



Why the cost of insurance is rising

Why are premiums rising?

It is an indisputable fact that insurance premiums across Australia are rising.

Fundamentally, rising premiums are being driven by a sharp rise in claims volumes, higher claims amounts, and a substantial increase in the costs associated with meeting those claims.

Recent weather-related and other natural catastrophes in Australia and in other regions around the world are having huge flow-on consequences for the insurance sector globally. In just this year alone, cyclones, severe storms, floods and bushfires have ravaged many parts of Australia, leading to record claims levels across the nation.

Elsewhere in the world, major earthquakes have had devastating effects in both New Zealand and Japan, with parts of Japan also being destroyed by a tsunami, while tornadoes and severe flooding has impacted large parts of the United States.

Insurance companies are increasing their policy premiums in all regions and in most product areas to offset the sharp rise in the cost of reinsurance and in the direct claims being made against them, as well as the substantial increases in associated costs, including the higher costs of building materials and labour to carry out repairs.

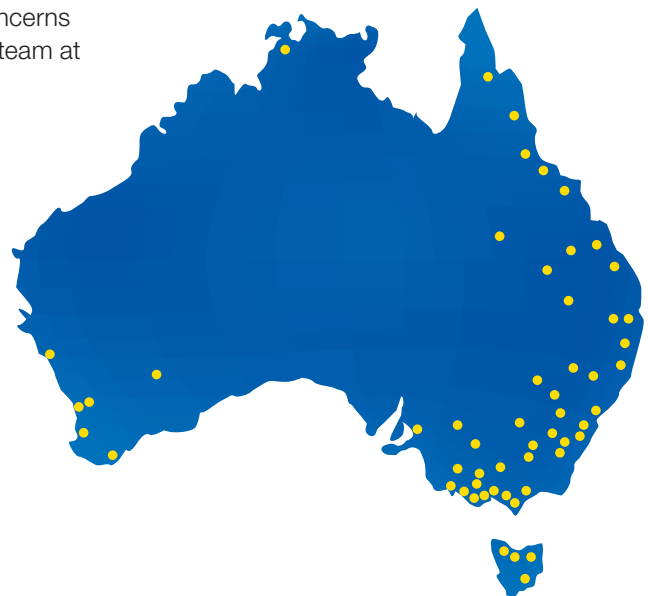
Our commitment to Australia

In tough times, the 'easy answer' would be to withdraw altogether from certain market segments. CGU has no desire to dilute our operating presence or product offerings to the market.

As a national insurer with 160 years of history, CGU is a trusted national brand with a wide geographic spread, and we have a demonstrated long-term commitment to providing comprehensive insurance cover.

Our priority is to minimise premium increases, while maintaining our high quality of policy offerings and level of service so we can continue our commitment to the market, our intermediaries and our end customers, both now and in the future.

After reading this report, or if you have any questions or concerns around insurance you would like to discuss, our dedicated team at CGU is on-hand to provide you with ongoing support.



Key issues affecting insurance premiums

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What makes up an insurance premium?

CGU wants to help you understand the reasons why premiums are increasing.

As a matter of course, we continually review our premiums to ensure they are priced adequately to protect all our customers. Our aim is to get the balance right between keeping premiums affordable while ensuring we have enough funds to fully support our product offerings.

At its simplest, insurance is all about pooling resources – it's about a group of people coming together to share their risks.

What happens is that a large number of people pay a relatively small amount of money into a pool on the basis that if their property is damaged, stolen or destroyed, money will be taken from the pool to help pay for their repairs or replacement.

An insurance company's job is to manage the pool and ensure there is enough money coming into it through premium payments to meet the cost of future claims as they arise.

To do this, an insurance company has to put a price on the likelihood of someone making a claim from the pool. It does this by estimating the chance a claim will be made and multiplying this by the expected average value of a claim.

Premium components

There are a number of key components that feed into the calculation for pricing an insurance premium.

These include:

- The overall cost to an insurance organisation of paying out claims to its customers;
- The cost of reinsurance, which involves buying cover from other insurance companies to spread out the risk from large major event claims;
- The cost of general expenses, including the cost of estimating, collecting and managing each insurance policy;
- On top of all the insurance-related costs, there are a whole range of government taxes, such as the Fire Service Levy, GST, stamp duty, and financial services licensing costs;
- There is also the cost of commissions paid to insurance intermediaries;
- And there are the business costs associated with borrowed capital and in meeting shareholder returns.

All up, therefore, insurance companies like CGU have a whole range of costs to consider in pricing their premiums. And recent events have compounded to put unprecedented financial pressure on insurance companies.



Rising cost of claims

The amount paid out to customers who make claims is the biggest single cost for any insurance company.

Claims levels across Australia have reached unprecedented levels over the past year as a result of a spate of natural disasters.

For example, CGU received 25,000 extra claims over the 2010/11 summer period alone as a result of events including cyclones and floods across Queensland, New South Wales and Victoria.

In conjunction with the rising number of claims, the actual cost of meeting claims has also been increasing because the materials for rebuilding and repairs have become more expensive, and the cost of labour and tradespeople has risen sharply due to the high demand for their services.

Increasing construction costs

From builders to carpenters, and electricians to painters, tradespeople in some areas of Australia have been inundated with work arising from insurance claims. Average payment rates have risen accordingly, and there is every likelihood they will continue to rise as labour demand exceeds supply.

And, of course, many of us also own more expensive items these days, and an insurance premium will rise to reflect the increase in the value of the assets being insured and their replacement value, regardless of any additional external factors.

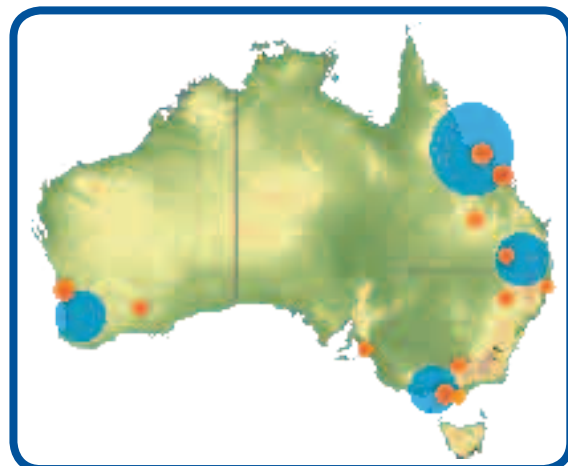
Together, these factors have resulted in a sharp rise in the cost of paying insurance claims in all locations, not just in areas that were specifically impacted by the weather.

Increasing size and frequency of natural disasters

There has been a significant increase in both the scale and frequency of severe weather events in Australia in recent times, with major storms, floods, cyclones and earthquakes causing massive destruction.

There has also been an increase in smaller storms and events, which receive less publicity but still generate a significant number of claims.

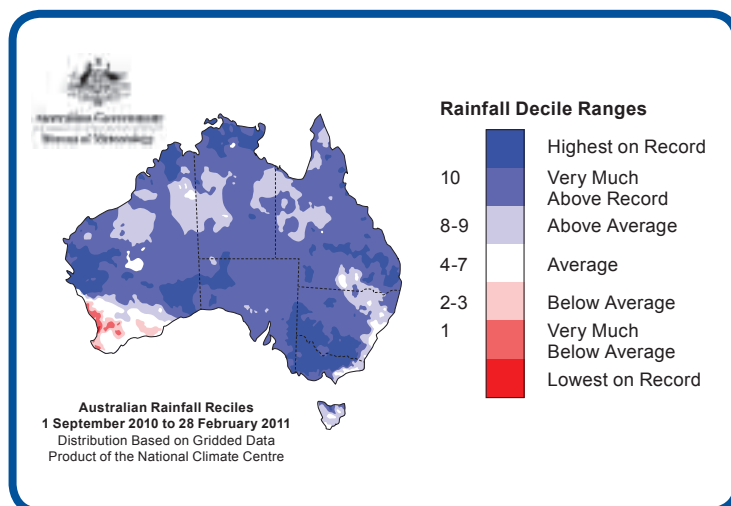
This map shows recorded events around Australia in the 12 month period from March 2010 to February 2011. The map shows the distribution of these events around Australia, with most affecting those areas where the bulk of our population resides and therefore causing more overall damage. The larger bubbles on the map represent bigger events – the larger the bubble, the bigger the event.



Weather events are Australia-wide

There is some perception that all the major events over the past year have occurred in Queensland, but they have been national and the effects felt across Australia.

The major events include the Melbourne hail storms, floods across Victoria and other severe rain storms in Melbourne; Cyclone Ului in central Queensland, Cyclone Yasi and Cyclone Tasha, all in Queensland, with Brisbane and Toowoomba suffering major damage; the Perth hail storms and other severe storms in Western Australia, and the Kalgoorlie earthquake; and major storms in South Australia. Bushfires have also caused severe damage across WA and other parts of Australia.



Also in our region we have had the NZ earthquakes and Japan earthquake.

The Bureau of Meteorology map below shows rainfall from across Australia from September 10 to February 2011. Areas of high population have had the highest rainfall **ever**, with most of Australia experiencing above-average rainfall.

It also shows that parts of Western Australia had the **lowest on record** – which contributed to recent bushfires in the state.

Size versus volume of claims

Each major event is unique and requires a different claims response and generates a different type of outcome.

Some events have only relatively few claims but each claim is large, for example the damage to houses caused by Cyclone Yasi in Queensland.

Others, such as the Perth and Melbourne hailstorms, create a large volume of relatively small claims. These type of events also impact on claims settlement periods because of the large numbers of claims involved.

Leveraging our national disaster response capabilities, CGU is one of the few Australian insurers with the scale and capability to effectively respond to a major event anywhere in Australia.

We insure all Australians – and, unlike some other insurers, we don't exclude certain regions.

What you can do to help

Key actions for brokers

- Emphasise risk management techniques to customers that may help stem loss from extreme climate events: robust flood defences or bushfire protection strategies, for instance.

Top tips for customers

- Integrate resilience and resistance measures into Property and Business Disaster Recovery Plans and work in tandem with local community initiatives.
- Adopt a robust policy to meet new and future building regulation and legislation.
- Take appropriate risk management advice to help avert loss from climate events.
- More broadly, keep abreast and act on the latest research into climate change, its impact, and potential solutions – in essence, be part of the solution.
- Maintain buildings – roofs and gutters should be regularly inspected and kept in good condition and free of debris
- Consider storing stock off the floor, perhaps using pallets. This will minimise the likelihood of stock damage in the event of heavy rain entering the building.

Damage and interruption to your business is costly and time consuming, so preventative action could make all the difference.

Rising natural perils claim costs

The graph below represents 12 years of natural peril and catastrophe claims costs, and presents a summary of rising claims costs.

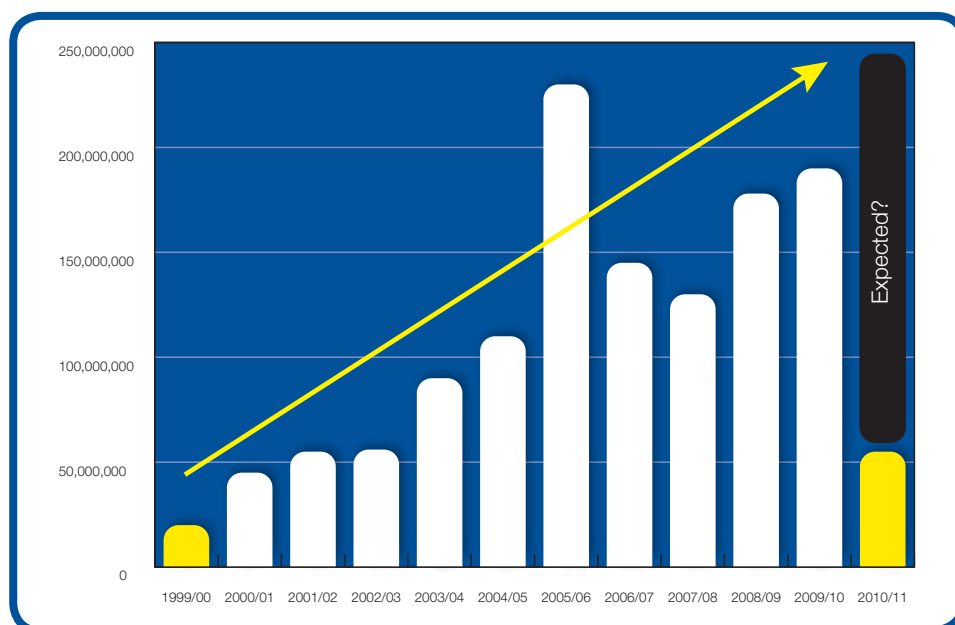
Natural peril claims costs, from events such as storm, fire, hail and rain, have been rising steadily since 2007-08. In the current calendar year (2011) to 21st April costs nationally had exceeded \$4.2 billion. This is already twice the \$2.14 billion in 2010, and nearly four times the \$1.18 billion in 2009 and \$1.1 billion in 2008*.

These costs are increasing, but it is not necessarily a new phenomenon, and the industry as a whole has been somewhat slow in accepting that these costs are normal or expected.

More frequent events are increasing the average claim size as demand for services increases.

Events are becoming the 'norm' – a new normal.

Combined Ult Cat and Ult Per Gross incurred



Claims material and labour costs

CGU received 25,000 additional claims as a result of the weather events and natural disasters across Australia over the 2010/11 summer. Across the industry in the first four months of 2011 there were nearly 120,000 more claims than in the whole of 2010.

The cost of claims has increased in terms of the number of claims has received and the scale of the damage.

Simple supply and demand principles mean that the cost of labour for builders, plasterers, plumbers and other tradespeople has increased due to higher demand. This is a national issue because tradespeople often travel to where the work is, so large events in Queensland also put pressure on labour costs in Victoria and South Australia.

The same goes for building supplies. There is a finite number of companies who supply plasterboard and high demand is causing an increase in prices. It's becoming more expensive to settle claims.

National suppliers such as Boral and One Steel experience big rises in demand when events become more frequent.

“A 5.4% rise in housing construction costs will dampen efforts to revive Queensland’s building and construction industry,” according to a report released by **Master Builders** – 3 March 2011.



The role of reinsurance

Reinsurance protects the insurance pool as a whole – it is effectively insurance for insurers.

Insurance companies cannot expose shareholders to significant one-off losses – so the support of reinsurance is vital.

One insurance company could not take the hit of a major catastrophe by itself. It's how we all spread the risk.

Reinsurance is critical to our ability to do business. It would be a foolish insurer who didn't insure themselves!

As a company, we need to ensure we have the right level of reinsurance which accurately, indeed conservatively, reflects our risks. We therefore annually review and purchase reinsurance which meets our needs, just as we expect our customers to review their own insurances every year and make the purchases required to meet their needs.

The strength and quality of our reinsurance program plays an important role in underpinning our AA- financial strength rating, the highest rating of any Australian general insurer. Maintaining this rating is important because it directly influences our cost of capital which is a significant expense for CGU.

Reinsurers' focus on Australia

Reinsurers are increasingly concentrating on natural catastrophe type events and this is having significant implications for Australia, as we have some of the top global exposures to storm and flood events.

- Four events in Australia and one in New Zealand were in global reinsurer Munich Re's 2010 list of 50 most-costly world events.
- Four of those events were in 2010's 10 most-costly events around the world.
- That's **10%** of the major events from a region that makes up less than 1% of the world's population.
- The cost of doing business is rising for global reinsurers and these costs need to be passed on to their customers – insurance companies.
- Lifting premiums across the board will help offset the expected increase in reinsurance costs.

The global reinsurance industry now perceives Australia to be a more 'risky' place.

Regional events such as the Christchurch earthquake in New Zealand and Japanese earthquake and tsunami also affect our regional pricing, and other world events impact overall reinsurance costs.

Rising reinsurance costs are therefore pushing insurance premiums higher across the board and in all areas.

Where will reinsurance costs rise?

- Reinsurance costs are driven by many factors, including the frequency and cost of natural disasters and other extreme weather events.
- Reinsurance is a global business, and so large events in the region as well as in Australia will impact how global reinsurers price the business they take on in Asia-Pacific and Australia.
- That's another reason why events in Queensland have an impact on premiums in other states – and so, for that matter, do events outside Australia in our region, such as the earthquakes in NZ and Japan.
- Recent events will influence how 'risky' reinsurers believe Australia is and this will be reflected in their prices.
- Property is most impacted by increased costs of reinsurance.

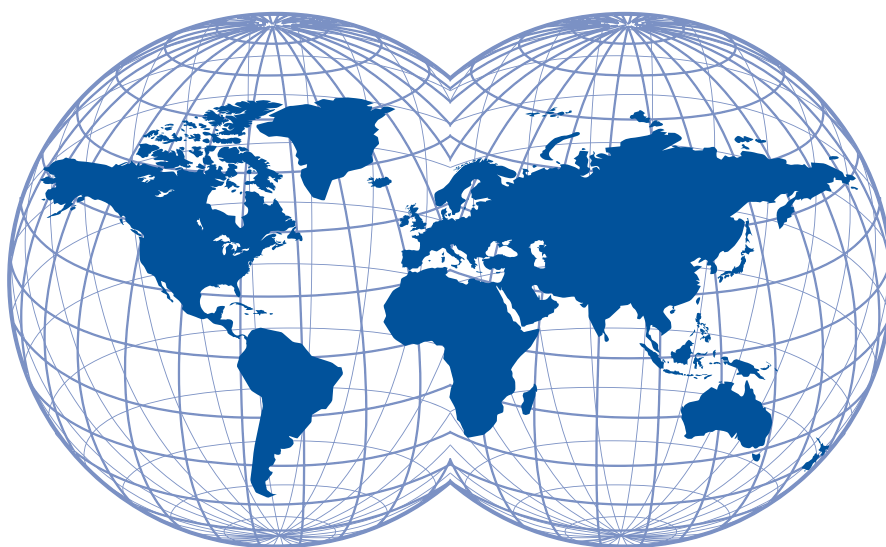
What you can do to help

Key actions for brokers

- Manage customers' expectations by keeping them informed of the implications of increased reinsurance costs on insurers' positions.
- Ensure optimal data is provided. Improved exposure and location data from customers will help insurers allocate pricing and capacity, to ensure the best prices are obtained.
- Educate your customers that policies covering homes and commercial properties in high risk areas will cost more to insurer than those in low risk areas.

Top tips for customers

- If you have a multi-location business or business covers on a floating basis, it will be important to provide your insurer with this information for accurate pricing and capacity considerations.



General claims inflation

The cost of claims settlements is increasing across all lines of business.

There are many elements contributing to this but essentially the cost of goods and services increases year on year but insurance premiums have been reducing or remaining unchanged.

There is a resulting need to increase rates in order to mitigate this trend.

Particular areas for concern include:

- Standard inflation, such as increases in average weekly earnings or increases to the consumer price index.
- Judicial inflation or an increase in legal costs, even for relatively low-level personal injury claims.
- Advances in vehicle technology and construction pushing up the cost of motor repair.
- Increased costs to meet changes in local authority legislation and building regulations.

What you can do to help

Key actions for brokers

- Manage customer expectations in view of the broad spread of factors giving rise to claims inflation with consequential implications on rates.
- Ensure risk management advice and building surveys address the latest factors that may prompt claims.
- Consider increasing excesses on policies to minimise the increase in insurance premiums.

Top tips for customers

- Keep abreast of, and heed, the latest risk management advice across the broad range of potential claims that may be incurred, and take appropriate steps to mitigate loss.
- Carefully review imports for currency conversion costs, including building materials and specialist components from abroad.
- Report all claims promptly to minimise delays.

Modern construction methods

What does this mean?

The growing awareness of the importance of environmental sustainability is playing a key role in the approach to modern construction methods. As a result, there are a number of factors that insurers have to take into consideration when assessing the risks involved.

Examples would include:

- External finishing systems such as timber cladding, EIFS (Expanded Polystyrene with render overlay) and EPS (Expanded Polystyrene Sandwich) panel can significantly increase external fire spread and vulnerability to arson losses.
- Timber frame buildings are becoming more popular due to the 'green' agenda, which presents insurers with increased risk of fire spread both in completed buildings and those under construction.
- Off site fabrication of building components or pods may increase the cost of reinstating losses in the event of partial damage.

What you can do to help

Key actions for brokers

- When surveying, adequately record where potentially combustible materials are being used, and provide appropriate risk management advice to help reduce the impact of perils that may cause loss related to modern construction methods.

Top tips for customers

- Where modern construction methods are used, take appropriate risk management steps to guard against both accidental fire loss and arson.
- Although Modern Methods of Construction (MMC) products have potential benefits for meeting climate change targets, proposed large scale developments should be discussed with your broker and insurer.
- If considering relocating your business or moving to alternative premises be mindful of the building material used in the construction of the building. Buildings with EPS (Expanded Polystyrene Sandwich) are often used in the food industry and are cost effective, and provide good thermal and hygiene benefits but perform poorly in the event of fire. Consequently a business costs more to insure if it is in a building of this construction. Consider premises with non combustible building materials.

Health and safety

Reduced spending on health and safety staff, processes, and training may occur as firms strive to make money on core functions during tougher economic times.

Faulty or old equipment, machinery, or vehicles may not be replaced to try to reduce expenses and servicing and maintenance may be cut back – this can increase claims frequency due to machinery ‘fatigue’.

Buildings may not be adequately maintained, making them hazardous or vulnerable to weather events, theft and arson.

Increasing levels of silent and unoccupied buildings will increase potential for illicit use of premises.

Attempts to cut cost and deliver supply chain efficiency can create greater vulnerability due to key site dependency, increasing business interruption losses in the event of an incident occurring.

Liquidation or downsizing of suppliers can disrupt key partnerships leading to unfamiliar working practices and greater risk of damage or injury.

What you can do to help

Key actions for brokers

- Emphasise to clients the potential false economy of spending cutbacks on health and safety procedures and processes.
- Emphasise to clients the importance of high quality maintenance and servicing to ensure safe working.
- Promote risk management assessment and solutions to clients, and if surveying clients premises, provide tailored advice.

Top tips for customers

- Look at ways to ensure health and safety is not compromised if spending cuts in relevant areas have to be enforced.
- Consider the positive cost benefits from an operation that is well maintained.
- Check property occupations regularly even if the occupation has not changed. Not only is the illicit use of premises an increasing trend, but regular inspection and protection of unoccupied premises is usually a precondition of cover.

Our long-term business commitment

Keeping premium increases to a minimum

CGU is doing all it can to keep any increases in premiums to a minimum. We are a national company with 160 years of history. We are wholly committed to the Australian market, but in order to maintain this commitment we need to ensure we are doing business in a way that is sustainable.

Insurance advisers help tailor insurance cover to meet the needs of consumers and businesses

Affordability and accessibility are continual issues in Australia, and also one of the reasons why there is such a high level of underinsurance and non-insurance.

Insurance is not just about price – the cheapest option is rarely the best option. It's much more important to have insurance cover that correctly meets needs.

This is where insurance advisers come in. Insurance advisers are experts in the insurance field and will help tailor the right insurance cover. That means consumers and businesses can keep costs down too because they are not paying for cover they don't need.

Individual circumstances influence level of premium because insurers price aspects of circumstances – for example, whether bars are fitted on the windows of a home or a business; the type of security system in place on a vehicle.

Some insurers also fill information gaps with premium. So, eliminating these gaps and by taking additional measures to improve risk profile can also help keep premiums lower. Insurance advisers can help with advice in these areas too.

These are just some of the many reasons why CGU strongly recommends that insurance is purchased through an insurance adviser.

CGU's approach to sustainable pricing

We are minimising premium increases by:

- Working with our claims service and product suppliers to keep their costs to a minimum while maintaining the highest service and repair standards.
- Implementing new, more efficient systems and processes to minimise our own costs and the costs of managing your policy.
- CGU continuously works with the Government in the course of its various enquiries to try and make insurance more affordable for all.

What we can do to help your customers

There are ways that customers can reduce the overall cost of their insurance premiums. These include:

- Opting for higher excess payments will reduce the premiums payable.
- CGU offer an instalment billing payment option at no extra cost to reduce the size of your up front policy payment.
- CGU can assist in making sure you have an appropriate level of insurance, not excessive insurance.
- CGU has people across Australia who can come to talk to you and your customers.

More information

Please speak with your insurance adviser. You will find that CGU is ready, willing and able to continue to deliver the right insurance solution.

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