

REINSURANCE COMES UP DOWN-UNDER

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AUSTRALIA is at the end of the line for trade and for services such as insurance associated with trade. There has been no significant amount of multilateral trade based in its seven states. So Australia has not yet developed a trading or insurance centre for international trade.

This is an important consideration, because major trading centres reflected exchanges of goods, either simple transshipment or exchange of processed goods for raw materials. Insurance naturally developed around these physical exchanges.

Therefore, in 1986 the GIO (Government Insurance Office of New South Wales) established within the general fund a reinsurance division, which trades as GIO Re. Given that this step is at odds with historical development it is interesting to review the experience so far, against the expectations. After all, the major insurance exchange, Lloyd's, developed as a product of London's dominance in worldwide commerce.

An exchange can take many forms. The traditional view that it must have a physical personal existence, such as Lloyd's, has been overturned in the trading of fixed interest and listed securities. In many places around the world, trading of securities on computer screens achieves an exchange which is a computer database. The mainframe computer can be situated anywhere in the world. In some sense the 'exchange' has no tangible physical existence except at the screen of each user, as he is using it. The historical dependence on trade routes has been broken.

The emergence of screen-traded insurance and reinsurance is already beginning. A true global screen-traded exchange may yet be many years away for insurance and reinsurance, but the estimate for the date of arrival is being brought forward each year. The traditional barriers to remote entry into the reinsurance scene are steadily eroding. Apart from the view that technology is causing the world to shrink, GIO Re grew out of an assessment of the core of the Government Insurance Office of New



South Wales. The management's conclusion was that the office possessed two businesses for profit. One of these was the provision of financial services to individual persons. The other was supplying services regarding various risks to the corporate sector.

The management of risk follows basic principles which apply to companies, to insurers, and even to national insurance markets. The international reinsurance scene presents the opportunity to identify the profitable segments of the worldwide

market, by class, and by country. Hence a fundamental requirement is knowledge and market information. GIO Re has three roles, covering the domestic market, countries nearby and the world at large.

National Reinsurer: Australia is a vast country. The separate urban capitals of each state are much more remote from one another than European capitals. Each has a different pattern of exposure and the risks are independent, much more so than are separate countries in Europe (a number of which can be exposed to the same storm).

The domestic household and motor vehicle market is generally dominated in each state by the local government insurance office and by an insurer associated with a motoring organisation. The business is written direct with high rates of retention on renewal. Reinsurance requirements for these portfolios are for catastrophe only. Since the population of the country is only 17 million, the catastrophe cover must be found on a worldwide market. Any one reinsurer can provide only a small share of the catastrophe protection for the market.

The market for commercial risks is very different. This market is dominated by brokers, and by international broking firms in particular. With the abolition of the tariff in 1974 (as a restrictive trade practice) there has been a sustained period of rate cutting and widening of coverage. A significant amount of business is placed overseas at even lower rates. Against this background GIO Re's writing of Australian



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risks has been low since 1986 and there is no incentive to compete in the cutthroat commercial market.

Regional Reinsurer: At commencement in 1986, offices were opened in Jakarta and Tokyo. In 1989 an office in Kuala Lumpur was opened and an office for Bombay is planned for 1992. The role of each office is primarily to collect information and market knowledge. A representative function which makes the market aware of GIO Re is also undertaken.

South-eastern Asia is an economic region which must grow in the next 50 years at a much faster rate than the rest of the world. Australia is physically part of this region and its future will be inextricably bound with the region. There is an increasing appreciation of this both in Australia and in many parts of Asia.

The regional demand for insurance and reinsurance is still relatively low, but growing rapidly. Asian attitudes to relationships are much more long-term than are western attitudes. Business development has been slower than expected to date but there are signs that it will in due course exceed the original expectations.

International Reinsurance: The international reinsurance broking community is the real exchange today. Some firms, or perhaps more correctly, some parts of firms, are more efficient than others in tapping the market for cessions of business and then finding accepting markets in which to place it. The danger for a

remote accepting market is that it will be a market of last resort for cessions on poor terms which cannot otherwise be placed.

This has certainly been true of international reinsurance placed in Australia in the past, and has led to a healthy suspicion of the business as a class. One must never lose sight of this in a remote centre and there is ample evidence that some broking firms have offered only 'rubbish' business. To break with this pattern several principles have been followed:

- Seek good market information
- Be a net underwriter (reinsure only the catastrophe aggregation)
- Write significant lines (make it worthwhile for the underwriter to spend time on analysis and for the broker to spend time on responding to questions)
- Write only on terms which are expected to be profitable (often, a significant line will influence the terms)
- Each underwriter must visit the region for which he is responsible twice a year
- Eschew broad covers in favour of regional covers to minimise catastrophe accumulation.

As part of the drive to obtain additional market information a video telephone link was established in November 1990 between GIO (UK) office in Lime Street and head-office in the capital of New South Wales. This link gives

underwriters in Sydney an opportunity to speak face to face with London brokers. This has been outstandingly successful in terms of increased information flows and has been amply justified by the additional profitable business written.

The performance of the international broking community covers a spectrum. At one extreme is the view that London is the only underwriting centre and that flows of business are one way, to London. At another extreme is the view that the broker is the exchange and his role is to seek business opportunities wherever they may be.

The first view tends to be correlated with a rejection of screen-based trading, video telephones and so on; the second view actively embraces the new technology and an awareness of change. The establishing of GIO Re is wholly predicated on the second view.

At the time of writing the net profit for 1990-91 is expected to be at least as great as it was for 1989-90. The losses for Hurricane Hugo and for the European storms (90A) are each of the order of A\$20 million gross, well within the retroinsurance protection held for these events. No other event has breached the retention level for the retro programme (currently A\$6.25 million).

IBNR provisions are tested against RAA standards for liability business and against

statistics for comparable property reinsurers for property business. In each case the nature of the portfolio is likely to have a shorter tail than those benchmarks — but that of course is yet to be proven. The judgement to date is therefore that the initial object of a profitable entry to reinsurance has been achieved.

As a reinsurer, the current strategies will continue. The classes/regions of business written will change as the areas of profitable opportunity change over time. The development of the GIO as a whole, nationally and internationally, means that its existence as a statutory insurer for a single state has been left behind. Planning for the floating of the GIO as a listed insurer with a wide shareholder base is an active strategy of the management. It is hoped that this will be achieved within the coming year. ■

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