Just another crisis?

Recent Professional Development seminars covered the insurance industry, Australia's economic outlook and financial services licensing.

While the collapse of HIH and other insurance groups has been a crushing blow, it is not the sole problem confronting the insurance industry in Australia. After a relatively easy ride in the 1990s, the industry faces the challenge of poor underwriting profitability, which can no longer be outweighed by investment returns.

Further, events such as the 11 September terrorist attacks in the US have forced insurers globally to reassess their exposure to risk, resulting in steep premium increases. And public suspicion about management quality has resulted in calls for greater disclosure and tighter regulation.

These points were made by speakers at a Securities Institute PD seminar, "Insurance in Crisis-Critical Issues for Managing Risk and Capital". Perhaps reassuringly, the title of the seminar prompted one speaker, J.P. Morgan's Shane Fitzgerald, to comment that the "crisis" was "nothing particularly new" and that the industry was in part responding to cyclical factors including the availability of capital, new and existing business capacity and reinsurance costs.

Fitzgerald said industry profitability depended on underwriting profit or loss plus investment returns. In most recent years, underwriting had shown losses, and in the current bear market the industry could no longer rely on investment returns. In liability insurance, as an example, in 1998/99 the industry lost 50c for every dollar taken onto the books. "Poor profitability is one reason for large premium increases," he said, predicting double-digit premium increases in 2003, single-digit in 2004 and "then, it's anyone's guess".

Jim Atwood, of Swiss Re, defended the positive functions of reinsurance but acknowledged press reports of its use for "cosmetic purposes" and to deceive investors. "It could be managed better for the benefit of the industry," he said.

Reinsurance represented protection for policy-holders, enabling insurers to continue trading even in the face of unusual claims. Its innovative financial techniques promoted the efficient use of capital, resulting in cheaper insurance.

Better disclosure is the key to the proper understanding of reinsurance, Atwood said. "I would find it difficult to invest in any general insurance company on the amount of information that is out there publicly," he said. "I would like to see the publication in accounts of all reinsurance contracts."

The Australian Prudential Regulation Authority is acting to improve management practices and prevent undercapitalisation in the insurance industry, according to Darryl Roberts, APRA general manager, central region. Until now, insurers had too much discretion in the estimation of liabilities, he told the seminar. Now, these calculations must have actuarial supervision.

APRA was paying more regard to early-warning signs, with supervision applied "in a more forceful and less accommodating manner", he said.

Win some, lose some

Three economists presented a PD seminar with their assessments of the short-term prospects for the Australian economy. Michael Blythe of the Commonwealth Bank, Gerard Minack of ABN Amro, and Huw McKay of Westpac did not agree on all aspects of the outlook but made these general points:

Blythe: Housing investment returns are high but will turn down; the drought will be a brake on the national economy; a profit squeeze in industry may curtail capital spending; real wages will rise, consumer spending will rise; interest rates will remain under control.

Minack: Australia has been an economic outperformer in recent years but not for much longer; household debt is higher than in the US and saving rates are down largely as a result of the "off-the-scale" housing market; equities will underperform relative to the global scene; Australians will have to get used to single-digit returns on equities and eventually on housing.

McKay: The Australian dollar remains undervalued—despite recent gains, it is merely "treading water", although it may reach US65c in the second half of 2003; the end of the housing bubble will have knock-on effects throughout the economy; the drought will continue to affect exports; business investment will depend on the state of the international economy.

Time running out

Financial advisers received an emphatic reminder at a PD seminar that their applications for financial services licences should not be left until the last minute. Nigel Bond, of Freehills, and Richard Farmer and Frank Varga, of ASIC, stressed the importance of familiarity with the relevant law and regulations.

Before completing applications, advisers should analyse their businesses and determine the type of advice to be given, the type of licence required, the systems need to provide the services, the identity of representatives, the documentation to be prepared, and the required record-keeping and disclosure.

Online help and published guides were available to supplement the application information. J

Audio tapes are available by emailing audiotapes@securities.edu.au