



Access Your Account for FREE Now

Home / Markets

Sep 9 2016 at 11:45 PM Updated Sep 9 2016 at 11:45 PM

Save Article Print License Article

Australian insurers face a tough three-year outlook



Australia's insurance industry is being lashed on all front. **Michele Mossop**



by Vesna Poljak

The insurance industry globally is going through one of its toughest periods in history because of the corrosive effect ultra-low interest rates have on their businesses.

Australian listed general insurers are better off than their global peers. But the three-year outlook for the sector is still clouded by growing competition; discounted premiums because of the unusually long period without catastrophic disasters; and the realisation that income from investments will stay at low levels as long as central banks maintain their stimulatory policy settings.

The big Australian general insurers, IAG and Suncorp, have their challenges. The largest part of their business is short-tail, or short-term insurance such as car cover. These policies often rely on investment income to contribute to profitability and low interest rates are hampering these earnings. Their long-tail business, such as workers' compensation, could demand payouts for five or even 20 years. So in this case, not only do they need to manage the problem of low earnings on the investment side, but low rates also inflate the value of all future liabilities.

Investors and analysts believe that premiums in the Australian market, and for commercial insurance globally, are too low. It's almost counter-intuitive, but it takes a

Advertisement



Access Your Account for FREE Now



Expressions of Interest



catastrophe event to see capital withdraw from the industry and allow insurers to lift their prices. The benign run of weather conditions and lack of large events globally has held back repricing.

"The industry manages to compete away the good times too quickly," says fund manager Mark Nathan from Arnhem. There's another problem with taking a short-term view on insurance stocks: inevitably it means investors don't get the benefit of averaging out of catastrophe risk, leaving them exposed to a narrow window of disasters. "If you're buying an insurer for the short term, the returns will be subject to the volatility in those catastrophes," Nathan adds.

"Insurance cycles tend to be reasonably long and generally you need some sort of catastrophe to harden the market or push prices up. Globally we haven't seen much in the way of significant events so we're still in a reasonably challenging environment."

Having two dominant general insurers keeps the industry reasonably rational, but competition is especially fierce right now.

That's no different to what's happening to the former supermarket duopoly, says fund manager Hugh Dive from Aurora Funds Management. "What's a bigger issue for me which hasn't really been focused on in the market is Suncorp and IAG are facing market share losses through a bunch of challenger brands. It's a bit like what's going on in grocery. The higher margins have given the Aldis of their world more oxygen and the ability to nibble away at market share," he says.

"Looking at the domestic insurers, over the next three years it's hard to paint a picture where the situation is going to be better in three years than it is now. You want to buy them when they're on their knees, not at the top of a cycle."

That's why the weather is so important, even though it's not something investors can forecast, and why insurance is more complicated than banking. Insurance is also highly regulated – for example, companies have to invest policyholder funds in the market where that insurance was written.

"Most of the participants in the market are suggesting this is one of the toughest operating environments they've ever seen," says Nathan.

QBE Insurance Group is regarded as a global commercial insurer [and its last results were greeted with a sell-off](#). On a total return measure, its shares have underperformed the S&P/ASX 200 Index over five years incurring a loss of 16.7 per cent versus 58.85 per cent for the index including the benefit of dividends. Suncorp is ahead 113.97 per cent and IAG 144.25 per cent.

But with an eye to 2019, Dive thinks that QBE is the better long position of the three. QBE has more to gain from any increase in the level of interest rates in the United States and it would also benefit from Australian dollar depreciation. The Federal Reserve has been unable to replicate its December 2015 rate hike and as, of Friday, financial markets are pricing in a 59 per cent chance it will raise rates at its December 2016 meeting.

"Insurers along with retirees have been among the most challenged by zero rates globally," Dive says. "The GFC wasn't caused by insurance companies, but these extremely low rates have impacted insurers."



33-35 Braybrooke Street BRUCE ACT

Development / Land 6,559m²



POA



For Lease

1 Nash Street PERTH WA

Offices 500 - 3,900m²

Related articles

Former EC president loses privileges

2 mins ago

Markets Live: ASX slides in \$27b selloff

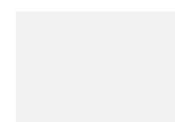
LIVE |

Autosports float under Pockett watch; Freedom taps Hancock

The second life of a superstar currency trader

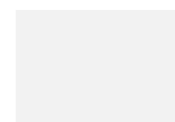
Skittish markets brace for end of policy era

Latest Stories



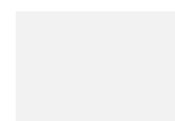
Former EC president loses privileges

2 mins ago



Cabcharge chairman to retire

2 mins ago



Reality set to bite for lithium hordes

36 mins ago

Advertisement

The extreme of this is witnessed by the international life insurers. Platinum Asset Management argues the worst-case scenario is one of government guarantees and policyholder haircuts [if central banks continue on their course of negative interest rates](#). Long-dated government bonds are used by life insurers and defined benefit pension schemes to pad out their liabilities. When the Bank of England responded to Brexit with a rate cut, the pension deficit of FTSE 350 companies blew out by an estimated £10 billion, the fund manager says.

Recommended



Apple iPhone 7's faster chip takes smartphones into gaming console...



AccorHotels Asia Pacific boss tips more rewards on the cards



Aged care crisis puts family home in firing line



ECB, banks drag ASX down for fourth consecutive week



Could the bond bull market really be over this time?

From Around the Web



3 Ways You Can Avoid Your Car Insurer's "Loyalty Tax"

Mozo



Victorian home ownership rates collapse

Domain



Claiming your rebate for private health insurance

Tax Return | Tax Accountants Australia | H&R Block



Apps: 5 Great Alternatives to Microsoft Project

Get App



Say Goodbye To Snoring With This Cool Trick

Online Health Wiki

Recommended by