ABN Amro Morgans breakfast. June 19.
Polo Club, Brisbane

INTRODUCTION

Good morning ladies and gentlemen.

This is my first address to an ABN Amro Morgans breakfast, and it's an honour to be invited here this morning.

As Queensland's biggest company,
I think it's important that Suncorp is visible in the business community and these breakfasts clearly bring together the business leaders in Queensland.

Suncorp has a long relationship with Morgans,
as the firm was integral to the initial transaction which brought together Suncorp, Metway and QIDC in 1996.

Morgans clients who invested in the newly created Suncorp Metway back then have been well rewarded.

You will recall, many people said at the time that the merger wouldn't work, but they were clearly wrong.

Our unique combination of banking, general insurance and wealth management has created good returns for shareholders,
and we think it is the model for financial services in the future.

Although we are a diversified financial services company, I would like to talk this morning about the general insurance industry and the considerable shakeout that has occurred in the sector over the past couple of years.

Clearly, we have faced a number of problems, both in Australia and internationally, in general insurance during the recent past.

Globally, we've had reinsurance collapses, we've had some traumatic events like the September 11 tragedy in New York, and capital constraints due to investment losses.

In Australia, we've had our own series of reinsurance problems, and of course the collapse of HIH, the Canberra bushfires,
and the public liability crisis which caused significant reputational damage to the industry.

There were a number of factors contributing to those difficulties the industry encountered, including some of our own making.

IMPORTANT ROLE OF INSURANCE IN SOCIETY

But before I go into those factors, let me just ask you to stop for a minute and imagine a world without insurance.

Could you sleep easily at night if you didn't have house insurance? Would you ever drive your car if you didn't have third party insurance,
knowing that if you hit someone you could be sued for everything you owned?

Could you operate a business if you didn't have the protection of your insurance policies?

What sort of hardship would people suffer if the general insurance safety net were not there to catch them?

Clearly, insurance is a necessity, not a luxury.

At Suncorp, we provide cover for 900,000 homes in Australia, 1.8 million cars and around 270,000 businesses.

Each year, we pay out approximately $1.5 billion in claims.

At Suncorp, we take seriously our responsibility to provide financial support for people who are confronted with unfortunate accidents and incidents.

We sell that financial security and that is what people pay for.

It might sound unusual, but we like to pay legitimate claims.

For example, when the Canberra bushfires occurred, we were there in a flash handing out emergency cash to our customers and offering the highest quality support.

We are the safety net in those situations.

But we are also a publicly listed company.

The owners of our company put up their money so that we can operate a business to make a profit,
and provide them with a reasonable return on their investment.

If insurance companies don't make decent returns, then investors won't put up their capital, and we won't have an insurance industry,
nor a mechanism to provide an appropriate safety net.

HOW INSURANCE WORKS

Despite the very important role that General Insurance plays in society, the principles of insurance are not well understood by many consumers.

Many people see insurance as some sort of social security service, or a bottomless pit of money they can draw on whenever anything goes wrong.

These days, some people think that if they suffer any misfortune, then someone should pay.

The increasingly litigious nature of society is well documented, particularly in the United States.

Perhaps the most famous case is that of Stella Liebeck of Albuquerque, New Mexico, who spilled hot McDonald's Coffee on her lap.

For her trouble, she was awarded $640,000, US. That was in 1992, and the decision caused an international furore.

Then there was the case of Curtis Campbell,
who was driving a car in Utah and had an accident in which one person was killed and another permanently disabled.

A jury initially found Campbell at fault and entered a judgement against him totalling $186,000, which was in excess of his $50,000 insurance policy.

Campbell then sued his insurer.

A jury found the insurance company had acted in bad faith in refusing to settle the case.

It awarded Campbell $2.6 million in compensatory damages, and $145 million in punitive damages.

Yes, $145 million.

In California, a man was using a public telephone booth when an alleged drunk driver careened down the street, lost control of her car, and crashed into the phone booth.

He sued of course – the phone company.

Thankfully, this is generally not the way the courts have worked in Australia.

But we have had our own cases over the past few years.

You may recall the case of the young man who dived into a sandbank at Bondi Beach in Sydney and tragically became a quadriplegic.

He sued the Council and initially won almost $4 million.

That case was overturned on appeal.

But it is certainly the situation that court awards have been increasing at a disturbing rate.

Of course, that is unsustainable.

You see, insurance works on the principle of pooling.

So if 1000 people each pay a premium of $500 to insure themselves against a particular risk, then there is a pool of $500,000 available.

That has to cover the expenses of the insurance company, plus the costs of claims, and allow the insurer to make an appropriate profit margin. (Ignoring investment income for a minute)

If claims costs rise unexpectedly, beyond the limits of the pool, then the insurer makes a loss.

Clearly, losses can not be sustained on an ongoing basis.

Either premiums have to go up, or claims costs have to go down.

The money has to come from somewhere.

The pool of funds is finite.

POOR INDUSTRY PROFITABILITY

Unfortunately, over the last decade, profitability in insurance has been unacceptably low.

In the year to June 2002, the industry made an underwriting loss of more than $530 million.

And that was the best result in eight years.

After investment income, the total industry made a combined profit of $505 million, which represented a return on assets of just 1%.

In Public Liability alone, losses in 2002 were some $450 million.

There were a number of factors that contributed to the situation:

One - Insurers had underpriced their products. This was partly due to the fact that we had HIH in the market chasing its tail.

By that I mean that it had not put away enough money in reserves to pay claims, so when the claims came in, it had to cut prices to lift cashflows to pay claims – it was a fatal spiral.

Another factor was that NRMA was a mutual until 2000.

And as a mutual, it did not face the same disciplines as a listed company, with no requirements to produce returns for shareholders.

A third factor was that investment returns,
which had previously supported insurance profits,
fell away with the equity markets, placing some insurers under capital stress,
and this was exacerbated by events such as 9/11.

Four - People's propensity to sue appears to have increased over time, as I mentioned earlier.

And finally, increased court awards appear to have played a part in raising claims costs.

PUBLIC LIABILITY CRISIS

Combined, these factors caused a crisis in insurance in Australia during 2002, and this was particularly evident in public liability.

Faced with mounting losses, insurers either withdrew from the market, making it difficult for people to source cover, or they lifted their prices.

So we had situations where horse riding schools, ballet classes and Anzac Day functions couldn't get public liability cover and had to close down operations.

As a result of the public furore legislative reforms were introduced.

Prudential standards were strengthened, requiring insurers to hold certain levels of reserves,
thereby reducing the capacity for them to underprice their products.

Then there were a number of reforms to tort law aimed at reining in escalating claims costs and stemming price increases.

Concepts of negligence were redefined and tightened, and thresholds and caps were introduced on damages payments.

Importantly, the Courts' interpretation of the general law of negligence has also shifted,
putting greater onus on plaintiffs to prove their cases.

These reforms, combined with the correction in pricing, have restored balance to the system,
improving profitability, bringing insurers back into the market and ensuring that consumers can obtain the required cover.

So it has been a positive outcome.

QLD CTP

A related example is the Queensland Compulsory Third Party Insurance scheme, which has been through its own crisis.

For those of you who are unfamiliar with the scheme, it is the compulsory insurance you buy when you pay your registration.

So if you are driving your car and you cause an accident and someone is injured,
your insurance will provide cover for the injured party.

The Queensland scheme is privately underwritten by insurers like Suncorp, which incidentally has 54% of the market.

We pay approximately $300 million in CTP claims each year.

The scheme is regulated by the State Government's Motor Accident Insurance Commission,
which sets a price band within which insurers can set their premiums each quarter.

In practical terms, insurers can't offer different prices for different consumers within a particular vehicle class, and they can't reject applications for insurance.

It is essentially one price, take all comers.

The scheme has operated very effectively in Queensland since 1936 and has been remarkably stable,
providing good cover at reasonable prices and appropriate compensation for accident victims.

The first signs of trouble emerged in the period up to 1998,
when we saw an increase in the number of claims that were being made.

The government responded by introducing a package of legislation which included steps to stop ambulance chasing
– that is the practice whereby some aggressive lawyers were touting for business,
often via tow truck drivers at the scene of accidents.

Claims frequency has since fallen by approximately 40%, partly due to these legislative reforms and other factors.

But while the number of claims reduced, average claims costs increased, driven largely by the increasing awards for smaller claims - such as minor whiplash injuries.

This in turn forced insurers to lift prices.

From July 2001 to July 2003, CTP premiums for a car or station wagon rose from around $290 to just under $360
– that's a 20% increase.

To its credit, the Queensland Government recognised the problems and worked with the insurance industry and other stakeholders to develop solutions.

A key was the Civil Liability Act, which was enacted in December 2002 with supporting regulations passed in October last year.

The Act was described in its second reading speech as a fundamental change designed to reduce awards of damages and to introduce reform to address the escalation of premiums.

It achieves this through the introduction of a scale determining the amounts to be paid to injured parties, depending on the nature of their injuries.

All of the available actuarial assessments suggest that the Act will substantially reduce awards, particularly at the lower end of the scale.

The impact will be to redirect more of the available funds to more seriously injured parties,
while restoring appropriate profitability and stability to the scheme.

Importantly, the benefits of the Act will be shared with consumers, because CTP prices are coming down.

From July 2004, CTP premiums for a car or station wagon will reduce to around $336 – a remarkable and successful turnaround.

At Suncorp, we're confident the scheme is back on an even keel,
and with the help of the government and the regulator,
and ongoing open dialogue,
we're confident we can keep it that way.

CONCULUSION

So in summary then, the insurance industry has definitely been through a period of crisis over the past few years.

While I don't want to echo the insensitivity of Paul Keating's famous "the recession we had to have" statement,
I would say that the problems that we experienced in general insurance over the past few years have represented a catharsis, from which has emerged a much stronger, more secure industry.

Lessons have now been learned.

Insurance is not a bottomless pit of money.

Insurers have to be able to achieve appropriate returns for the risks they underwrite, or investors will not put up their capital.

Insurers have become much more sophisticated in measuring the risks they accept,
and more disciplined in ensuring that they charge the appropriate prices for those risks.

While competition between insurers remains intense, it is healthy, rational competition.

The legislative reforms that governments have introduced have helped to restore profitability to the industry,
and security for consumers,
who can now feel much more confident that their insurance provider is financially secure, and will be there to pay their claims.

So while this process has been a difficult experience for many people,
the outcome is positive and ultimately will benefit consumers across the country.

FINAL WORD

Finally, given this is a Morgans breakfast, I would like to finish with some comments on the future of the financial services industry as a whole.

I would suggest that the improved fundamentals in the general insurance industry,
the changes that I have just been speaking about,
have made it a much more attractive investment opportunity, particularly for the major banks.

We have seen in the past that the Majors have embraced the wealth management industry for two reasons:
The first was in order to access alternative pools of savings, because the development of the superannuation industry had diverted funds away from low cost bank deposits.

And secondly, because they recognised that their greatest asset was their substantial customer bases
and they wanted to make the most of those customers by selling them more products.

So we have seen the Commonwealth Bank take over Colonial, National acquire MLC, and Westpac buy BT and Rothschild.

Now you may question the prices the Majors paid, but you can't fault the logic or the strategy.

More than 40% of the funds management industry in this country is now held by the major banks.

However, the majors have always been a little hesitant in general insurance because the industry was seen as too volatile and unprofitable.

While some have stuck their toe in the water as distributors, or by underwriting some simple personal lines products, as a rule, they have avoided the industry.

But as I have said, the many changes that have occurred in general insurance mean that the industry is now on a much more stable footing, and permanently so.

Insurers are now achieving ROEs of approximately 15%, and I think that the capital markets will be putting pressure on insurers to deliver better returns in the future.

I think that in this environment, the banks will recognise that general insurance is a natural fit in a financial services company, and I strongly believe that in the next few years, you will see aggregation between banking and general insurance in this country.

So, while Suncorp is currently a unique diversified financial services company,
I predict that in the future,
you will see the Suncorp model adopted across the industry.

That will happen as the banks seek to bolt on general insurance capabilities to grow their businesses,
leverage their customer bases and increase operating efficiencies.

So I will leave you with that thought, and I thank you for your time this morning.