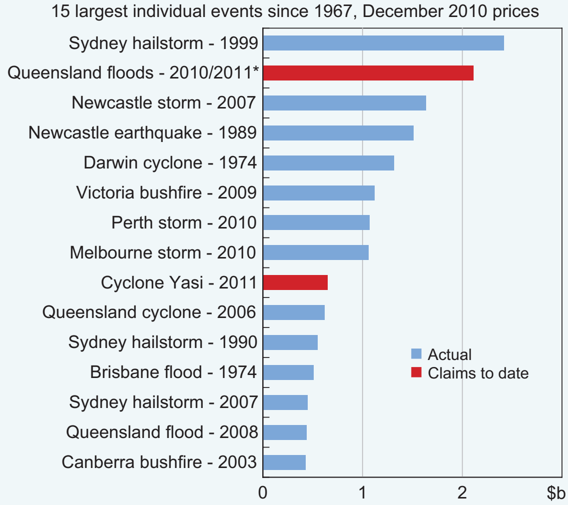
Box B

Reinsurance and the Australian General Insurance Industry

The recent floods, cyclone and other natural disasters in parts of Australia have caused a sharp increase in insurance claims on general insurers. Although general insurers are still working through their claims, early indications from their submissions to the industry body, the Insurance Council of Australia (ICA), suggest that some of these events will generate claims that are high by the standards of previous Australian natural disasters. According to the latest figures published by the ICA, the insurance industry has received nearly 50 000 claims, totalling $2.1 billion, from the flooding in Queensland. This would make this one of the largest Australian natural catastrophe claim events on record, as measured by the value of claims in constant price terms (Graph B1). Over 50 000 claims have also been received in relation to Cyclone Yasi, with an estimated claims value of $650 million.

More generally, there has been a pick-up in the frequency of large claim events in recent years. Nine of Australia's fifteen largest claim events since 1967, measured in constant price terms, have occurred since 2006. Consistent with this, total annual catastrophe claims, in constant prices, have averaged around $2 billion since 2006, compared with an average of $0.6 billion since 1970 (Graph B2, top panel). To some extent this increase reflects Australia's ongoing economic growth and rising population density, which can raise the value of claims from a given catastrophe event. To account for this, the ICA produces estimates of the value of claims from earlier catastrophes assuming they had

Graph B1
Australian Natural Catastrophe Insurance Claims
15 largest individual events since 1967, December 2010 prices



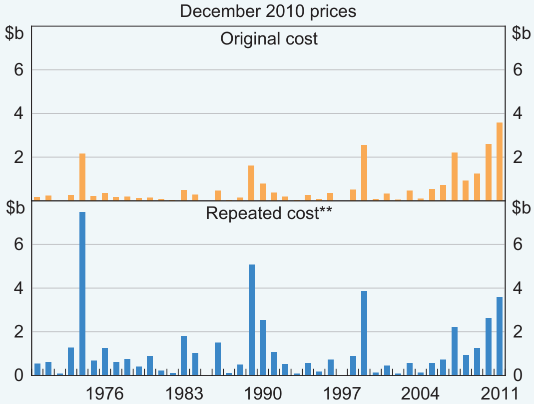
* The insurance industry is treating this as multiple events
Sources: ABS; Insurance Council of Australia; RBA

taken place under recent circumstances. Among other things, these 'repeated cost' estimates factor in changes in land use, building standards and economic development since the original event. These estimates indicate that the cost of recent catastrophe events has been more moderate by historical standards (Graph B2, bottom panel).

Graph B2

Claims from Natural Catastrophes in Australia*

December 2010 prices



* 2010 and 2011 include estimates for the recent natural disasters; 2011 is year-to-date

** Estimates of likely costs under recent circumstances

Sources: ABS; APRA; Insurance Council of Australia; RBA

Australian insurers are well placed to cope with the claims from the recent natural disasters. It is a standard part of their business to ensure they can meet their commitments to policyholders following events such as the Queensland floods. The Australian Prudential Regulation Authority (APRA) also promotes the resilience of insurers by mandating minimum capital holdings, supervising their risk management practices, monitoring their overall performance and, in the unlikely event of a shortcoming, requiring remedial action.

Reinsurance will play a significant role in capping the payouts by Australia's general insurers resulting from the recent natural disasters. Reinsurance is where an insurer pays a premium to transfer part of its claims risk to a reinsurer. This allows the original insurer to underwrite larger or unique risks; in effect, it is insurance for insurers. APRA's risk-based capital requirements for general insurers take into account both the insurer's risk profile and their reinsurance arrangements. Insurers must report details of their reinsurance arrangements periodically to APRA. They are also required to review their reinsurance arrangements regularly to ensure they remain compatible with their risk profile and risk appetite.[1]

Two particular forms of reinsurance mitigating the exposure of Australian insurers to recent natural disasters are single-event cover and 'aggregate' cover. The most common is a single-event policy which provides reinsurance cover (usually up to a limit) once claims due to a single catastrophe event exceed a certain threshold. An 'aggregate retention' policy provides cover (also up to a limit) once an insurer's cumulative claims from one or more events over a given period reach a certain threshold. In combination, these reinsurance arrangements can provide protection against a series of more moderate events, as well as one-off large events. Details of each insurer's reinsurance arrangements are generally not public. However, one large insurer in Australia has reported that the combination of its single event and aggregate retention reinsurance policies will cover more than three quarters of its gross claims from the flooding in Queensland.

Reinsurers are typically large specialist insurance companies with well-diversified global operations. For instance, the two reinsurers most commonly used in Australia, Swiss Re and Munich Re, have Australian operations that account for less than 6 per cent of their total global operations (Table B1). A large Australian claim event, such as the Queensland floods, therefore represents only a fraction of their normal level of claim payouts. It is not uncommon for reinsurance companies

1 For more information on reinsurance and minimum capital standards for Australian direct insurers, see Ian Laughlin (2011), 'Views from APRA', address to the Insurance Council of Australia's Regulatory Update Seminar, 9 March.

Table B1: Largest Domestic Reinsurers

	Global net premium revenue[a]		Standard & Poor's credit rating
	Total	Share earned in Australia	
	$billion	Per cent	
Munich Re	56.3	2.4[b]	AA–
Swiss Re	19.3	5.7	A+
Memo: largest domestic insurers[c]			
QBE	11.2	26.7	A+
IAG	7.1	78.7	AA–
Suncorp	6.4	90.7[b]	A+

(a) For the year ending December 2010; includes direct insurance and reinsurance premiums
(b) Share based on gross premium revenue
(c) Credit ratings are for the Australian insurance operations
Sources: RBA; Standard & Poor's; insurers' annual and interim reports

themselves to purchase reinsurance, a practice known as retrocession. Moreover, like Australia's domestic general insurers, reinsurers are closely monitored by regulators, both locally and in their home jurisdictions, to ensure they can meet their reinsurance commitments. The largest reinsurers operating in Australia are highly rated by international credit rating agencies, with each having a credit rating from Standard & Poor's of A+ or higher.

Though the reinsurers are well placed to meet the residual claims arising from the recent spate of natural disasters in Australia, it will probably cause them to reassess their reinsurance premiums. Several reinsurers have reported that the floods, in conjunction with Cyclone Yasi, the Christchurch earthquakes and the Melbourne and Perth storms, have prompted them to rethink their pricing for cover in the Asia-Pacific region. In addition, while it is too early to fully assess the impact of the recent earthquake and tsunami in Japan, this may place further pressure on the pricing of reinsurance.

Many direct insurers in Australia have had to pay to reinstate their reinsurance cover after it was triggered for the recent catastrophe claim payouts. These insurers will need to balance these additional costs with the capital savings obtained by reinsurance when renewing their cover for the next financial year. It might also be a challenge for some insurers to obtain the same reinsurance protection as contained in their 2010–2011 reinsurance programs.