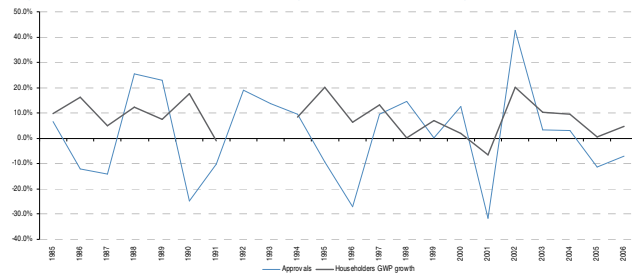
Figure 18: Motor loss ratio vs. unemployment



Source: J.P. Morgan, APRA, ISC

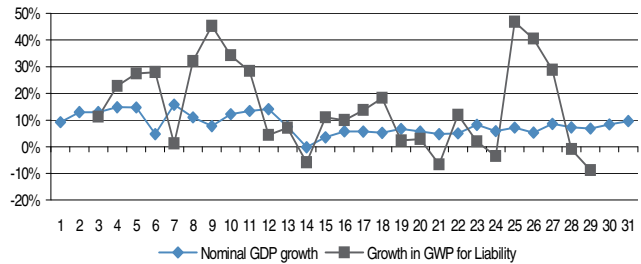
2. **A strong economy implies volume growth:** We would expect positive growth in the number of policyholders and in Gross Written Premium to continue in many lines during buoyant economic times. The correlation we believe would be greatest for Motor and Householders. Commercial lines are influenced much more by the insurance cycle than the economic cycle – as evidenced by the following graphs.

Figure 19: Householders' GWP growth vs. Building Approvals



Source: ABS, APRA, J.P. Morgan/Deloitte General Insurance Survey, J.P. Morgan estimates

Figure 20: Commercial Liability GWP vs. Nominal GDP



Source: ABS, APRA, J.P. Morgan estimates

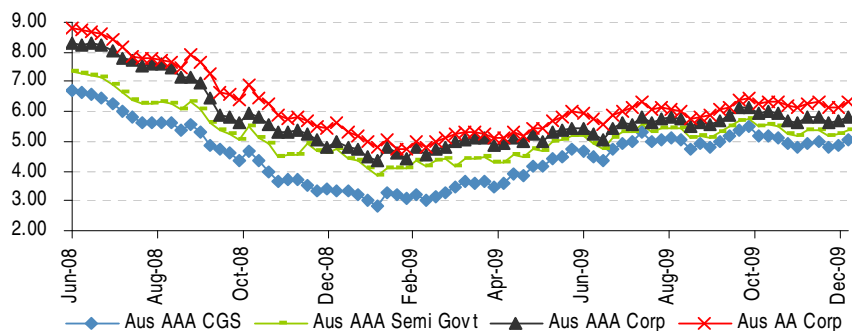
**Inflation is forecast to be modest, which should be a positive for short tail classes.**

**3. Inflation remaining under control is a positive for the short tail classes:** The short tail classes' claims trends should benefit if the forecasts that inflation will largely remain under check prove to be correct.

**Yields are improving – but still down on 2008:**

Running yields in Australia fell dramatically on all investment grade securities between June 2008 and March 2009. They have since started to recover. Both these trends are evident on the following chart.

Figure 21: Running Yields on 3 year duration debt in Australia (various grades)



Source: Bloomberg, J.P. Morgan Estimates.

**Yields are improving (+1.6% since March 2009) – but are still worse than 18 months ago.**

**Long tail lines face the greatest risks from low yields. This is particularly on new business being written.**

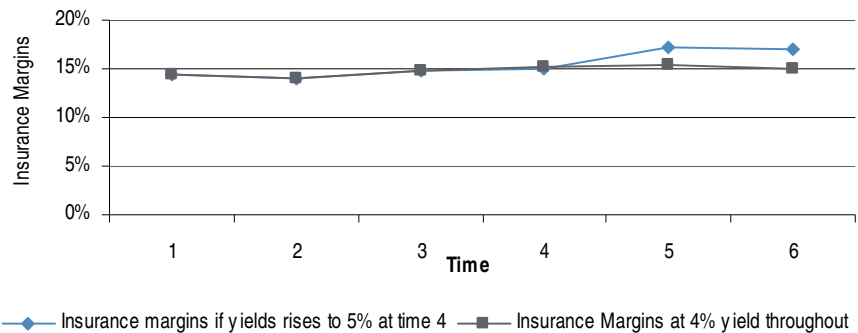
**Between Jun 2008 and March 2009, the running yields on a diversified portfolio of the above securities would have fallen about 3.7% p.a. Since March 2009 however, they have proceeded to recover about 1.6% p.a.. The net result is that the outlook for insurers is improving - but it is still about 2.1% p.a. worse than 18 months ago.** Spreads have contracted in the last 9 months having previously widened substantially.

**1. Long tail lines face biggest exposure to yields:** We believe long tail lines are very exposed to moves in the yield curve as a significant proportion of the returns they make come from investing in assets where yields have fallen:

- Whilst most insurers seek to match the duration of their assets and liabilities, some may face immediate losses / gains if they are mismatched – with their bond assets rising less /more than liabilities. Rising yields will benefit insurers who have their assets shorter than their liabilities.

- Duration matching of assets and liabilities is at best an imperfect hedge. Contracting credit spreads should aid returns lower rated investments – which would imply asset values would rise more than liabilities even if insurers are duration matched.
- Most importantly – on new business rising yields are equivalent to a large rate rise. On business such as liability or CTP where average durations from the date the policy is written to when weighted average claims costs are paid the duration is typically 5 years. As such a 1% increase in yields can mean a 5% reduction in the discounted value of claims, which can imply a 3.5% improvement to margins (i.e.  $5 * 1\% * 70\%$  loss ratio). We show below what the impact to insurance margins could be for an insurer that writes a mixture of long and short tail business, for a 1% increase in investment yields.

Figure 22: Impact of a 1 % rise in yields on insurance margins at time 4 for pro-forma insurer



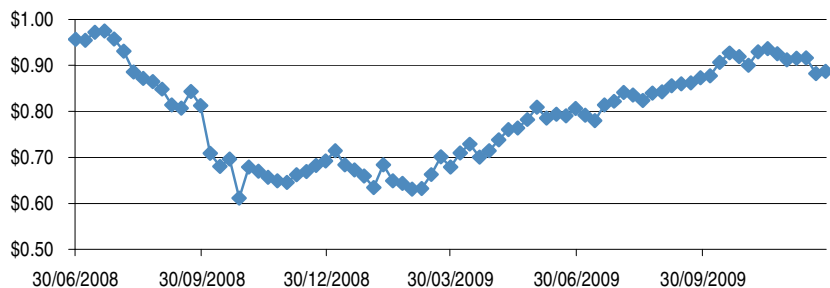
Source: J.P. Morgan Dynamic Financial Analysis Model of a Pro-Forma Insurer. Yields are assumed to rise just before time 4 from 4% to 5%. Impact is initially immunized at time 4 because of duration matching. New business however comes on at the lower yield. Mean term on outstanding claims for the insurer assumed to be 2.2 years.

### A strong A\$ is a positive for some – but hurts some

The A\$ fell 34% between June 2008 and March 2009 vs. the US\$. It has since recovered 40% from March 2009 to December 2009. There are some economists (including our own) who are forecasting that the A\$ will approach parity with the US\$ sometime in 2010.

**A strong A\$ helps short tail insurers, but hurts domestic insurers with offshore operations.**

Figure 23: AUDUSD Exchange Rate over time



Source: Bloomberg

- 1. A strong Aussie dollar is a positive for short tail insurers:** As we highlighted before, a strong Australian dollar is a positive for claims costs in short tail lines, as both building and motor vehicle parts rely on some quantity of imported materials. This leads to a downward pressure on costs.
- 2. A negative for insurers with offshore operations:** A strong Australian dollar is a negative for domestic insurers with offshore operations that receive some of their revenues in overseas currencies. Their value of that investment in A\$ is lower.

## Capacity & competition provide problems

**Siddharth Parameswaran and Paul Mobilio, J.P. Morgan**

The global supply of capital is very important for Australian insurers in commercial markets (particularly at the large end). Overseas trends will have an impact on the outlook for premium rates domestically, as insurers can easily transport their capital as they seek the best markets to maximise their return on capital around the world.

Until the recent global financial crisis premium rates around the world had been falling. Many in the market (although not us) were calling a quick turnaround in the global commercial and reinsurance rates cycles, following significant damage to insurer balance sheets from falling yields and investment losses. Since then however, the following have become clear.

- Whilst insurer balance sheets did suffer in the months to March 2009, they were coming from a period of significant surplus, and as such rather than there being a capacity crisis, the excess capital was instead just used up.
- Recoveries in credit spreads and equity markets (see previous articles) have meant that capital positions have improved since March 2009. For example the US S&P500 index recovered 65% from mid March 2009 to December 2009.
- The catastrophe season has been benign globally in 2009. Munich Re estimate that catastrophe insured losses in 2009 were approximately US\$22bn versus US\$50bn in 2008 (Press Release: 29 December 2009). This has added to the amount of capital in the industry. The low frequency and severity of catastrophes during 2009 takes away a justification for rate increases as well.
- Demand for insurance remains weak due to subdued growth forecasts globally.

As a result, it appears likely that the capital position of insurers will provide headwinds to the prospect of achieving significant premium rate rises.

Locally, there are added pressures from increasing competition coming from market developments:

- In the commercial lines space, market changes are occurring which make it easier for customers to compare premium rates between competitors.
- In the personal lines space, the impact of new entrants (such as YouI, and Progressive) are likely to continue to provide increased competition in the space for the existing players. There remains a threat from internet aggregation, although to date the success of these players has been rather limited.

In this article we focus on global trends in commercial and reinsurance premium rates, trends in the industry's capital position and developments in competition in the local market.

We provide our conclusions on the outlook for premium rates in Australia.

### Global Premium Rate Trends...are soft

Premium rate trends in global insurance markets in 2009 have proved to be rather soft and forecasts are that this is likely to continue on a global basis during 2010. We provide statistics on trends in many of the markets below.

**US Direct Commercial Rate Trends:**

We recently reviewed information on US premium rate trends from 4 sources; namely AON, Towers Perrin, Market Scout and comments from the US Insurers during their 3rd quarter 2009 reported results. The trends from all sources are similar in suggesting that premium rates in the US commercial markets still remain soft, with rates on average flattish to slightly down in the 3Q09 vs. 3Q08.

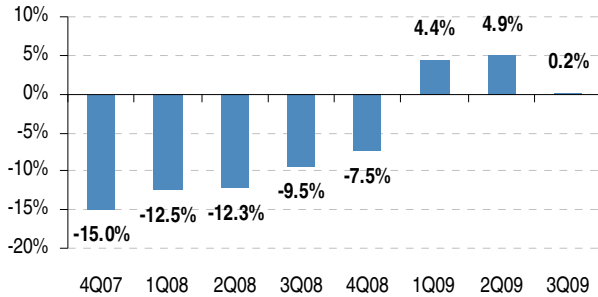
- The AON survey suggests that property rates were flat in 3Q09 vs. 3Q08. Commentary in their report suggests that capacity was up on the pcp- but there also appeared surprisingly to have been an increased amount of insurance taken up in “new property markets” – perhaps absorbing some of the capacity. In liability in 3Q09 – there were low single digit rate reductions (2 -3%) in both primary and excess markets. The Towers Perrin study provides a combined commercial rate index - which suggests rates in 3Q09 were exactly flat on 3Q08.
- Insurer comments are shown in the table below – which indicate a subdued rating environment.

**Table 9: US P&C 3Q09 Results: Commentary**

Company	Comments
W.R. Berkley	"Although the insurance cycle has not yet turned, for the quarter pricing on renewal business year over year is down less than one half percent and our premium volume is down less than three percent.
Chubb	"While the difficult economic environment continued to adversely affect premium growth, we remained focused on bottom-line earnings. Results for the third quarter also benefited from a benign hurricane season."
Travellers	"We were once again successful in achieving positive renewal rate changes across all of our business segments, although net written premiums were down modestly, largely attributable to declining economic activity in recent quarters. As in previous quarters, we remain cautious about the magnitude of rate gains that are achievable in the near term given general economic conditions. Nonetheless, we plan to continue to seek rate gains where needed and we will continue to focus on execution. Commercial Accounts: Renewal premium changes, although slightly negative, were improved from recent quarters as the impact of improving renewal rate trend was partially offset by lower coverage demands from existing policyholders.
Amlin	"U.S: We continue to believe that pricing in the US commercial insurance market is unsustainably low, but while the prospect of lower investment returns should encourage an upward trend, we are cautious in our expectations for 2010"
ACE	"While we sacrificed some growth, we achieved positive rate change in the quarter of about 2%."
XL Capital	"Pressures from the current economic environment and where we are in the underwriting cycle have not deterred us from seeking the right price regardless of the impact on top line. We will continue to do so."
Endurance	"Although market conditions remain competitive, we are committed to maintaining our underwriting discipline and we are well positioned strategically and financially to capitalize on attractive underwriting opportunities."

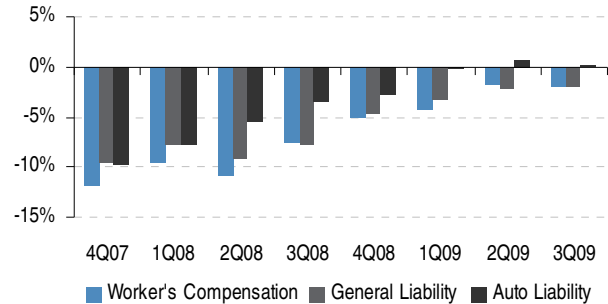
Source: J.P. Morgan estimates, Company data.

Figure 24: Property –Quarterly (YoY) Δ in average premium rates (AON)



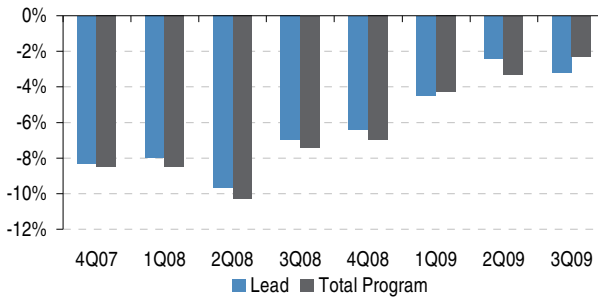
Source: AON

Figure 25: Primary Liability–Quarterly (YoY) Δ in average premium rates (AON)



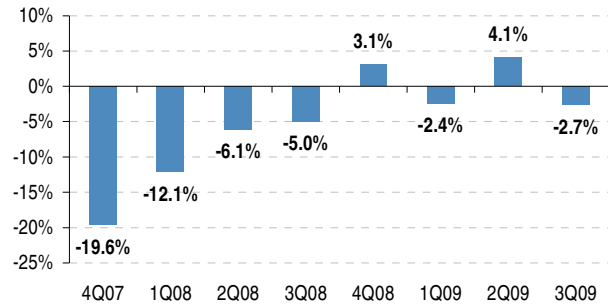
Source: AON

Figure 26: Umbrella / Excess Liability–Quarterly (YoY) Δ in average premium rates (AON)



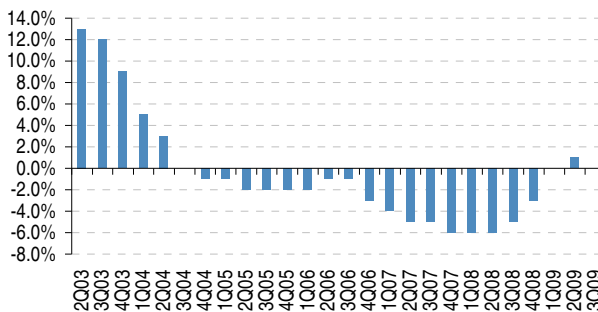
Source: AON

Figure 27: D&O – Quarterly (YoY) Δ in average premium rates (AON)



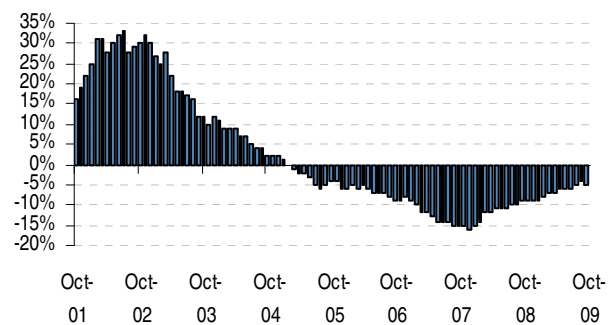
Source: AON

Figure 28: Commercial Market Rates Quarterly (YoY) Δ in average premium rates (Towers Perrin)



Source: Towers Perrin

Figure 29: Commercial Market Rates Quarterly (YoY) Δ in average premium rates (Market Scout)



Source: Market Scout

- The forward looking comments from the AON survey suggest that in the property markets we are likely to see continued flatness in rates. They were expecting increased competition for premium in 4Q09 as insurers try and meet GWP budgets. They also expected 2010 property rates to reduce as revised catastrophe models suggest lower rates are needed for Cat prone areas. In the liability markets, AON was forecasting soft market conditions to continue into 2010 due to substantial capacity with reductions in rates likely to continue in flat to low

single digits. They are forecasting tough GWP trends in this market for the next 3 to 5 years.

**Reinsurance Rate Trends:**

Global reinsurance providers have largely indicated that they expect rates to continue to be soft:

*Guy Carpenter (Jan 2010):*

*“Reinsurance rates for most lines of business decreased at the January 1, 2010 renewal. The Guy Carpenter World Catastrophe Rate on Line (ROL) Index decreased by 6 percent in response to a swift and substantial recovery in the capitalization of the reinsurance sector.”*

*AON (Jan 2010):*

*“January 1 catastrophe reinsurance renewals were focused on rate decreases in the market’s peak zones of U.S. hurricane and U.S. earthquake. - Aon outlook for the April, June and July renewal seasons (2010) reflects the firm’s expectation that the pace of reinsurer capital growth will decrease, due to share repurchases and more stable investment prices. The reduced pace of reinsurer capital growth is still likely to outpace the growth in insurer demand for reinsurance. Therefore Aon Benfield forecasts continued softening over these upcoming renewal periods, assuming no significant reinsured catastrophes occur prior to final negotiations.”*

*Willis (Jan 2010)*

*“Strong reinsurance underwriting profits, a recovery in the global investment markets and a lack of premium growth for primary underwriters has resulted in a disciplined softening of reinsurance pricing in the January 1, 2010 renewal season. ”*

*Swiss Re Comments (November 2009)*

*“The market fundamentals point towards higher prices (lower yields, under-priced lines of business, end of positive run-off for industry). The recovery of industry capital and absence of hurricanes may partially delay the market correction.”*

*Amlin comments (November 2009)*

*“Our catastrophe reinsurance account, which represents approximately 28.1% of 2009 gross written premium, has experienced solid rate increases in the year and continues to offer good margin potential for our London and Bermuda businesses. The average renewal rate of increase for the Reinsurance business during the first ten months of 2009 was around 5.3% (Amlin Bermuda & London Reinsurance). The Property and Casualty business achieved an overall rate improvement of 3.4% on the renewal portfolio. Competition in this area is stronger than expected.”*

*Catlin comments (November 2009)*

*“Market conditions were little changed during the third quarter of 2009. Average weighted premium rates increased by 6 per cent across the Group’s entire portfolio of business during the nine-month period ended 30 September 2009; the Group reported an identical increase in average weighted premium rates as at 30 June 2009. Average weighted premium rates increased by 11 per cent for catastrophe-exposed business classes and*

increased by 3 per cent for non-catastrophe classes during the nine-month period. These average rate increases are consistent with those reported at 30 June.”

**European Premium Rate Trends:**

Our European insurance team has summarised some of the premium rate trends seen for some of the large insurers they covered below. As can be seen, commercial markets in Europe have, by and large, been subdued in terms of rate increases in 2009.

**Table 10: Premium Rate Trends for European Primary Insurers**

	Allianz 3Q 09 Commercial	AXA 1H 09 Commercial			Zurich 9M 09 Commercial
		Motor	Property	Liability	
<b>Europe and UK</b>					
Germany	0.60%	1.00%	-0.80%	-1.00%	1.00%
France	1.90%	2.00%	4.00%	4.00%	na
UK	5.20%	>+4%	>+4%	2.00%	2.00%
Italy	n.a.	0.00%	-0.80%	4.50%	4.00%
Spain	-7.20%	-2.00%	2.50%	-1.50%	7.00%
Austria	n.a.	na	na	na	na
Belgium	n.a.	na	na	na	na
Switzerland	n.a.	-2.00%	0.00%	-1.50%	0.00%
Ireland	n.a.	3.00%	na	na	na
<b>Others</b>					
Canada	na	1.00%	2.00%	0.80%	na
USA	-0.30%	na	na	na	na
Australia	6.60%	na	na	na	na
International market for ZFS	na	na	na	na	5.00%
<b>Total</b>	<b>1.20%</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>3.00%</b>

Source: Company presentations, J.P. Morgan European Insurance Team

We also include below some of the comments given by market participants on premium rate trends.

*Amlin comments (November 2009)*

“UK: Looking forward we expect further increases in UK commercial motor rates in 2010. Typically other UK commercial classes are slower to improve at this stage in the cycle, but we anticipate greater upward momentum over the next few months.”

*Allianz comments (November 2009)*

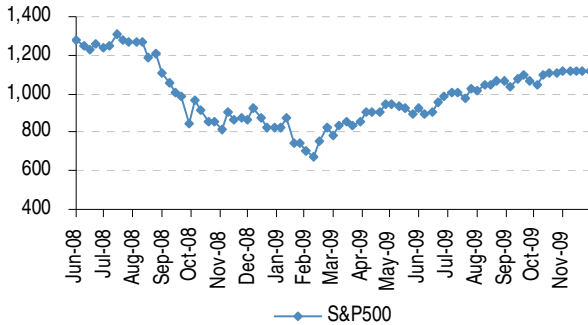
“In general we see premium rates slowly hardening as we and most of our competitors apply tariff increases. However while pricing is on an upward trend, our volumes remain challenged due to weaker demand, the effects of our portfolio cleaning measures and selective underwriting. - U.S: Overall rates were still relatively low, and the market remains soft. - U.K: Rates increased strongly in commercial and personal lines. Allianz estimate a positive price effect of 13.1%. - Australia: Significant price increases were implemented starting mid 2008. Allianz estimate a positive price effect of 5.6%.”

**Supply of Capital still robust; Demand for Insurance weak**

Post the financial crisis, insurers’ balance sheets have suffered some damage from investment losses and a tougher catastrophe year in 2008 than recent history. Since then, to recap, the following have become clear.

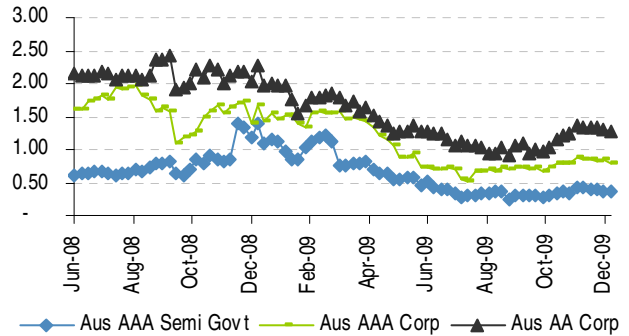
- Recoveries in credit spreads and equity markets (see previous articles) have meant that capital positions have improved since March 2009. For example the US S&P500 index recovered 65% from Mid March 2009 to December 2009.

Figure 30: S&P500



Source: Bloomberg, J.P. Morgan

Figure 31: 3 yr Fixed Income Spreads on Common Gov't Securities



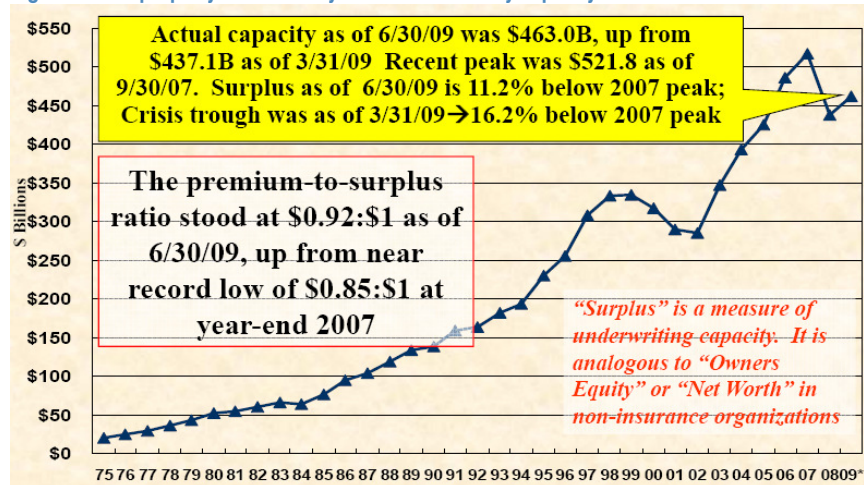
Source: Bloomberg, J.P. Morgan

- The catastrophe season has been benign globally in 2009. Munich Re estimate that catastrophe insured losses in 2009 were approximately US\$22bn versus US\$50bn in 2008 (Press Release: 29 December 2009). This has added to the amount of capital in the industry. The lack of catastrophes takes away a justification for rate increases as well.
- Whilst insurer balance sheets did suffer in the months to March 2009, they were coming from a period of significant surplus (where they were under-taking capital returns), and as such rather than there being a capacity crisis, the excess capital was instead just used up. This is best illustrated by the chart of capital levels in the US shown in the next section.

**US Capital Trends:**

The level of capital amongst the US insurers is a good bellwether of global capital levels. The following chart from the Insurance Information Institute shows that their forecast of surplus levels in the US for 2009 are lower than the peak seen in 2007. However we note that they are still substantially higher than those observed in 2001, when the last (very) hard market was triggered.

Figure 32: US property and casualty insurance industry capacity



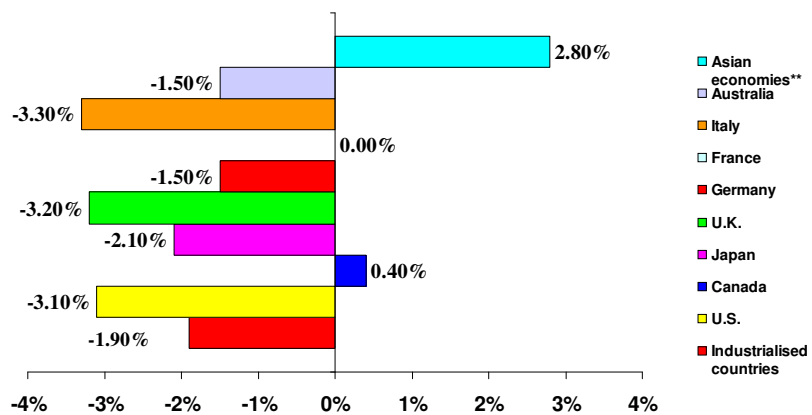
Source: A.M. Best, ISO, Insurance Information Institute

This does not provide any confidence for rate increases being led by a shortage in supply (capital). Given that reported profit trends remain strong in the US P&C market, we suspect that premium rates will continue to decline.

**Demand for insurance weak in the developed world:**

Demand for insurance in the developed world is quite weak, as can be seen from the following chart showing the change in real insurance premiums in different markets. Across industrialized economies, there was a real decline of 1.9% in General Insurance premiums between 2007 and 2008. This provides a further reason for asserting it will be unlikely that there will be quick rises in premium rates.

Figure 33: Change in P&C Insurance Premiums in real terms (2008 vs 2007)



Source: Insurance Information Institute, sourced originally from Swiss Re (Sigma 3/2009)

**Domestic trends in capital and competition**

**Capacity position**

The following table shows the trends in the capital position of the industry from June 2004 to June 2009 versus their long term targets. It shows that even domestically, the capital adequacy position is reasonably strong.

Table 11: Changes in Capital Position for Survey Participants (June year ends)

	2004	2005	2006	2007	2008	2009
Average coverage of MCR	1.87	2.04x	1.98x	2.10x	2.22x	1.97x
Average long term target MCR	1.63	1.65x	1.73x	1.92x	1.85x	1.88x

Source: General Insurance Survey (2004 - 2009)

This year’s insurance survey highlights that premium rates are increasing in commercial lines (+4%), and the industry is forecasting strong increases going forward (+6% for 2010). However, the premium rate increases are not being driven by supply side factors. Instead they are driven by upward estimation on the cost of claims or the required level of rates to meet target profitability.

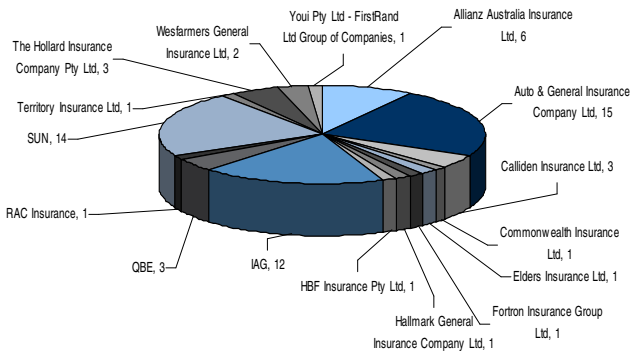
**Competition / Aggregators in the personal lines market.**

An added factor to consider in the domestic / personal lines market is the influx of capacity from new players.

- Currently, the motor market in particular already has quite a large number of brands. There are additional brands however entering the market place, such as Virgin Money, Progressive, Australia Post, Coles etc.

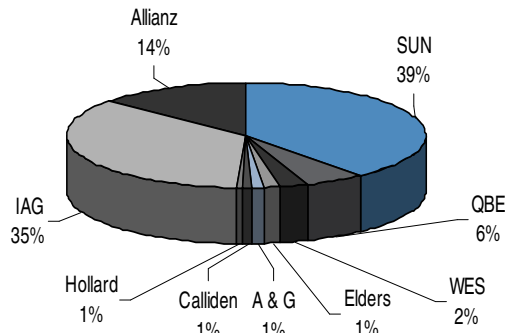
- The industry structure is still quite favourable as most of the premium is still concentrated in the hands of just a few insurance groups as can be seen in Figure 35. This means that those groups have significant price influencing ability, which explains part of the reason why such large increases in price were pushed through the market in personal lines in Australia this year (8% in 2009).

Figure 34: No. of Existing brands in Personal lines Insurance - by Group



Source: J.P. Morgan Estimates, Company Reports. Chart shows number of brands held by each insurance group

Figure 35: Market Share in Personal Lines – by Insurance Group - GWP



Source: J.P. Morgan Estimates for 2009 Personal Lines GWP, Company Reports. Chart shows % of Personal Lines GWP that each insurance group writes

A significant medium-term threat that still hangs over personal lines underwriters is competition from internet aggregators, such as iSelect and Rate City.

Figure 36: Sample Screen Shot from iSelect internet Aggregator website



Source: J.P. Morgan

Whilst these businesses clearly have some benefit to individual customers, they pose a threat to large underwriters for the following reasons:

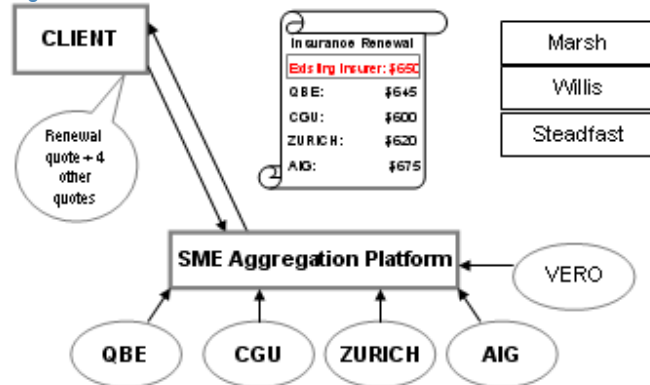
- They make it easier for customers to compare pricing differences between insurers. This can expose the different rating structures, making it likely that each insurer will only win business where they are the cheapest. This can cause a downward spiral in premium rates across the market.
- Lapse rates may increase dramatically, which can be bad news all around for the industry, as it will increase processing time and make it more difficult to analyse risk.
- Distribution costs could increase as the aggregators are another “mouth to feed” in the value chain.
- The market could potentially become commoditised where brand does not matter.

To date, all of the large incumbents have avoided using aggregators, which suggests that the threat is limited for now. However, the increased capacity in general will continue to place strains on the ability to continue to drive up prices.

**Commercial lines aggregators:**

Perhaps an even greater threat from aggregation service exists in the commercial markets. We are seeing the emerging use of technology to make it easier for brokers to obtain multiple quotes for clients. As an example, in the SME segment AON have introduced a contestable environment where all underwriters sign up to a standard service agreement for claims management, and agree to provide quotes to AON (generally via an electronic hub). The client will see renewal quotes from their existing insurer, along with quotes from other insurers on the platform. Other brokers are working on similar platforms.

Figure 37: AON Contestable Environment in Commercial Lines SME



Source: J.P. Morgan schematic diagram of how a client receives a quote from AON's contestable environment. We understand other brokers are working on similar platforms

We believe this development will continue to place some downward pressure on premium rates and will make it difficult for the large rate rises forecast by the industry for 2010 to emerge.

**Conclusion**

- We conclude that premium rates appear quite soft in global insurance markets (right across reinsurance, Europe and the US). This market phenomenon continues to exist because:
  - supply of capital remains reasonably strong, following recoveries in equity markets, recoveries in bond markets and a weak catastrophe reason in 2009;
  - reported profitability worldwide remains high at the underwriting margin level;
  - and demand for insurance remains weak.

We believe rates turn most quickly in markets where: there has been a significant reduction in capacity. For example after an insurer bankruptcy where suddenly many clients do not have existing insurers, or if the ability of insurers to write business has been limited by a lack of capital. We don't believe we have those conditions at the moment.

This will provide some headwind against the sharp increases in Australian commercial market prices that are being forecast by the industry.

- Rates can also turn quickly in consolidated markets, with pricing power resting in the hands of a few. We believe some of the Australian markets exhibit these

characteristics e.g. Australian personal lines (+8%). Even Australian commercial lines delivered 4% rate increases in 2009.

- Whilst the Australian industry is forecasting strong increases in premium rates for 2010, we are cautious on the ability of the industry to achieve the quantum of increases sought due to:
  - Increased competition in personal lines from the influx of new players.
  - increased competition in the Middle and SME segment of the commercial market from the emergence of technology-assisted broker quotation services.

## The challenge of claims management: forecasting the 20%

*Given that on average more than 96% of the total general insurance enterprise cost base is directly influenced by the claims organisation, **Deloitte Consulting Partner Susan Woods** explores how achieving management excellence in the claims function in 2010 can positively impact claim outcomes and drive real value throughout the enterprise.*

Events related to the global financial crisis including increased claims notifications in various lines, reduced investment returns affecting long-tail claims reserves, and increasing trends towards a customer selection of lower cost products with basic coverage or excesses, meant a tumultuous year in 2009 for insurers, with significant pressure on profitability. It was increasingly difficult to maintain target combined ratios in this environment and insurers are facing pricing pressure in 2010.

Given this scenario the J.P. Morgan Deloitte GI survey asked underwriters and reinsurers to outline:

1. any lines of concern about claims outcomes such as frequency reductions slowing, signs of superimposed inflation returning or economic related claims?
2. whether to increase or invest further in fraud prevention or better claims management measures in light of these threats? If so what?
3. if for target ROE purposes, they had adjusted their target combined ratios for sudden large falls in yield or viewed these movements as temporary and used normalised investment return assumptions?

### The responses

**Lines for concern:** Underwriters and reinsurers were concerned about long tail classes such as public liability and workers' compensation showing signs of deterioration as the lines most quickly reflective of economic conditions. There was also a pipeline of large claims industry wide that will impact Directors & Officers and Indemnity post-GFC. Commercial Third Party (CTP) portfolios had responded to the superimposed inflation with rate increases, and some underwriters had to exit SME lines all together as more and larger claims were made in the commercial SME property lines over last few years. Others put in place corrective underwriting measures to maintain profitability.

In addition increases in non-insurance and under-insurance were areas of concern for some resulting in a shift to reduce premiums through more basic coverage and higher excesses.

Overall the biggest threat from the uncertain economic times was from long-tail classes, with longer term concerns for liability classes as tort reform begins to be unwound, and a spike in superimposed inflation is expected over the next three to five years. Thus future profitability of these classes is expected to reduce as reserve releases continue to diminish moving forward.

**Fraud /claims management:** Most underwriters had increased awareness of potential fraud throughout their organisations, with some noting an increase in claims

referred for potential fraud. Motor, home and property were singled out. Some underwriters had increased their claims investigation resources and others had also brought their claims handling in business in-house to help reduce claims leakage and tighten claims management.

Reinsurers had maintained existing claims resources and instituted a proactive approach to claims settlement, adjusting risk appetite through increased pricing, coverage and risk selection. More than one organisation noted how important it was to firm up claims leakage measures, and beef up strategies to settle claims as quickly as appropriate, to reduce the impact of superimposed inflation.

**Temporary adjustments for target ROE purposes:** All organisations acknowledged the importance of constant close and regular reviews of their target combined ratios, particularly long tail classes; with some adjusting their targets downwards based on yield curve movements. Lower investment returns on long tail claims reserves will also have a bearing on company's results although there is an expectation of a return to "normal" yields in due course particularly from the reinsurers with their longer term view.

**Given the comment by one large insurer, that a key driver of insurance profitability is continually improving all elements of the claims cost value chain including claims management, we outline some of the challenges below and a three part approach to mitigating them.**

## The challenge

Claims organisations must navigate a difficult course to meet their strategic, operational and financial objectives. Key challenges include:

- **Complex processes and organisation structures** e.g. claims processes inevitably involve multiple hand-offs, duplicated work and an overlay of business compliance processes.
- **Changing external environment** i.e. increasing regulation and compliance activity, shifting reserve returns and claims frequencies.
- **Aging technology** i.e. multiple legacy platforms lacking enterprise wide integration and focused on financial processing rather than customer centricity, systems rich with data that are virtually untapped.
- **Fragmented /dispersed business partner base** and channels.
- **Access to skilled resources**, mobility of career paths and movement of talent.
- **Access to capital** as a result of constraints created by the global financial crisis.

These challenges create significant opportunities for insurers to improve their claims management effectiveness.

## Effective Claims Management

Our approach to driving effective claims management is in three parts. It is founded on the premise that effective claims management is achieved by leveraging information and technology to drive superior service, optimal loss outcomes, and efficient operating costs.

1. Most significantly we lead with **Advanced Analytics** which provides a vehicle to deepen understanding of the claims operations and to identify opportunities to advance performance.
2. Insights gained through advanced analytics empower you to make more informed decisions to enhance claims **Operational Effectiveness & Excellence** through business process change, up-skilling of staff, development of capabilities etc.
3. Finally we use **Technology Enablement** to drive claims process consistency and execution, automate processes to optimise costs, and enable data collection and maintenance.

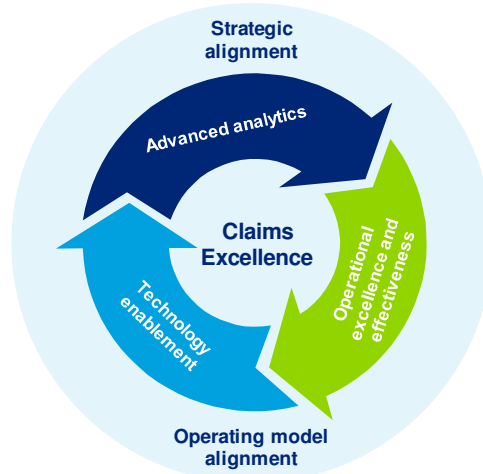
### Deloitte’s approach to claims excellence

#### *Advanced analytics*

Analysis of claims data is important for three reasons:

1. Initially it provides important metrics for measuring and monitoring the performance of the claims function and can be used to identify and drive potential improvement opportunities.
2. It also enables a focus on drivers of claim complexity, and a quantitative analysis of claims characteristics and distributions.
3. Finally it enables the application of data mining techniques and statistical algorithms known as Predictive Modeling to produce a mathematical model that effectively predicts claim outcomes and segments claims by level of exposure.

Figure 38: Deloitte approach to claims excellence



Source: 2009 General Insurance Survey

Claims organisations need to consider their analytical processes and methods and their consistency of data capture and use. This enables a greater understanding of operational dynamics and helps make decisions using appropriate metrics, with analytics built into performance management and governance.

#### *Operational excellence & effectiveness*

While the starting point for operational effectiveness is leading and best practice to drive process and organisation redesign, the organisation must not lose sight of the need to develop organisational capabilities, ensure that strong performance

management and governance is in place, and that project and change management disciplines are the norm.

#### *Technology enablement*

Technology-driven process consistency and execution should improve decision making, optimise costs through automation, and provide appropriate information through effective data collection and maintenance.

### Predictive modelling

Predictive modelling is an example of advanced analytics to power claims management through improved underwriting decisions. A closer look at a typical claim inventory reveals that, aside from a small percentage of high-cost catastrophic claims, the lion's share of costs stems from claims that appear, on the surface, to be routine. The classic example is the "mild" back or neck strain suffered by an injured party that ultimately escalates into a six-figure exposure.

**The perpetual challenge of claim organisations is to identify, early on, the 20% of claims that will cost two or more times the average, and get them into the hands of the claim organisation's best claim personnel.**

Predictive modelling provides such a tool by using data mining techniques and algorithms to create mathematical formulas that can forecast and segment future events.

Rather than treat similar appearing customers as equal risks, predictive modelling enables organisations to identify specific customers with greater or lesser risk, and then assess them accordingly. Most insurance companies know that a small percentage of claims account for a majority of losses. The only problem is they don't know which claims are likely to cost the most until they have suffered the losses. Predictive modelling, however, can change that.

By analysing dozens of risk characteristics that impact claim outcome e.g. age, location, nature of the claim event or medical history, and focusing on claimant behaviour in addition to medical factors, predictive models can help insurance companies identify problematic claims earlier and assign the right resources to apply the right process to their potentially costliest claims. In this way it is possible to reduce losses by 3% to 5% and in some cases by as much as 10%.

#### *Creating predictive models*

A minimum amount of data is required to produce meaningful results through predictive modelling. Typically, 200 to 300 raw variables are identified and distilled into 50 to 75 final variables e.g. distance from work, financial position, family responsibilities, obesity, diabetes and other co-morbidities, that best describe the future estimation in the most effective manner. These variables are then analysed statistically to assess the relevance of each variable to the claim outcome.

Once the final variables have been chosen, mathematical scores are created for all of the elements and combined into an algorithm that can be used to maximise predictive quality. Scoring occurs throughout the course of the claim life cycle to reflect potential changes in exposure.

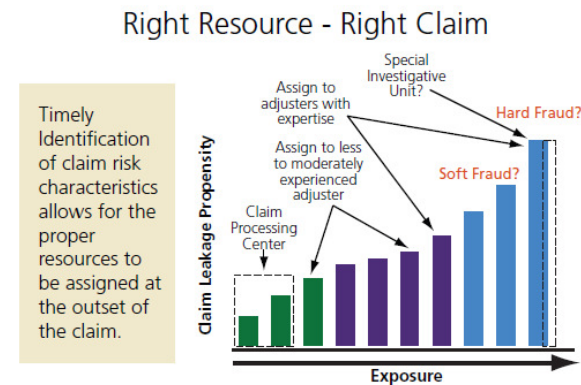
**Turning insight into action**

Once a predictive model is built it begins prospectively to pinpoint claims with the highest potential exposure. Success results from effectively putting the knowledge to work by matching the right resource to the right claim.

Claim resources today are spread thin, with highly qualified adjusters, fraud specialists and medical management resources in scarce supply. The large numbers of claims that appear homogeneous, yet in fact have a wide range of outcomes – from simple to severe – only magnify the challenge.

**The science of predictive modelling both enables claim supervisors to make more informed judgments about the best destination of each claim and prompts an accelerated approach to claim management.**

Figure 39: Predictive Model Approach



Source: 2009 General Insurance Survey

Explanatory “reason codes” provided by the predictive model serve as early indicators for medical complexity and “soft fraud,” evinced by a propensity for claimants to exaggerate or inflate claims. With such information available – in real-time at claim assignment – claim organisations can engage resources such as fraud investigators and nurse case managers early on, well before warning signs would typically become apparent.

**Predictive modelling turns data into information and converts information into insight.**

Through this valuable insight, insurance organisations can match high-exposure claims with the right resources early in the claim process and quickly take action to improve claim outcomes. Predictive modelling has been changing the face of insurance underwriting. It is fast becoming the standard in claims management globally, and will ultimately deliver on customer satisfaction and retention, and generate significant value.

## Capital and enterprise risk management linkages: adds up to performance

*APRA GPS 113 Capital Adequacy internal model-based method provides an overall framework for calculating economic and regulatory capital to the minimum capital requirement for a general insurer or Level 2 insurance group. In this article **Deloitte Financial Services Risk partner, Mark Young** puts GPS 113 in context, exploring the conceptual issues behind assessing economic capital and how to use it for performance management and decision making. He looks at how this approach can support a general insurers' enterprise risk management framework.*

### Introduction

APRA has progressively introduced refinements to the general insurance framework moving from a "rules based approach" to a "principles based approach". Indeed the revolution of moving from the ratio-driven capital adequacy regime (rules-based) to assess resilience and solvency, to a 'probability' or stochastic model (principles-based) to determine risk-based capital for key risk classes, has affected the entire financial services industry over the last decade.

Basel II and more recently Solvency II have accelerated our ability to treat risk, capital and return, as measures of financial stability. GPS 113, APRA's general insurance version of Basel/Solvency II, requires that a capital charge be assigned to capture the underlying economic, business and strategic risks that affect an insurer's liability/balance sheet. This is done at varying levels of statistical confidence on either a one year projected basis in the case of operational and catastrophic risks, or to the extinction of risk, for underwriting, reserving, market and credit risks.

### Surveying the industry: will you won't you?

The J.P. Morgan Deloitte General Insurance Survey 2009 asked insurers and re-insurers if they intended to use the GPS 113 option to adopt an internal model-based approach for minimum capital requirement and/or economic capital calculation. If they did, they were asked how it would impact their enterprise risk management (ERM) framework. They were also asked to rate their existing framework and its attention to scenario planning.

Most underwriters and reinsurers were not intending to use APRA's GPS 113 internal model based approach for various reasons, including already using the Dynamic Financial Analysis model, or the fact that they were comfortable with the existing 'rules based' model. Those that were going to or already had changed to GPS113 felt reasonably confident that their existing or intended ERM framework adjustments, would not be major. Overall the industry rated their ERM systems at close to 7 out of 10.

**Scenario planning:** On the whole insurers reported that existing quarterly stress tests or annual risk management strategy reviews involve identifying material scenarios, which are then subject to scenario planning to evaluate potential exposures and effectiveness of controls. One insurer also specified that material risks are part of the process of the Internal Capital Model. So again the industry was fairly comfortable with its status quo on scenario planning.

The fact that a principles-based model offers a sophisticated way of calibrating performance was still new.

While the idea of associating capital and risk is not new for actuaries and quantitative analysts, linking economic capital to performance is still a relatively new concept outside of large sophisticated banks and financial conglomerates.

Understanding the elements of economic capital is key to this discussion. How it differs from other existing measures of capital that a general insurer is required to hold, and how it aids decision making and performance management, adds a new option for insurers.

**GPS 113 in context**

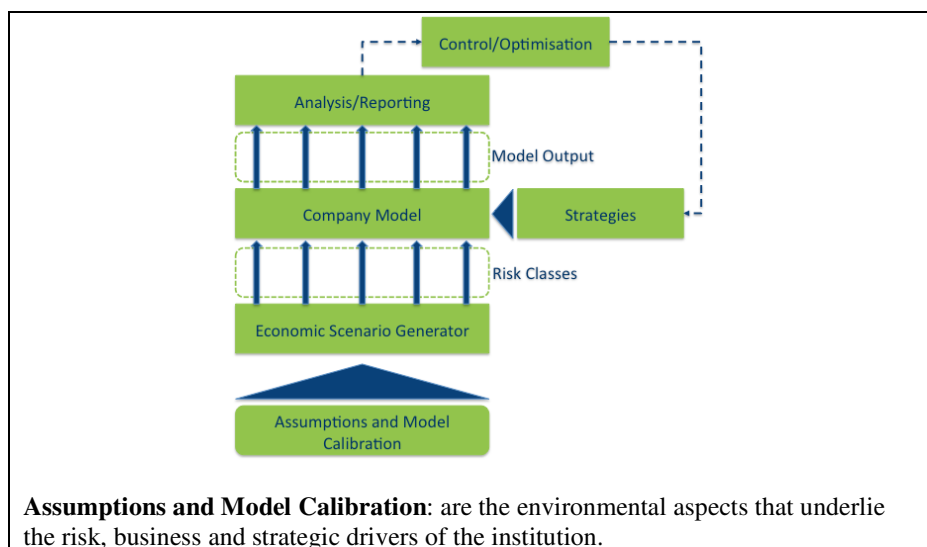
GPS 113 issued in final version in March 2009 after industry consultation, and rather than acting as a replacement to existing capital management standards for solvency and capital adequacy, is offered as an additional optional requirement that a general insurer or Level 2 insurance group may pursue.

Determining economic capital is at its heart and in turn determining regulatory capital to calculate the minimum capital requirement. This is done by the institution’s economic capital model with dynamic financial analysis (DFA), a popular choice.

**Why invest in EC?**

The benefits of using economic capital to determine risk over current pricing and actuarial/financial practices were hinted at when Australia’s Basel II experience suggested that banks pursuing advanced accreditation might, post accreditation, be able to achieve a release in the required amount of regulatory capital. However despite the first wave of banks now being either partially, or fully accredited, and ready to test the assumption, access to debt capital markets is tight and very different to pre GFC times. The likelihood of capital release is now so low, that using economic capital for regulatory capital arbitrage is unlikely.

However underlying the economic capital model is an approach that must capture the six key risks\* specified in GPS 113 (see box). The dynamic financial analysis approach is a popular choice as it is a holistic, multi-period financial modelling environment that analyses via stochastic simulation (“Monte Carlo”, many projected outcomes) the financial, business, company and risk outcomes for the insurer’s current book over a fixed period and in run-off. The diagram below provides a generic outline of the components of a DFA.



**Economic Scenario Generator:** is an econometric model that projects differing equity, real estate, yield and interest rate simulations under differing projected scenarios. The economic scenario generator provides the basis along with assumptions and model calibration fields to determine a range of risk outcomes.

**Risk Classes:** these are the six risk classes (or more depending on the dependent of risk clarified in risk landscape in the insurer) as per GPS 113.

**Company Model:** brings together the effects of the model assumptions and risk classes and may constitute individual statistical/mathematical/actuarial models for each of the risk classes and the correlation effects between each. The resultant economic capital derives economic capital from these models.

**Strategies:** these are senior and line management strategies overlays to bring a practical business focused dimension to the company model.

**Model Output:** the model output includes but is not limited to minimum capital requirement, economic capital, loss ratios and income and IBNR forecasts.

**Analysis/Reporting:** this analysis and reporting summarises the model output for management as well risk adjusted profitability drivers to support performance management approaches.

**Control/Optimisation:** this is the control mechanism for the model to optimise simulation runs and differing strategies.

## Economic Capital: risk and performance navigation

The rationale for implementing a DFA and the resulting economic capital provides a unified means of measuring and in turn managing, financial, operational and strategic risks that an insurer faces.

But how does economic capital differ from regulatory capital and what are the benefits of measuring it?

## Economic Capital: holistic capital management

Economic capital is the level of capital that a insurer needs to hold to strike a balance between bearing too much risk (too little capital) and delivering an unsatisfactory return to shareholders (too much capital). The risk bearing capacity in the case of GPS 113 aligns with regulatory expectations for the minimum capital requirement.

The benefits include:

- Cost effectiveness mechanism to determine the benefits of reinsurance programs
- Avoid over-capitalisation issues
- Asset and business funding allocation to make sure the right business units are properly compensated

## Enterprise risk management and a way forward

The International Association of Insurance Supervisors (IAIS) October 2008 “Guidance Paper on Enterprise Risk Management for Capital Adequacy and Solvency Purposes” while pre-dating the final release of GPS 113 explicitly links economic capital to the risk management practices of an insurer. The IAIS guidance paper points out the fundamental reason for an ERM is that it establishes a risk-aware culture that uses economic capital as the common currency of risk. An important element is that it aligns management incentives to capital requirements, and uses risk measurement models and tools to measure and manage risk.

ERM in this context means a shift from traditional risk management where risk is identified and mitigated to using risk measurement and risk practices as an opportunity driver. The Board and senior management typically get involved with ERM and so endorse risk management practices through the framework even when measurement and line management practices are in place. Thus using economic capital as the currency of risk in an organization gets its tone “set at the top”.

The IAIS guidance paper provides five key ERM governance requirements that if implemented effectively, go towards achieving organisational buy-in. These requirements range from having a sound ERM framework that covers all material aspects and risks faced by the insurer, to senior management and board oversight.

Moving forward involves a board endorsed, senior management understood ERM framework that dynamically incorporates a risk appetite with economic capital as the basis.

**GPS 113 comprises:**

1. **Quantitative Standards:** The insurer’s minimum capital requirement must be an amount of capital sufficient for the insurer’s probability of default to be 0.5 per cent or less. Default means the inability to meet claim payments or other liabilities, excluding liabilities that form part of the insurer’s capital base, as and when they fall due. This framework must allow for business written over a 12-month time horizon, catastrophe and operational risks over a 12-month period, underwriting, reserving, credit and market risks in run-off to extinction.
2. **Model Governance:** To be granted use of their internal model(s), the insurer must be able to satisfy APRA that the economic capital aligns an insurer’s risk management framework as per GPS 220 Risk Management (and GPS 221 for level 2 insurance groups). Additionally the insurer must be able to demonstrate that it has adequately trained resources to develop and maintain the economic capital. This must also incorporate adequate model lifecycle control of the economic capital and supporting documentation.
3. **Model Use:** APRA must be satisfied that model is incorporated into the management and decision-making processes of an insurer’s operations. APRA has set out indicators as to how to demonstrate this.
4. **Model Sufficiency:** The insurer must be able to demonstrate that it has an underlying risk taxonomy\* that captures:
  - a. **catastrophe risk** – natural or man-made events that produce insurance losses from many insured at the same time;

- b. **underwriting risk** – the possibility that future insurance exposures (both from business in force and future business) will be loss making;
- c. **reserving risk** – the possibility that the provisions for claims outstanding will be inadequate to meet the ultimate costs when the business is run off to extinction;
- d. **market risk** – the risk arising from all aspects of the value of investments and currencies, including interest rate changes, market price changes, counterparty default, exchange rates and liquidity of investments;
- e. **credit risk** – the risk of loss arising from failure to collect funds from creditors, including reinsurers and intermediaries; and
- f. **operational risk** – the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This includes legal risk but excludes strategic or reputational risk.

Within this there must also be a means of statistically determining risks accounting for any correlation between risks that might overlap, for example market or credit risk. Additionally for operational risk, there must be sufficient use of internal and external data sources, stress testing and scenario analysis.

5. **Partial Model Use:** An insurer may be able to use individual models within its minimum capital requirement calculation approach. This may be approved depending on company structure or acquisitions.

Underlying these elements is a clear annual reporting program and associated report that must be provided to APRA.

## Lessons learned: and the changing global regulatory landscape for insurers

*What went wrong and what did we learn from it? Deloitte Actuaries & Consultants Partner Elaine Collins looks at this thread running through many of the sessions of this year's International Association of Insurance Supervisors (IAIS) annual meeting in Rio de Janeiro with particular reference to regulation and what we can expect for Australian insurers with regulation nominated in this survey as their top issue for concern.*

At the organization's 16th annual conference, held in Rio de Janeiro, Brazil last year, the trend toward global insurance regulatory cooperation was evident, as regulators from around the world met to discuss lessons learned from the recent market events, the promotion of sound insurance markets, and what the future of solvency regulation and supervision might look like going forward.

**As for a session on lessons learned, panellists seemed to agree on one issue: that the insurance industry should find its own solution to systemic risk, separate from the answer arrived at for the banking sector.**

Michaela Koller, director of the CEA, the European insurance and reinsurance federation, said the distinct differences between banks and insurers can be summed up in three areas:

- **Business model** – Banks are more credit focused
- **Risk diversification** – Reinsurers and insurers globally trend toward having higher collateral
- **Systemic relevance** – Less likely in insurance

Mr. Koller said that international challenges include ensuring that regional and international initiatives on improving financial architecture can collectively monitor systemic risks worldwide. There must also be sufficient alignment between different approaches, while multiple layers of supervision should be avoided and the various characteristics of insurance well understood.

It should also not be forgotten that other threats to stability include natural catastrophe and terrorism. He also said that the European Union's Solvency II approach to solvency should be adhered to, while taking care to avoid measures that do not appropriately recognise the difference between banks and insurers.

"We all agree the insurance industry was not at the centre of the crisis but was certainly affected by it," panellist Jan Brockmeijer, deputy director of the Monetary and Capital Markets Department of the International Monetary Fund said.

While such practices as identifying systemically important institutions and addressing systemic risk up front through prudential standards may be ways in which future systemic risk might be avoided, Mr. Brockmeijer cautioned that turbulent financial times may continue for some time.

"Don't get too excited about recovery," Jan Brockmeijer, IMF deputy director of the Monetary and Capital Markets Dept said.

The future of financial regulation is likely to undergo significant, unprecedented change in the near future; therefore, all should be on their guard, in spite of the signs

of recovery being seen in the marketplace, J. Hari Narayan, chairman of India's Insurance Regulatory and Development Authority of India, noted during a panel discussion on corporate governance and risk management.

First steps might mean ensuring companies have the right people in the right roles. Chief risk officers, for example, should play central roles on company boards of directors. Enterprise-wide, companies should be filling senior management roles with highly qualified and proven leaders, panellists agreed.

Regulators and companies must also strike a balance between what is extreme and what is reasonable in terms of proper risk management practices. In some respects, culture will play a great part in the decision making process in this arena. Indeed, people matter more than structures, said panellist Maarten Hage of the De Nederlandsche Bank in the Netherlands and chairman of the IAIS Governance & Compliance Subcommittee.

He said regulators should focus attention on the staff skills of a regulated entity as well as the compatibility between staff members. Regulators must also be mindful of remuneration policies to ensure they do not contain adverse incentives. He said that modern compensations schemes may have encouraged disproportionate risk taking with insufficient regard to longer-term risks.

“Without trust, insurance cannot exist. As it is, the need for consumer protection arises from an imbalance in power, information, and resources between consumers and their financial services providers.” World Bank Senior Insurance Specialist Rodolfo Wehrhahn

On the plus side to the insurance industry, Mr Wehrhahn added, consumer protection can provide an important source of market discipline to the financial sectors, encouraging financial institutions to compete by offering better products and services. He noted that a good consumer protection scheme benefits consumers and the market in the long run.

If the past 18 months has demonstrated anything to insurance policymakers and regulators around the globe, it is that a strengthening of bonds across regulatory and jurisdictional borders is needed to stem the tide of future contagion and systemic risk in the financial markets.

Several sessions at the IAIS annual meeting spoke of how insurance supervision has changed as a result of recent challenges, and the efforts being made in the realm of cross-border regulatory cooperation.

The importance of risk-based capital requirements is gaining greater focus for regulators, as is consolidated group solvency assessment, proper actuarial assessments of insurance liabilities, and stringent stress testing. In addition, several countries reported they are finding answers in Solvency II, the EU's insurance rulebook.

In Australia APRA has recently closed a number of papers following requests for public comments and feedback. The most relevant to the General Insurance industry is the proposed changes to prudential reporting which seeks to align the current reporting requirements with those of Australian Accounting Standards while retaining certain prudential elements for capital adequacy purposes.

- December 2009 - Proposed changes to general insurance prudential reporting

The written submissions for this discussion paper are due 12 Feb 2010, with the proposed changes effective 1 July 2010, and the first reporting quarter, 30 September 2010

- September 2009 - Remuneration - Proposed extensions to governance requirements for APRA-regulated institutions - Response to Submissions
- June 2009 - Liability Insurance - public access to policy and claims information
- June 2009 - Consolidated Group Reporting for General Insurers
- May 2009 - Remuneration - Proposed extensions to governance requirements for APRA-regulated institutions

David Oakden of Canada's Office of the Superintendent of Financial Institutions said, in terms of capital modernisation, his jurisdiction is looking to the internal models found in Solvency II and Basel II to keep in line with what is happening in the rest of the world.

Matthew Elderfield, chief executive officer of the Bermuda Monetary Authority, added that Bermuda's solvency standards closely align to IAIS Core Principles and have achieved regulatory equivalence with Solvency II.

**European financial supervisory architecture: Shortcomings revealed by the crisis**

- Lack of adequate macro-prudential supervision
- Lack of early warning mechanisms
- No means for supervisors to make common decisions
- Lack of immediate cooperation between supervisors
- Inability to challenge supervisory practices on a cross-border basis
- Lack of consistency in supervisory rules, powers and sanctions across member states of the EU

This information was presented at the IAIS 2009 Annual Meeting by Karel Van Hulle, who heads the insurance and pensions division of the European Commission and is Directorate General of Internal Market and Services

**Making the way forward**

Panellists at a session entitled "Lessons from the crisis – for supervisors and the insurance industry" suggested the following steps to improve the quality and effectiveness of insurance regulation and supervision going forward:

- Move toward global convergence of standards, supervisory cooperation and a group-wide supervision framework
- Renew focus on investment management in the context of enterprise risk management and governance
- Increase focus on capital, investment and liquidity risk management
- Consider both macro and micro prudential perspectives in these areas

In terms of building common bonds between global regulatory authorities, a panel discussed the issue of the cost of recent failures by way of government bailouts and how, in the future, regulatory cooperation amongst international jurisdictions might better close the gaps in regulation and supervision – ensuring that no products or markets go unregulated.

In addition, it was noted that the IAIS is working to support the G-20 Leaders Declaration of November 2008, which called for supervisors to collaborate to establish supervisory colleges for all major cross-border financial institutions.

To this end, in addition to its Multilateral Memorandum of Understanding (MMoU) program, the IAIS is in the midst of reviewing and revising all of its Insurance Core Principles to meet the needs of 2010 and beyond. The meeting adopted a supervisory paper which provides guidance on the use of supervisory colleges in group-wide supervision.

**Action steps taken at the IAIS 2009 Annual Meeting in Rio de Janeiro<sup>2</sup>:**

- **The launch of the Access to Insurance Initiative, which is a new collaborative approach between international development agencies and insurance supervisors designed to strengthen the capacity and expertise of insurance supervisors and to facilitate their role in expanding access to insurance markets.**
- **The signing of three further insurance supervisory authorities to the IAIS Multilateral Memorandum of Understanding (MMoU). The MMoU facilitates cooperation and exchange of information between supervisors.**
- **The adoption of a guidance paper providing the key features for effective supervisory colleges in group-wide supervision.**
- **The extension of the Financial Stability Institute (FSI) on-line training tutorials to areas of specific interest to insurance supervisors, supported by the IAIS. Over the next few years, the FSI will introduce a number of additional insurance-focused tutorials.**
- **The adoption of a standard and guidance paper on the capital resources for solvency purposes to support the enhancement, improved transparency and comparability and convergence of insurer solvency internationally.**

---

<sup>2</sup> Source: IAIS Press Release, Oct. 26, 2009

## Issues Confronting the Underwriters

Underwriter respondents were asked to nominate and rank the five most important issues they thought were currently facing the insurance industry. We have provided the five main issues raised across all underwriters, with the results presented in Table 12.

Underwriters have once again, noted increased weather related claims and the implications of climate change as the main issue confronting underwriters.

The level of competition was once again listed as an industry issue. Most underwriters have indicated that the level of competition during 2009 was either the same or higher than 2008. Domestic motor appears to be the most competitive class with a number of new entrants writing business in the last year (see “*Significant issues impacting the underwriters – Competition*”). Underwriters expect rates to continue to harden despite high levels of competition.

Underwriting discipline was flagged as an issue by one-third of respondents. Respondents noted that the focus needs to return to underwriting discipline to offset the deterioration in investment income and restore profitability.

Similar to previous years, some respondents noted challenges in attracting and retaining staff. Only a quarter of respondents raised this issue in 2009 relative to 80% of respondents in last year’s survey. In our view this is a result of the tougher economic conditions and higher unemployment experienced during 2009, which is likely to have made easier for employers to retain and attract skilled staff (see “*Significant issues impacting the brokers – Talent Management*”).

**Table 12: Top 5 issues confronting the underwriters**

	% of respondents who raised the issue
Weather / Catastrophes / Climate change	67%
Changing regulatory environment	58%
Increased competition	42%
Underwriting discipline / Profitability	33%
Attracting/retaining staff	25%

Source: 2009 General Insurance Survey

## Issues confronting the Brokers

Broker survey respondents were asked to nominate and rank the five most important issues they thought were facing the insurance industry. We have provided the five main issues raised across all brokers, with the results presented in Table 13.

In 2009, attracting and retaining staff was the key issue raised by brokers. This was also raised in last year’s survey by both brokers and underwriters; however a much smaller percentage of respondents ranked this as an issue this time, perhaps given the rising unemployment.

Brokers flagged the flow on effect from the weak economic environment as the second most important issue. Participants flagged that claims stemming from the global financial crisis, in particular, Directors & Officers class actions are still coming through.

Like underwriters, brokers also noted increased weather related claims and the implications of climate change as one of the main issues. According to Insurance Council of Australia catastrophe disaster statistics (events>A\$10m), 2009 was a relatively benign year for weather related events, with 4 weather related events in 2009 relative to 7 in 2008.

Distribution was also an area of concern from the broker’s perspective.

**Table 13: Top 5 issues confronting the brokers**

	<b>% of respondents who raised the issue</b>
Attracting / retaining staff	60%
Economic environment and associated claims	50%
Government taxes / regulation	50%
Weather / climate change	40%
Profitability / Pricing	40%
Distribution (direct marketing, electronic)	40%

Source: 2009 General Insurance Survey

## Issues Confronting the Reinsurers

Reinsurance respondents were asked to nominate the issues most relevant and most likely to have an impact on their businesses. We have presented here the top six issues raised by the reinsurers.

Overall reinsurers have raised as the top issues the global financial crisis and its potential impact on claims particularly for the professional indemnity and D&O classes; the impact of climate change on the frequency and severity of catastrophic weather events; and pricing of risk (referring to a lack of stable and disciplined underwriting). Reinsurers expressed concern about the adequacy of rates in the primary market, particularly for the property proportional class.

Participants mentioned lower investment yield/return as an issue given the long tail nature of the liabilities in certain classes and the lack of disciplined underwriting. Reinsurers also raised regulatory change as an issue, referring to the introduction of higher capital charges on reinsurance recoveries from non-APRA authorised reinsurers. Participants voiced that as a result of the changes the demand for “local” reinsurance was high, highlighting that for some classes (such as public and product liability) the reinsurance suppliers had reduced down to APRA regulated reinsurers and Lloyd’s (given that Lloyd’s syndicates are effectively authorised by APRA). In their view, the availability of APRA regulated reinsurance support was likely to impact on capacity and influence rates. However some reinsurers also brought up concern over the high level of competition in the reinsurance market potentially deterring efforts towards rational pricing.

**Table 14: Issues confronting the reinsurers**

<b>Issue</b>	<b>% Respondents</b>
GFC / Economic environment	100%
Pricing of original risk	100%
Natural catastrophe event losses / climate change	100%
Investment returns	67%
Regulatory changes (APRA ruling on reinsurance recoveries)	67%
Rates/competition	67%

Source: 2009 Reinsurance Survey

## Survey Participants

We list here the participants in this year's survey. Where an international organisation is shown, the response is from its Australian-based subsidiary or branch.

---

### Underwriters

ACE Insurance Limited	LeasePlan Australia Limited
AIG Australia	Liberty Mutual Insurance Company
Allianz Australia Insurance Ltd	NTI
Ansvar Insurance	Sompo Japan Insurance Inc
Chubb Insurance	SRS Underwriting Agency Pty Ltd
CommInsure	Suncorp
Guild Insurance Ltd	Wesfarmers General Insurance
IAG	Westpac General Insurance Ltd.
ING Australia - Direct Insurances	Zurich

### Brokers

AON	Macey Insurance Brokers PL
Fitzpatrick & Co	Marsh
Guy Carpenter Reinsurance Brokers	Philp, Newby & Owen Pty Ltd
Insurance Advisemet Australia	Willis Australia
Jardine Lloyd Thompson	

### Reinsurers

General Re	SCOR
HANNOVER RE	Swiss Re
Munich Re	

---

## The Deloitte Insurance Industry Group

**Actuarial**

Elaine Collins	(02) 9322 7533	<a href="mailto:elcollins@deloitte.com.au">elcollins@deloitte.com.au</a>
Andrew Gale	(02) 9322 5011	<a href="mailto:agale@deloitte.com.au">agale@deloitte.com.au</a>
Caroline Bennet	(03) 9671 6572	<a href="mailto:cbennet@deloitte.com.au">cbennet@deloitte.com.au</a>
Lucy Simpson	(02) 9322 7329	<a href="mailto:lsimpson@deloitte.com.au">lsimpson@deloitte.com.au</a>
Paul Goswamy	(02) 9322 5542	<a href="mailto:pgoswamy@deloitte.com.au">pgoswamy@deloitte.com.au</a>
Catherine Dube	(02) 9322 5584	<a href="mailto:cadube@deloitte.com.au">cadube@deloitte.com.au</a>

**Assurance and Advisory**

Stuart Alexander	(02) 9322 7155	<a href="mailto:stalexander@deloitte.com.au">stalexander@deloitte.com.au</a>
Neil Brown	(03) 9671 7154	<a href="mailto:nbrown@deloitte.com.au">nbrown@deloitte.com.au</a>
Peter Caldwell	(03) 9671 7167	<a href="mailto:pcaldwell@deloitte.com.au">pcaldwell@deloitte.com.au</a>

**Consulting**

Fraser Ross	(02) 9322 7445	<a href="mailto:fross@deloitte.com.au">fross@deloitte.com.au</a>
Raffe Margossian	(02) 9322 5753	<a href="mailto:rmargossian@deloitte.com.au">rmargossian@deloitte.com.au</a>
Susan Woods	(02) 9322 5813	<a href="mailto:swoods@deloitte.com.au">swoods@deloitte.com.au</a>

**Forensic**

Kelvin Kenney	(02) 9840 7904	<a href="mailto:kkenney@deloitte.com.au">kkenney@deloitte.com.au</a>
Matt Kuperholz	(02) 9322 7000	<a href="mailto:mkuperholz@deloitte.com.au">mkuperholz@deloitte.com.au</a>

**Risk Services**

Harvey Christophers	(02) 9322 3477	<a href="mailto:hachristophers@deloitte.com.au">hachristophers@deloitte.com.au</a>
Mark Young	(02) 9322 3533	<a href="mailto:mayoung@deloitte.com.au">mayoung@deloitte.com.au</a>
Dennis Krallis	(02) 9322 7119	<a href="mailto:dkrallis@deloitte.com.au">dkrallis@deloitte.com.au</a>
Catherine Chu	(02) 9322 7808	<a href="mailto:cathchu@deloitte.com.au">cathchu@deloitte.com.au</a>

**Tax**

John Giannakopoulos	(02) 9322 7827	<a href="mailto:jgiannakopoulos@deloitte.com.au">jgiannakopoulos@deloitte.com.au</a>
Phil Lee	(02) 9322 7700	<a href="mailto:phlee@deloitte.com.au">phlee@deloitte.com.au</a>

**Corporate Finance**

Richard Young	(02) 9322 7348	<a href="mailto:richyoung@deloitte.com.au">richyoung@deloitte.com.au</a>
David Cooper	(02) 9322 5783	<a href="mailto:davcooper@deloitte.com.au">davcooper@deloitte.com.au</a>

**Note on industry group:**

Elaine Collins, Partner, leads General Insurance at Deloitte Actuaries & Consultants, the actuarial advisory practice of Deloitte. She acts as Appointed Actuary and Reviewing Actuary to a number of APRA-authorized general insurers. Elaine has also advised her clients on insurance liabilities at 99.5% probability of adequacy, as well as undertakes capital projections, profitability modelling, expense analyses, pricing, reinsurance and risk management assignments. On the professional side, Elaine has chaired Institute of Actuaries of Australia seminars and co-authored several actuarial papers.

Stuart Alexander, Partner, Assurance and Advisory, Deloitte has over 15 years experience managing engagements for a wide range of clients specialising in assurance and advisory services to financial institutions. He has worked with Deloitte in New Zealand, United States and Scotland and is an Approved Auditor for a number of authorised general insurers. Stuart also provides clients with financial due diligence, internal audit services and process improvement advice.

**General information only**

This publication is provided as general information only and does not consider your specific objectives, situations or needs. You should not rely on the information in this publication or disclose it or refer to it in any document. We accept no duty of care or liability to you or anyone else regarding this publication and we are not responsible to you or anyone else for any loss suffered in connection with the use of this publication or any of its content.

**About Deloitte**

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms, and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in over 140 countries.

With access to the deep intellectual capital of approximately 150,000 people worldwide, Deloitte delivers services in four professional areas—audit, tax, consulting, and financial advisory services—and serves more than 80 percent of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global companies. Services are not provided by the Deloitte Touche Tohmatsu Verein, and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas. Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/au/about](http://www.deloitte.com/au/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

**About Deloitte Australia**

In Australia, Deloitte has 12 offices and over 4,500 people and provides audit, tax, consulting, and financial advisory services to public and private clients across the country. Known as an employer of choice for innovative human resources programs, we are committed to helping our clients and our people excel. Deloitte's professionals are dedicated to strengthening corporate responsibility, building public trust, and making a positive impact in their communities.

For more information, please visit Deloitte's web site at [www.deloitte.com.au](http://www.deloitte.com.au)

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/au/about](http://www.deloitte.com/au/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

Liability limited by a scheme approved under Professional Standards Legislation.

© Deloitte Touche Tohmatsu, January 2010. All rights reserved.

**Analyst Certification:**

The research analyst(s) denoted by an “AC” on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analyst denoted by an “AC” on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst covers in this research) that: (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; and (2) no part of any of the research analyst’s compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

**Important Disclosures****Explanation of Equity Research Ratings and Analyst(s) Coverage Universe:**

J.P. Morgan uses the following rating system: **Overweight** [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Neutral** [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Underweight** [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] The analyst or analyst’s team’s coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

Coverage Universe: **Siddharth Parameswaran:** AMP Limited (AMP.AX), AXA Asia Pacific (AXA.AX), Insurance Australia Group (IAG.AX), NIB Holdings Limited (NHF.AX), QBE Insurance Group (QBE.AX), Suncorp-Metway Limited (SUN.AX), Tower Limited (TWR.NZ)

**J.P. Morgan Equity Research Ratings Distribution, as of December 31, 2009**

	<b>Overweight</b> (buy)	<b>Neutral</b> (hold)	<b>Underweight</b> (sell)
JPM Global Equity Research Coverage	42%	44%	14%
IB clients*	58%	57%	42%
JPMSI Equity Research Coverage	41%	49%	10%
IB clients*	78%	73%	57%

\*Percentage of investment banking clients in each rating category.

For purposes only of NASD/NYSE ratings distribution rules, our Overweight rating falls into a buy rating category; our Neutral rating falls into a hold rating category; and our Underweight rating falls into a sell rating category.

**Valuation and Risks:** Please see the most recent company-specific research report for an analysis of valuation methodology and risks on any securities recommended herein. Research is available at <http://www.morganmarkets.com>, or you can contact the analyst named on the front of this note or your J.P. Morgan representative.

**Analysts’ Compensation:** The equity research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Institutional Equities and Investment Banking.

**Registration of non-US Analysts:** Unless otherwise noted, the non-US analysts listed on the front of this report are employees of non-US affiliates of JPMSI, are not registered/qualified as research analysts under NASD/NYSE rules, may not be associated persons of JPMSI, and may not be subject to NASD Rule 2711 and NYSE Rule 472 restrictions on communications with covered companies, public appearances, and trading securities held by a research analyst account.

**Other Disclosures**

J.P. Morgan is the global brand name for J.P. Morgan Securities Inc. (JPMSI) and its non-US affiliates worldwide.

**Options related research:** If the information contained herein regards options related research, such information is available only to persons who have received the proper option risk disclosure documents. For a copy of the Option Clearing Corporation’s Characteristics and Risks of Standardized Options, please contact your J.P. Morgan Representative or visit the OCC’s website at <http://www.optionsclearing.com/publications/risks/riskstoc.pdf>.

**Legal Entities Disclosures**

**U.S.:** JPMSI is a member of NYSE, FINRA and SIPC. J.P. Morgan Futures Inc. is a member of the NFA. JPMorgan Chase Bank, N.A. is a

member of FDIC and is authorized and regulated in the UK by the Financial Services Authority. **U.K.:** J.P. Morgan Securities Ltd. (JPMSL) is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority. Registered in England & Wales No. 2711006. Registered Office 125 London Wall, London EC2Y 5AJ. **South Africa:** J.P. Morgan Equities Limited is a member of the Johannesburg Securities Exchange and is regulated by the FSB. **Hong Kong:** J.P. Morgan Securities (Asia Pacific) Limited (CE number AAJ321) is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission in Hong Kong. **Korea:** J.P. Morgan Securities (Far East) Ltd, Seoul Branch, is regulated by the Korea Financial Supervisory Service. **Australia:** J.P. Morgan Australia Limited (ABN 52 002 888 011/AFS Licence No: 238188) is regulated by ASIC and J.P. Morgan Securities Australia Limited (ABN 61 003 245 234/AFS Licence No: 238066) is a Market Participant with the ASX and regulated by ASIC. **Taiwan:** J.P.Morgan Securities (Taiwan) Limited is a participant of the Taiwan Stock Exchange (company-type) and regulated by the Taiwan Securities and Futures Bureau. **India:** J.P. Morgan India Private Limited is a member of the National Stock Exchange of India Limited and Bombay Stock Exchange Limited and is regulated by the Securities and Exchange Board of India. **Thailand:** JPMorgan Securities (Thailand) Limited is a member of the Stock Exchange of Thailand and is regulated by the Ministry of Finance and the Securities and Exchange Commission. **Indonesia:** PT J.P. Morgan Securities Indonesia is a member of the Indonesia Stock Exchange and is regulated by the BAPEPAM LK. **Philippines:** J.P. Morgan Securities Philippines Inc. is a member of the Philippine Stock Exchange and is regulated by the Securities and Exchange Commission. **Brazil:** Banco J.P. Morgan S.A. is regulated by the Comissao de Valores Mobiliarios (CVM) and by the Central Bank of Brazil. **Mexico:** J.P. Morgan Casa de Bolsa, S.A. de C.V., J.P. Morgan Grupo Financiero is a member of the Mexican Stock Exchange and authorized to act as a broker dealer by the National Banking and Securities Exchange Commission. **Singapore:** This material is issued and distributed in Singapore by J.P. Morgan Securities Singapore Private Limited (JPMS) [MICA (P) 020/01/2010 and Co. Reg. No.: 199405335R] which is a member of the Singapore Exchange Securities Trading Limited and is regulated by the Monetary Authority of Singapore (MAS) and/or JPMorgan Chase Bank, N.A., Singapore branch (JPMCB Singapore) which is regulated by the MAS. **Malaysia:** This material is issued and distributed in Malaysia by JPMorgan Securities (Malaysia) Sdn Bhd (18146-X) which is a Participating Organization of Bursa Malaysia Berhad and a holder of Capital Markets Services License issued by the Securities Commission in Malaysia. **Pakistan:** J. P. Morgan Pakistan Broking (Pvt.) Ltd is a member of the Karachi Stock Exchange and regulated by the Securities and Exchange Commission of Pakistan. **Saudi Arabia:** J.P. Morgan Saudi Arabia Ltd. is authorised by the Capital Market Authority of the Kingdom of Saudi Arabia (CMA) to carry out dealing as an agent, arranging, advising and custody, with respect to securities business under licence number 35-07079 and its registered address is at 8th Floor, Al-Faisaliyah Tower, King Fahad Road, P.O. Box 51907, Riyadh 11553, Kingdom of Saudi Arabia. **Dubai:** JPMorgan Chase Bank, N.A., Dubai Branch is regulated by the Dubai Financial Services Authority (DFSA) and its registered address is Dubai International Financial Centre - Building 3, Level 7, PO Box 506551, Dubai, UAE.

#### Country and Region Specific Disclosures

**U.K. and European Economic Area (EEA):** Unless specified to the contrary, issued and approved for distribution in the U.K. and the EEA by JPMSL. Investment research issued by JPMSL has been prepared in accordance with JPMSL's policies for managing conflicts of interest arising as a result of publication and distribution of investment research. Many European regulators require that a firm to establish, implement and maintain such a policy. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is only available to relevant persons and will be engaged in only with relevant persons. In other EEA countries, the report has been issued to persons regarded as professional investors (or equivalent) in their home jurisdiction. **Australia:** This material is issued and distributed by JPMSAL in Australia to "wholesale clients" only. JPMSAL does not issue or distribute this material to "retail clients." The recipient of this material must not distribute it to any third party or outside Australia without the prior written consent of JPMSAL. For the purposes of this paragraph the terms "wholesale client" and "retail client" have the meanings given to them in section 761G of the Corporations Act 2001. **Germany:** This material is distributed in Germany by J.P. Morgan Securities Ltd., Frankfurt Branch and J.P.Morgan Chase Bank, N.A., Frankfurt Branch which are regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. **Hong Kong:** The 1% ownership disclosure as of the previous month end satisfies the requirements under Paragraph 16.5(a) of the Hong Kong Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. (For research published within the first ten days of the month, the disclosure may be based on the month end data from two months' prior.) J.P. Morgan Broking (Hong Kong) Limited is the liquidity provider for derivative warrants issued by J.P. Morgan Structured Products B.V. and listed on the Stock Exchange of Hong Kong Limited. An updated list can be found on HKEx website: <http://www.hkex.com.hk/prod/dw/Lp.htm>. **Japan:** There is a risk that a loss may occur due to a change in the price of the shares in the case of share trading, and that a loss may occur due to the exchange rate in the case of foreign share trading. In the case of share trading, JPMorgan Securities Japan Co., Ltd., will be receiving a brokerage fee and consumption tax (shouhizei) calculated by multiplying the executed price by the commission rate which was individually agreed between JPMorgan Securities Japan Co., Ltd., and the customer in advance. Financial Instruments Firms: JPMorgan Securities Japan Co., Ltd., Kanto Local Finance Bureau (kinsho) No. 82 Participating Association / Japan Securities Dealers Association, The Financial Futures Association of Japan. **Korea:** This report may have been edited or contributed to from time to time by affiliates of J.P. Morgan Securities (Far East) Ltd, Seoul Branch. **Singapore:** JPMS and/or its affiliates may have a holding in any of the securities discussed in this report; for securities where the holding is 1% or greater, the specific holding is disclosed in the Important Disclosures section above. **India:** For private circulation only, not for sale. **Pakistan:** For private circulation only, not for sale. **New Zealand:** This material is issued and distributed by JPMSAL in New Zealand only to persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money. JPMSAL does not issue or distribute this material to members of "the public" as determined in accordance with section 3 of the Securities Act 1978. The recipient of this material must not distribute it to any third party or outside New Zealand without the prior written consent of JPMSAL. **Canada:** The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, or solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. The information contained herein is under no circumstances to

be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities must be conducted through a dealer registered in Canada. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed judgment upon these materials, the information contained herein or the merits of the securities described herein, and any representation to the contrary is an offence. **Dubai:** This report has been issued to persons regarded as professional clients as defined under the DFSA rules.

**General:** Additional information is available upon request. Information has been obtained from sources believed to be reliable but JPMorgan Chase & Co. or its affiliates and/or subsidiaries (collectively J.P. Morgan) do not warrant its completeness or accuracy except with respect to any disclosures relative to JPMSI and/or its affiliates and the analyst's involvement with the issuer that is the subject of the research. All pricing is as of the close of market for the securities discussed, unless otherwise stated. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients. The recipient of this report must make its own independent decisions regarding any securities or financial instruments mentioned herein. JPMSI distributes in the U.S. research published by non-U.S. affiliates and accepts responsibility for its contents. Periodic updates may be provided on companies/industries based on company specific developments or announcements, market conditions or any other publicly available information. Clients should contact analysts and execute transactions through a J.P. Morgan subsidiary or affiliate in their home jurisdiction unless governing law permits otherwise.

"Other Disclosures" last revised January 4, 2010.

---

**Copyright 2010 JPMorgan Chase & Co. All rights reserved. This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of J.P. Morgan.**



## 2009 General Insurance Industry Survey

Direct Underwriters, Reinsurers and Brokers