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Riding the wave of uncertainty

Trends, opportunities and disruption shaping the insurance sector and the Australian economy in the year ahead.

Market Overview Report – March 2017

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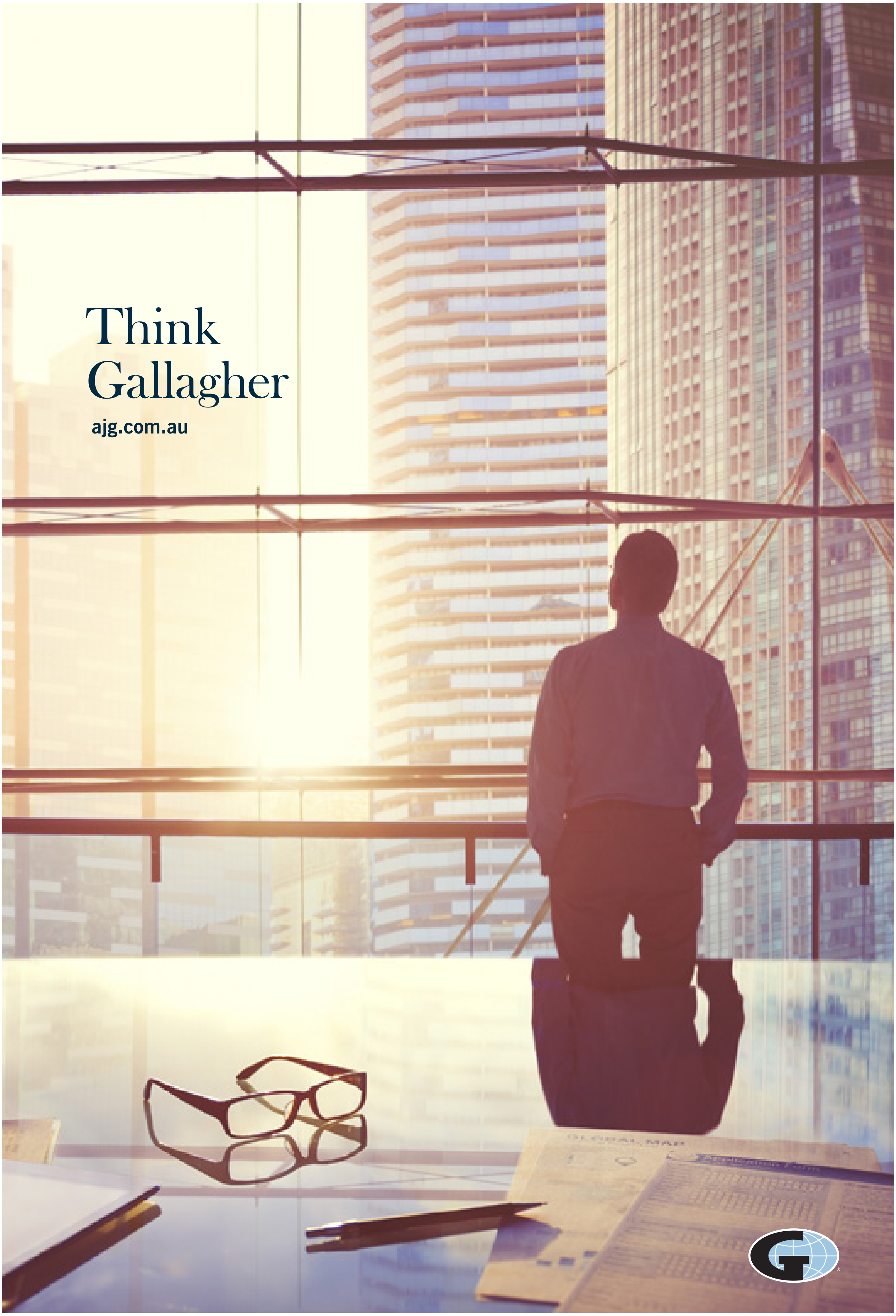
Arthur J. Gallagher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What's inside

CEO foreword

1

Welcome to our Q1, 2017 Market Overview Report. In this edition we have broadened our focus to include areas which are highly topical in current conversations with clients, and the emerging trends and issues that are likely to be relevant to your business and the businesses you work with.

Innovation remains high on Prime Minister Malcolm Turnbull's growth agenda. He has cited it as "the lifeblood of progress" and a means of "enabling Australia to become more productive" and making the smartest use of available resources.

2017 will see an increased focus in on integrating innovative technologies – artificial intelligence, wearables and blockchain – with enhanced insurance solutions. Whilst this is undoubtedly a good thing for both the consumer and the insurance provider, increased exposure to cyber risk is one of the unfortunate side effects of progress that we should be paying particular attention to.

There's no doubt we have entered the age of the "experience". The expectations of our clients and customers have evolved and the traditional view of 'one solution for many' must now be delivered as 'one solution, personalised to my specific needs and wants.' Millennials are shaping the experience agenda, driven by a desire and love of rapid change, and technology is only one part of the 'experience equation'.

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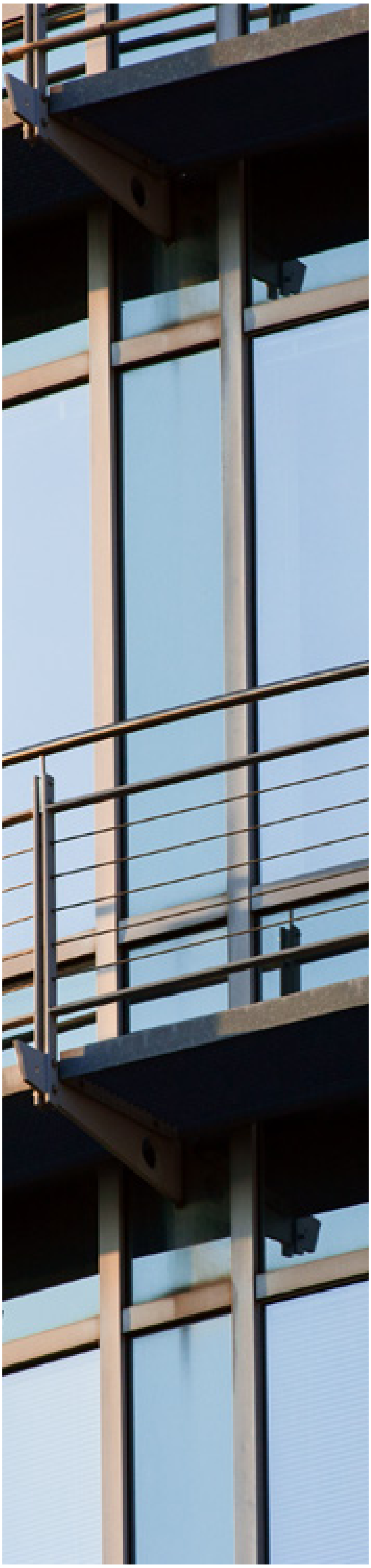


...CEO foreword

For insurance brokers this adds further fuel to the ongoing debate on disintermediation. There is an understood benefit of streamlining process and repetitive tasks using technology, but technology will never fully supplant human-to-human interaction and trust as the most important elements in a business relationship.

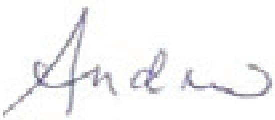
For company directors, the spectre of a cyber attack has required a change in tactic. Once viewed as the domain of the CIO or CTO, cyber resilience is now firmly positioned as the accountability of every person sitting at the board room table. Indeed, cyber security has become an issue of national importance; it's no longer solely the domain of large corporate organisations.

The complexity and shape shifting nature of cyber is presenting a challenge to the insurance industry and the question remains on the readiness of insurers to develop a "catch all" solution given the breadth and scope of the risk.

Today's uncertain business climate and emerging threats make it more important than ever for companies to seek the best possible advice on their risk exposures and how to manage them. That's what our brokers do every day, and their expertise and insights have been used to inform the content of this report.

We hope you find the report to be of value and enjoy reading it. If you would like to discuss any aspect of the report further, contact information for our specialist advisory team can be found on page 26.

Kind regards,



Andrew Godden

Chief Executive – Gallagher Australia

General Market Overview

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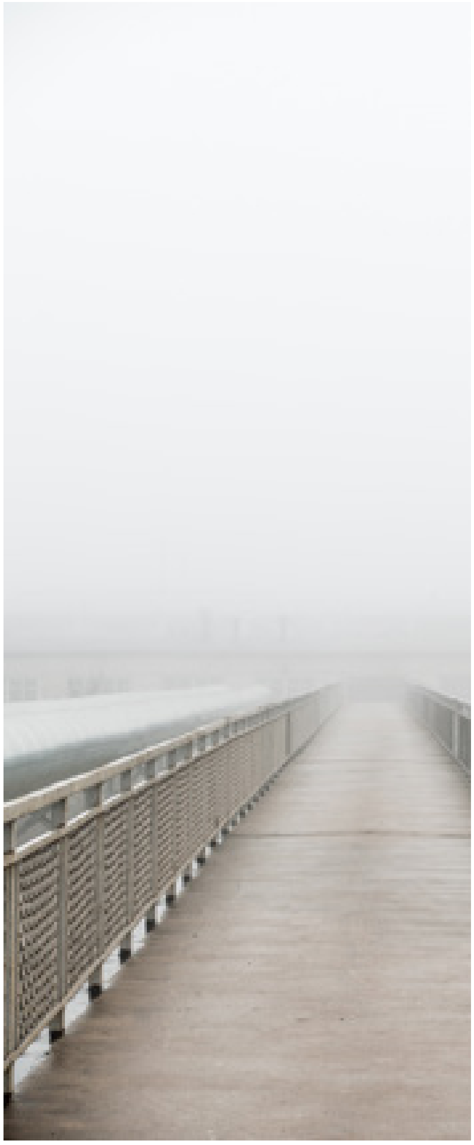


If 2016 was a year of continued change and disruption, 2017 looks set to be a year of uncertainty. The prospect of increased political and economic change will shift the focus and priorities of the insurance sector and other industries as the year progresses.

Global perspective

For politicians, company directors and business owners alike, the ongoing Brexit discussions and 'bedding-in' of the Trump administration are highly topical and present both an opportunity and a risk.

In the Eurozone the prospect of a European Union (EU) break-up seems increasingly plausible amidst Brexit negotiations, impending elections in Italy, France and Germany, and renewed speculation of a second Scottish referendum. If this happens it will most likely have a destabilising effect on the global economy for a significant period of time.

Meanwhile, in the United States President Trump's 'America First' economic agenda is still taking shape. It's too early to provide a clear expectation of things to come, but the prospect of fiscal stimulus and interest rate rises could be beneficial to the insurance industry given the size of its investment portfolio (roughly $24 trillion according to IMF reports) and the opportunities to stimulate growth.

These announced intentions for the US economy, if fully materialised and combined with Trump's commitment to build infrastructure, will no doubt be welcomed in Australia at a time of growing uncertainty surrounding future economic stability.

*

$860bn

US accounts for almost 30% of inward investment to Australia

...General Market Overview

The Australian outlook for 2017

The Australian economy looks set to remain tepid in 2017. Gross Domestic Product (GDP) grew by **1.1%** in Q4 2016 following an unexpected contraction in the previous quarter, but growth forecasts remain cautiously optimistic, if not uncertain. With wage growth lagging behind a long term average of **0.8%**, consumer spending has slowed in response.

Geopolitical and macroeconomic uncertainty will be two of the driving forces of change in 2017. Given the current diplomatic tensions between the US and China, Australia is likely to be focused on structuring its trading relationship between both nations to create a workable balance. With the US accounting for **$860 billion**[2] (or almost **30%**) of inward investment into Australia versus **$75 billion**[2] from China, both relationships are critically important to Australia's future growth plans and carry with them different dependencies and risks.

Also up for question is Australia's credit rating. The current expectation is that Standard & Poor's will strip Australia of its AAA rating in Q2. Economists are deeply divided over Australia's future growth path and the federal government may be comfortable with loosening its grip on the AAA security blanket, particularly given Australia's low public debt burden and the desire to stimulate increased spending and reboot an otherwise sluggish economy.

Tightening regulations, class actions and increased regulatory scrutiny will place heightened pressure on Australia's executives. Along with the US and Germany, Australia is home to some of the world's biggest D&O claims, with cyber, climate change and shareholder activism topping the list of challenges company directors will face this year. For insurance companies the challenge will be to ensure D&O policy wordings are effective in mitigating a rapidly changing risk profile.

Underemployment will impede growth[1]

The unemployment rate remained relatively stable at **5.6%**[3] as 2016 came to a close, but the underlying challenge of underemployment has persisted since 2015. This is not a new phenomenon, and is in fact a trend 30 years in the making.

With job growth outpacing growth in hours during 2016, and politicians using the unemployment rate as a marker of success, the rising rate of underemployment suggests an issue that is being largely ignored and an economy that is failing to fully leverage diversity and growth.

Source

1. *Australian Bureau of Statistics: Article: 'Spotlight on Underemployment'. 15/12/2016*
2. *Australian Government, DFAT (website). UNCTADstat database - October 2016.*
3. *Australian Bureau of Statistics*

Continued..

...General Market Overview

Clouds without silver linings

Early 2017 has witnessed a series of extreme weather events. Reports[1] that the total annual cost of extreme weather events in Australia is expected to rise from **$9 billion** to **$33 billion** by 2050 presents a worrying statistic. Counteracting this trend will require a significant shift in the prioritisation of forward planning for critical infrastructure and the ability to embed increased climate change resilience into all future plans.

Bushfires, severe storms and floods continue to occur with worrying regularity, and Australian insurers are feeling the resultant pain of increased claims costs. Insurance assessors are still counting the cost of February's bushfires in New South Wales, with current estimates nearing the **$30 million** mark and expected to rise further. Hail storms, which also battered the east coast of NSW in February, have seen lodged claims rise from an expected **$30 million** to upwards of **$350 million**, according to figures released by insurers IAG and Suncorp.

Millions of Australians are exposed to financial loss, business interruption and property damage relating to climate change and extreme weather events. What's more, if expected patterns of climate change play out, the financial impact of these events will worsen in the coming years.

Climate change has been identified as a potential D&O issue in a number of industry sectors, where company directors will be held personally liable for decisions where climate related events negatively impact the performance of their business and where the consequences are deemed to have been avoidable. Insurance is one of those sectors.

A recent legal opinion provided by Australian barrister, Noel Hutley[1], SC, indicated that courts would be likely to regard climate change risks as being 'foreseeable', and as such place the accountability for planning ahead for these risks on the shoulders of company directors as part of their due diligence and duty of care provisions.

Source

1. *IAG (iag.com.au). Article: 'Natural Disaster to cost Australia $33 billion per year by 2050'.*
   Reference: The Economic Cost of the Social Impact of Natural Disasters, and Building Resilient Infrastructure 2/3/2016
2. *Climate Change and Director's Duties, Noel Hutley, SC, Memorandum of Opinion, 2016*

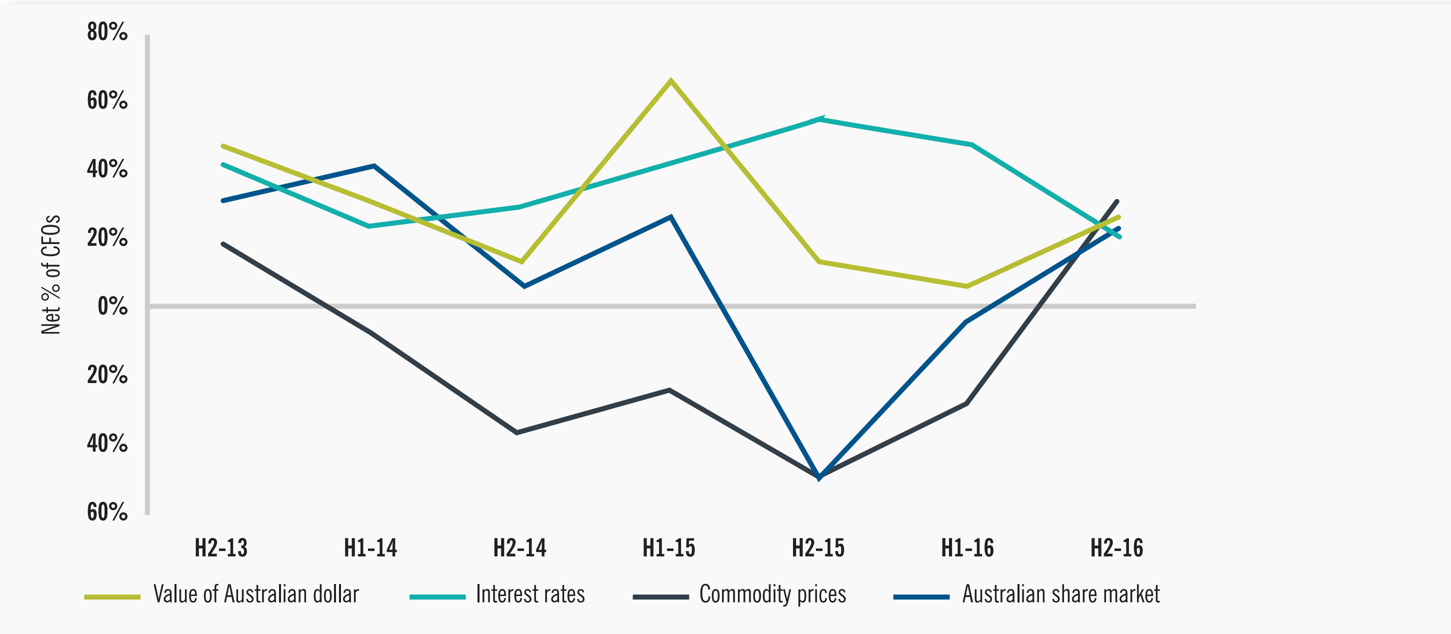
...General Market Overview

Australia will continue to transition from the mining boom

With Australia's former mining boom now resembling a 'mining bust', the RBA currently estimates we are approximately **90%** through the decline in mining investment. 2016 was a game of two halves for commodity prices with suppliers cutting supply and in turn sending prices upward in the second half of the year.

Despite this positive news, the outlook is likely to remain cautiously optimistic.

Ongoing growth in this space is largely dependent on two things: Chinese demand for raw materials and economic stimulus and the US pushing ahead with its infrastructure plans. If both outcomes materialise we may see a continuation of bullish commodity prices in the first half of 2017.



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Source

1. Australia Broadcasting Corporation (ABC). Website article: 'Commodity prices risk slide after 2016 rebound'. 21/12/2016

...General Market Overview

Sharing economy hits a bump in the road

Disruptors appear to have been disrupted this year, with Uber claiming unwanted headlines for alleged workplace malpractice and suggestions of IP theft for its impending driverless fleet.

Regulators across the board are placing increased scrutiny on compliance in this space. If recently announced plans to introduce a second tranche of legislation materialise, introducing tax compliance measures for the ride-share industry aligned to the taxi industry, the loop holes will close for anyone looking for a free ride in the sharing economy.

The strength of the P2P (peer-to-peer) market lies in its ability to provide access rather than ownership, but sharing economy participants are facing increased exposure to underinsurance and the risk of voiding their insurance policies. Whilst in many cases existing personal, home or small-business insurance policies can be adjusted to cover P2P activities, a high proportion of people remain unaware of their risk exposure.

A 2015 consumer survey by IAG found that out of 200 people surveyed, **54%**[1] of participants had little to no understanding of how their insurance policy covered their home share activities. Claims lodgement is often when the real cost of being underinsured (or, worse still, not being covered at all) becomes apparent.

One recent example involved an apartment being sub-let via Airbnb without the owner's consent, which risked voiding their building insurance and breaching a number of strata bylaws. Although Airbnb offers $1 million property protection cover[2] through its Host Guarantee package, most home insurance policies do not provide cover for hosts or their tenants, thereby placing the host (and Airbnb) at significant risk of being sued in the event of an accident and/or facing personal liability for an otherwise insurable risk.

Bumps aside, Australia's sharing economy will continue to go from strength to strength in 2017 and we are likely to see further weeding out of the weaker offerings as the dominant players approach full maturity.

Convergence between technology, data and human interaction will increase

In late 2016, global insurtech (insurance technology) investment crossed the **$1 billion** line. In Australia, we saw 2016 investment levels jump more than **$450 million** on the previous year.

The evolving role of automation, telematics, predictive analytics and artificial intelligence in the insurance sector is transforming the customer experience across all stages of the value chain. As one of the world's leading fintech innovation hubs, Australia is well placed to research and develop new products.

Insurtech offers benefits for both customer and suppliers. For insurance providers, enhanced risk profiling and underwriting capability can be gained from using technology to model for prevention rather than purely for protection. For customers, this enables insurance providers to alert their clients to potential compliance breaches, to better understand (and bridge) gaps in their cover, and to model their future needs as well as fully understanding their current risk profile. As a minimum this better positions insurance providers to serve customers and adapt to their evolving needs.

PwC's 2016 *Global Fintech Survey*[3] found that whilst three quarters of insurance companies recognised that disruption would affect their business, one-third of those surveyed had not explored fintech or insurtech at all. Connecting ideas with scalable solutions and strategic partnerships with new product developments will pave the way forward for the insurance industry over the next three to five years.

Ultimately, a key challenge for insurers is their readiness to fully embrace this opportunity. This includes the availability of innovation dollars to fund essential customer research and open up new pathways to technology related discovery. Inside the organisation, consistent concerns include regulatory uncertainty, bridging the gap between innovation and legacy IT platforms, and a growing sense of discomfort around information security and cyber resilience.

Source

1. *Insurance Australia Group (IAG): Letter to David Hale, Committee on Environment and Planning. 9/11/2015.*
2. *Airbnb: AUD Host Guarantee https://www.airbnb.com.au/guarantee*
3. *PwC 2016 Global Fintech Survey*

Disruption and disintermediation

The emergence of the P2P on-demand platform, Trōv, along with new market entrants including online aggregators and comparison platforms, is disrupting traditional insurance purchasing models. Consumers looking for ease, agility and convenience are turning to digitised platforms that let them buy insurance cover on demand, for the specific period of time they need it.

To cater for this shift in demand, a growing number of insurance carriers are investing in web-based self-help and self-service platforms, for customers who are willing to receive robo-advice and are more knowledgeable about which type(s) of insurance to purchase.

Big data is also a big opportunity. Interpreting data, using analytics to translate insights into actions and intelligently predict the future will be a critical component in cementing the role of an insurance provider as a trusted advisor, and successfully transitioning from a purely transactional, lower touch experience.

Energy is the new political football

Following the 2016 black-outs in South Australia and the failure of Tasmania's Basslink, energy remains a hotly debated issue in Australian politics this year. The debate hinges on two things: price and reliability of supply.

Malcolm Turnbull joined the energy debate in March by announcing a scheme to boost the Snowy Mountains' hydroelectric output by **50%** and increase its capacity to power an additional **500,000** homes[1]. With an expected cost in the region of **$2 billion** this is seriously big business for the federal government.

Yet Australia's ratification of the Paris climate change agreement last November means that the balance between renewable versus non-renewable energy required to power Australia's National Electricity Market will need to significantly shift to meet targets set for 2030.

With promises of job creation and large scale infrastructure and construction sector investments, Mr Turnbull and the federal government have moved into major policy change territory and away from the smaller, incremental changes that carry less political capital.

And with its ability to positively shape public opinion at a time of increased criticism on other aspects of government policy, cheaper energy costs and more money in the pockets of hard working Australians is likely to be a welcomed outcome for the government. Political gold dust.

Source

1. The Australian, 'Snowy Mountains fix for power crisis'. 16/3/2017

Cyber insurance

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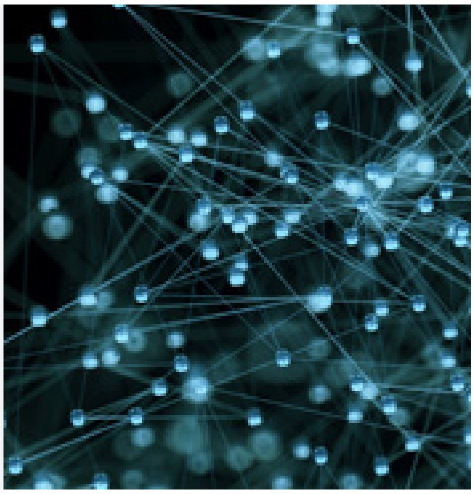

New legislation surrounding a national mandatory data breach notification scheme looks set to provide the impetus for directors to place cyber security front and centre of board discussions in 2017.

The importance and relevance of cyber insurance is increasingly recognised in Australian board rooms – helped in no small degree by the level of publicity surrounding major cyber security breaches across the globe.

If hackers are in a position to influence the US Presidential election and bypass the security protocols of some of the world's leading companies, there's no room for complacency in the Australian corporate sector. And while there's no doubt that the risks are better understood at C-suite level than ever before, it's not uncommon for corporate entities to underestimate their level of exposure.

We would expect that to change further in 2017, however, following the Senate's passing of new legislation on a mandatory data breach notification scheme in February. This is likely to come into force this year and, put simply, it's a game-changer. There will soon be no place left to hide for corporate entities that don't take the cyber security threat seriously.

26 billion
Estimated number of devices connected to the Internet by 2020.[1]

24,000 ransomware attacks occur in Australia each day, costing between **$420-$700** per incident; and losing businesses **13.7 hours** per attack.[2]

Source

1. *Gartner*
2. *Symantec Internet Security Threat Report 2016*

What will the mandatory data breach notification scheme mean for your business?

Once introduced, the mandatory breach notification scheme will apply to all organisations that are governed by the *Privacy Act*. This includes government agencies, and businesses with an annual turnover of more than **$3 million**.

Organisations will be required to report eligible data breaches to the Privacy Commissioner as well as notifying any customers that may have been affected, 'as soon as is practicable'.

There will be consequences for those who do not adhere to the regulations. Repeat offenders can be hit with fines of up to **$1.8 million** for organisations and up to **$360,000** for individuals.

There is also a heightened risk of reputational damage for companies found to have experienced a serious data breach. Those organisations that don't already have a robust data breach response plan should make this a priority ahead of the new laws coming into effect.

...Cyber insurance

The state of the cyber insurance market

The value of cyber insurance is most clearly recognised with regard to privacy. The costs attached to losing clients' personal data are high – the average cost of each individual lost or stolen record in Australia was calculated to be **$142** by IBM and the Ponemon Institute in 2016[1].

Providing protection against such losses is often considered the essential element of cyber insurance, but there's more to it than that. Cyber insurance also provides protection against liabilities arising from loss of employee and company data, and loss of income while systems are down, or being investigated and repaired.

In terms of the cover available on the market, there are some major differences in policy wordings, highlighting the need for companies to seek expert advice from an insurance broker.

Some policies can be limiting in the type of breach and expenses they cover and, as a rule, indemnity periods tend to be quite short – although extensions are available at an additional cost.

With regard to pricing, cyber insurance remains reasonably stable. However, this is likely to change as information yielded through the mandatory data breach notification scheme enables underwriters to more accurately assess and price the risk.

As with other areas of insurance, the best way to minimise premium costs is to have demonstrable evidence that best practice is being adopted in terms of data security, staff and contractor training, breach response plans, penetration testing and vulnerability assessments.

Business tenders – particularly government tenders – will increasingly be asking for proof of this nature as well.

Source

1. *Ponemon Institute 2016 Cost of Data Breach Study: Australia*

Continued...

What lies ahead?

Conversations with corporate clients regarding cyber security threats have changed markedly over the past year. There is much more ownership at higher levels of the business, when as recently as 18-24 months ago cyber security was seen as being much more of an IT issue than a whole-of-business concern.

This is a positive step, and we recommend that cyber security remains a fixture on agendas at board level. This is a fast-moving and continually evolving area of risk. Boards are well advised to ensure they stay abreast of the latest threats and to factor them into network security and breach response planning.

Phishing, DDoS and malware attacks are becoming ever-more advanced. Indeed today's cyber criminals are arguably the best innovators in the IT space. They don't have to follow standard rules of business and their sophistication elevates the risk of breaches caused by human error.

We're also seeing an increase in social engineering fraud (known as 'CEO invoice fraud') where hackers assume the digital identities of C-level employees to influence others to break normal financial security procedures around paying invoices. This has the potential to disrupt any business that fails to follow stringent accounting sign-off processes.

We live in interesting times. Companies should not be fearful of the threats to their cyber security, but must place an onus on caution and vigilance around data protection and how they conduct their business in a connected environment.

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The threat is everywhere

Much is made of high-profile cyber attacks on globally-recognised companies. This can lead to a false sense of security for smaller business owners that they are not at risk of cyber breaches.

However, nothing could be further from the truth. Money is money, and criminals don't discriminate against business size.

Mid-market and small businesses are often easier targets due to less stringent security protocols and easier-to-crack networks. Indeed, Symantec's *2016 Internet Security Threat Report* highlighted that **43%** of cyber incursions target small businesses – especially via phishing attacks.

The proliferation of the Internet of Things (IoT) adds to the cyber threat. Interconnected devices, including smartphones, watches and even television sets are now viable targets. It's estimated that there will be **26 billion** devices connected to the internet by 2020. Businesses will become more reliant on them to operate, creating risk.

If hackers gain access to networks they could potentially disable thousands of devices through a single breach. Network outages of that magnitude could result in significant business interruptions, and large financial losses.

Preparation for such incidents should be a way of life for all business owners, with cyber insurance part of a holistic risk management program.

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D&O insurance

4

Proactive, cooperative regulators and an increase in shareholder activism and insolvency claims mean that scrutiny of directors and officers is as intense as it's ever been.

We're starting to see some interesting developments in how regulatory agencies are approaching the monitoring of directors and officers, and early indications suggest that a new era of cooperation and referrals between agencies has dawned.

As recently as January, in what we believe is the first case of its kind in Australia, the former executive chairman of Waratah Resources Ltd was convicted in the Sydney District Court on a charge of aiding and abetting the company to breach its continuous disclosure obligations, and of having authorised false information to the market. The guilty party was ultimately sentenced to 12 months' imprisonment, to be served as a 12-month Intensive Correction Order.

A new regulatory order?

The integrity of our markets is of the utmost importance and the public has high expectations of regulators, who have often been regarded as weak on the financial services sector in particular. Following the Dick Smith failure and the scandal surrounding the initial public offering and prospectus raising in 2013, the Australian Securities and Investment Council (ASIC) released new guidelines around offerings – particularly around private equity involvement.

The regulators have become much more active in issuing guidance since, but it is the trend towards them working more collaboratively on a range of issues (including workplace health and safety and pollution) that is most interesting. This heightens the likelihood of breaches being discovered and exposed. We're also seeing the Commonwealth Director of Public Prosecutions increasingly involved where there are criminal matters at stake, as was the case with Waratah Resources Ltd.

With more directors and officers involved in formal investigations, companies have a higher exposure and heavier reliance on their D&O insurance policies.

Continued...

...D&O insurance

Trends in the market

The conduct of individual directors has rarely been under so much scrutiny. We're seeing clear evidence of a drift towards personal liability claims being made against directors – particularly around securities disclosure breaches, which are seeking huge levels of compensation. We're also seeing a rise in claims around insolvency.

An emergence of issues around the Australian Competition and Consumer Commission (ACCC) highlights the need for directors to be extremely transparent about the services and offerings made by their companies to avoid breaching fair trading regulations.

A high profile law suit is currently playing out in Australia in which liquidators are seeking more than **$270 million** in damages from the former managing director and chairman of failed satellite company NewSat for multiple breaches of directors' duties. NewSat collapsed in 2015, losing investors an estimated **$200 million**.

As with most areas of corporate insurance today, directors and officers are increasingly considered to be personally responsible for the on-going cyber security of their entities. Regulators are again being proactive, warning directors that they must add specific IT skills to boards, or up-skill themselves.

What may have been regarded as 'just an IT issue' as recently as a couple of years ago is now a business critical aspect of corporate governance. New legislation on a mandatory data breach response scheme was passed by the Senate in February and, once formally introduced in the coming months, will necessitate businesses develop adequate breach response plans.

Financial penalties of up to **$1.8 million** for companies and **$360,000** for individuals for repeat offences make it a business imperative for directors to take strong personal ownership of data privacy and network security issues.

All this equates to a challenging period for D&O insurers and directors themselves. This is not a profitable class of insurance, and with long-tail claims and rising levels of class actions in Australia through shareholder activism, it is unlikely to become so in the immediate future.

In order to write sustainable programs moving forwards more insurers are now looking to reduce their capacity while keeping premiums static. That's an interesting dynamic and one with the potential to lead to competitive and profitability issues for both clients and insurers.

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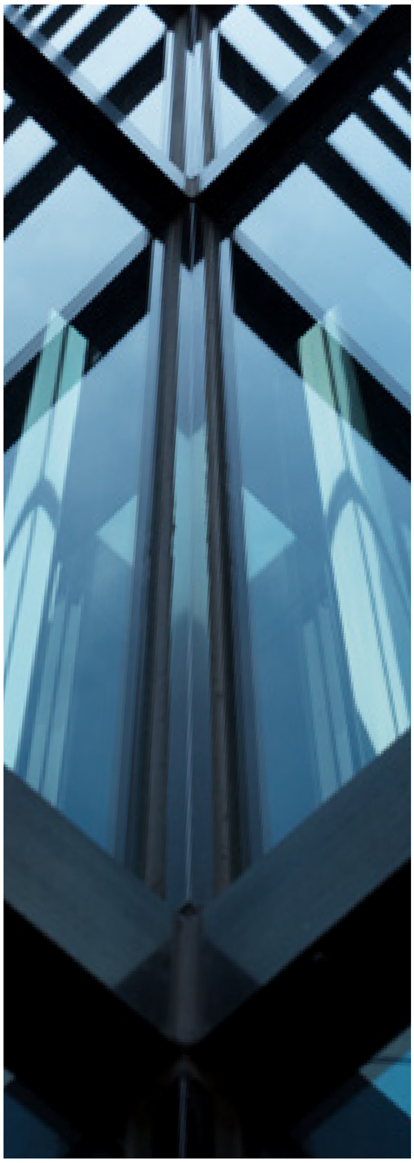
$1.8m
for companies

$360,000
for individuals

Maximum fines that can be applied for breaches of the mandatory data breach notification scheme



Tax insurance

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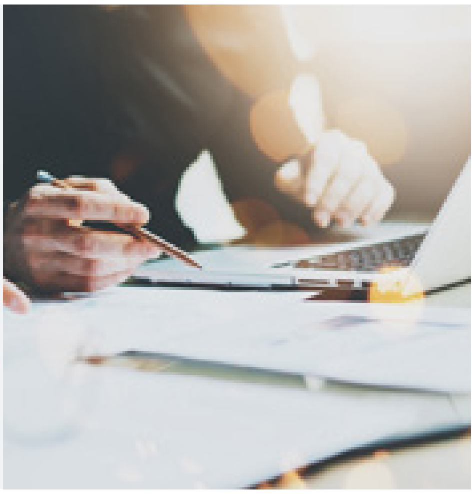


Uptake of tax insurance in Australia is relatively low, despite the fact that the product is a great fit for the uncertain and aggressive tax environment many businesses are operating in.

The pursuit of certainty

Highly publicised tax disputes, global reforms and an increasingly confrontational stance from the tax office have all contributed to what analysts are calling an 'uncertain' tax environment. But the business community's pursuit of certainty could be just the environment in which a competitive tax insurance (TI) product could prove its value.

Tax clashes more common and more costly

A survey of corporate tax professionals conducted by EY in 2016 found that **23%** of companies were under audit, a **10%** increase from 2014. Furthermore, more than **70%** of respondents said the enforcement stance and methods of foreign tax administrations were more aggressive in 2016 than ever before.

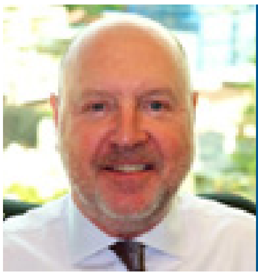
In Australia, high profile tax disputes have added further fuel to the fire of uncertainty. From Chevron to BHP Billiton, the Australian Taxation Office (ATO) has demonstrated greater confidence and a propensity to challenge multinational corporations about their tax affairs – particularly in relation to transfer pricing and tax avoidance.

An unknown quantity?

Though common in the UK and Europe, uptake of tax insurance in Australia remains relatively low. This is fundamentally due to lack of awareness. The product is far from new and there is significant capacity in the market, but the business and tax community remains largely unaware of it.

While we anticipate that widespread interest in TI is some way off in Australia, we expect that if it does take off, it will follow the same track as the warranty and indemnity products: additional capacity will become available in the market, terms will broaden, premium rates will drop and it will become more of a mainstream product.

But as for how far down the track this is? Only time will tell.



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Professional indemnity insurance

6

The broadening scope of professional indemnity (PI) insurance has seen its take up in non-traditional professions increase significantly in recent years, driven by the growth of litigation in Australia. But with the number of miscellaneous wordings on the rise, and emerging risks such as cybercrime blurring the distinction between types of cover, client education has never been more important.

Australia's PI market is very mature, and PI remains one of the core profitable liability lines for insurers. According to the Australian Prudential Regulation Authority (APRA), net earned premium for the year ending 2016 reached **$1.09 billion**, while net incurred claims reached **$609 million**.

...Professional indemnity insurance

Professional indemnity is broadening, but still profitable

Professional indemnity insurance was originally developed specifically for the 'traditional' professions, such as the legal and accounting professions, and their associated risk exposures. But in recent years we've seen a broadening of PI to the extent that it now spans across a number of traditional and non-traditional professions.

One of the biggest drivers of this change has been the growth of litigation in this country. Australia is the second most active class action market in the world (behind the US) and the largest litigation funder is averaging a **144%** gross return on funds invested.

New entrants in the litigation market and a growing appetite for a greater variety of claims outside shareholder class actions is fuelling activity in Australia, and a recent Federal Court decision may lead to the faster commencement of class actions as well as an increase in damages sought. All things considered, this is likely to bolster demand for PI insurance across the board.

Bridging the gaps

As the scope of professional indemnity has grown, so has the incidence of miscellaneous PI wordings. The main issue with these is that they're drafted to be generic to a large number of industries, so it takes considerable skill to tailor a policy that meets the specific risks faced by an individual client.

In 2015 ASIC reported that 'gaps' exist between what clients need from PI insurance and what's actually available on the market. Analysing the cause of these gaps identifies two main concerns:

- The specific risks of complex clients and activities, particularly the PI risks relating to AFS licensees; and
- the appetite of insurers to provide coverage in areas where there has been adverse claims exposure, such as wealth management.

But emerging risks, including cyber risk, are posing a challenge for clients and insurers too. Understanding what's covered (and what's not) in a PI policy and a cyber policy is becoming increasingly important, as we're experiencing more and more claims situations where it's not immediately clear where coverage is available.

Professional indemnity is becoming an area of insurance that requires more care, skill and attention to detail. Brokers need to take the time to really understand what our clients do, the activities they undertake as part of their profession and the full gamut of risks they're exposed to.

Bridging the PI gap is really about open communication, probing clients to understand what their risks are, how they respond to them, and what the potential treatment factors available to them are.

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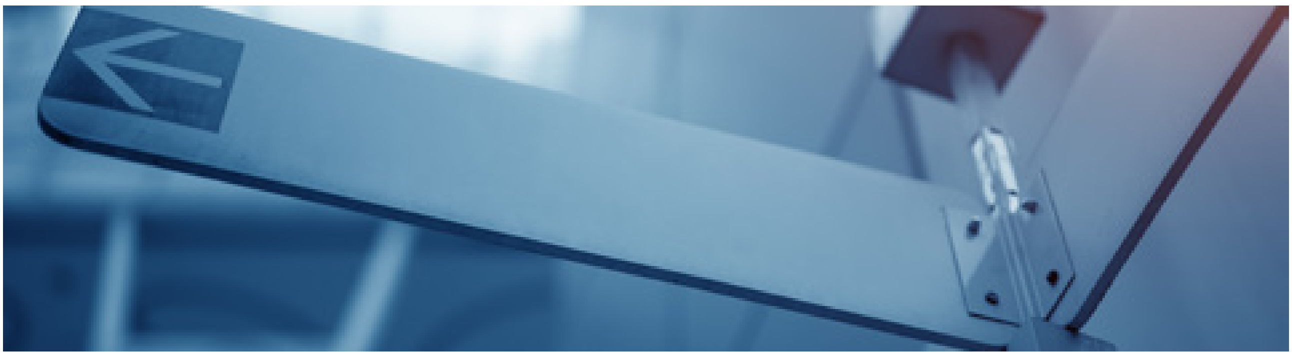
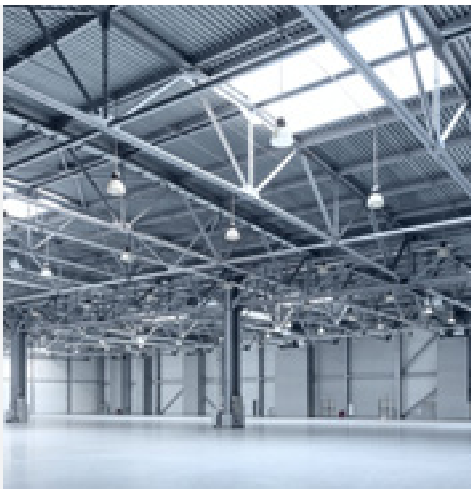


Property insurance



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In an intensely competitive market, property insurance is entering a period of 'managed change'. But despite insurers increasingly pushing back on complex claims, there is room to manoeuvre and to secure good deals.

Last year we saw premium rates across property lines begin to firm, ending the long-term trend of **10-20%** year-on-year premium reductions. What's caused this? Several things:

- cash rates are at an all-time low;
- insurers are not earning the return on investment they did in prior years; and
- reinsurers are looking for an increased return on capital

Given these factors, we expect to see premium rates firming further throughout 2017.

In prior years insurers were able to write for an underwriting loss as their investment returns would turn this into a gross profit, but this isn't happening anymore. Now we're seeing insurers regroup, review rates on each line of business and adjust accordingly.

But this doesn't mean we're seeing an immediate, broad-spectrum reaction from insurers to the market. Insurers are not simply increasing rates across the board; they're looking at rates on a *class-by-class basis*.

Moving forward, insurers are likely to be more selective in providing cover and we expect coverage to be less broad in scope than it has been in the past. This doesn't mean clients will see their cover being diluted. Rather, we simply anticipate pushback on the breadth of cover.

In the claims department we're seeing a number of insurers digging in on complex claims. Where there may have been more consideration from insurers in the past, brokers are now being asked to explain why non-straightforward claims should be accepted. Again, this is a symptom of the market: competition, claims deterioration and poor investment returns are driving insurers to be more cautious and protect their profit margins.

This is where the value of long-term relationships between clients, brokers and insurers will become more important. As insurers start to scrutinise claims in more detail, clients and brokers who have built solid relationships with insurers will be the ones who are more likely to get 'grey area' claims paid.

...Property insurance

On top of this, insurers continue to grapple with natural hazard claims. A relatively brief hailstorm that hit Sydney in February alone resulted in a **$350 million** insurance bill, according to figures from IAG and Suncorp. Meanwhile the Insurance Council of Australia (ICA) reported that insured losses from NSW bushfires had reached **$28.5 million**.

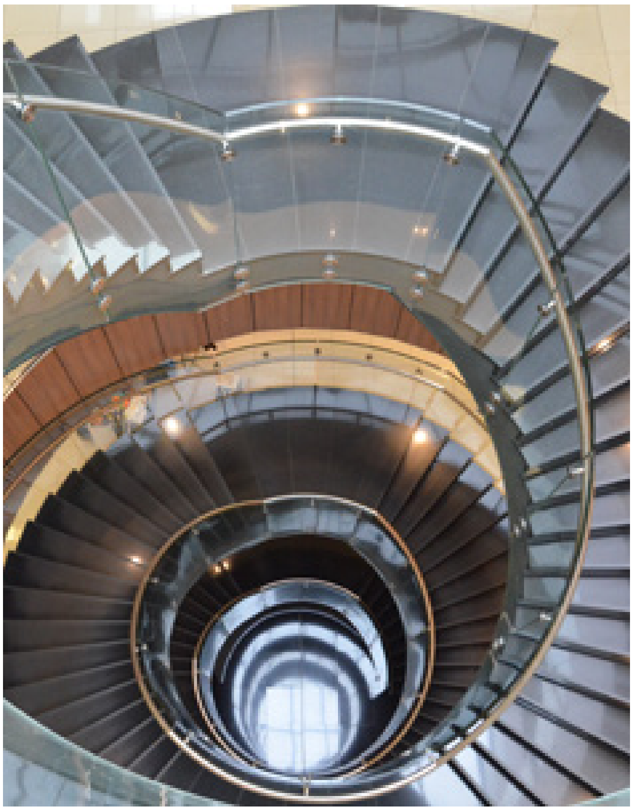
In the first few months of 2017 insurers such as IAG have already come close to reaching their annual natural perils allowance, and with ongoing climatic change we expect to see more of these unpredictable catastrophic weather events. Activity around the major trading period in June will likely signal how insurers are reacting to this.

Room for manoeuvre in the market

Insurers are cautiously approaching the broking market to see how we'll receive the idea of firming rates, and this presents an opportunity for our clients. Brokers with strong cases for why rate increases shouldn't apply to their client, based on sound claims and risk analysis, will be much better placed to negotiate preferential rates in the current market.

Clients need to be educated about the fact that the market is changing, but with an emphasis that it is a managed change. Premium rates have not gone from soft to hard overnight. There is still competition within the market place and there are other opportunities for brokers to look elsewhere if an insurer is not giving their clients the best deal.

Brokers who invest time in building relationships, collecting quality risk information and understanding the details of claims will see their hard work pay off in dividends. As always in insurance, relationships and information are critical to success.



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Marine insurance

8

Liability and asset protection have formed the backbone of marine insurance solutions since the dawn of Lloyd's of London in the 17th century. And while that will never change, marine is yet another sector for which cyber security risks are evolving rapidly and becoming a major cause for concern.

60%

of global piracy attacks occur in the South East Asia region.[1]

The logistics and shipping industry is growing at a global level, and typically there are a number of business entities involved in moving goods from one place to another. Technological advances have greatly improved communication between these companies, creating greater efficiency in a variety of areas. But these interconnected communication mechanisms carry risks, and we're experiencing increased cyber criminal activity within the marine industry in Australia.

Troubled waters?

Marine is a very traditional, historic industry, and that may explain why there's sometimes a lack of appreciation of cyber security threats that have emerged over the last 18-24 months. In our experience, unless a business has actually experienced a cyber attack, they often have a false sense of confidence around the security measures they have in place.

We've seen enough examples of cyber attacks that have impacted Australian marine businesses to know that the threat is real and growing. Business owners and directors need to be proactive and on the front foot to ensure they are aware of the cyber risks, and that they're following best practices to minimise threats through regular reviews of security systems and procedures. Cybercrime is now a whole-of-business issue, which requires a whole-of-business response.

How has the insurance sector evolved to meet this threat?

There are no specific cybercrime policies for the marine sector. This places an onus on insurance brokers to tailor policies to their clients' specific needs, or to add cyber endorsements on to existing marine policies. This, in turn, requires close liaising between brokers, insurers and cybercrime specialists to identify the risks so that wording can be tailored to cover those unique exposures. It also necessitates a complete and thorough understanding of how a business is set up to respond to a cyber breach, and what measures are already in place to limit them.

Insurers need this information to be able to accurately price the risk, and that's why we reiterate to clients that cyber security should be discussed at every management and board meeting.

Other risks on the rise

Disruption to supply chains, and the subsequent business interruptions, can cause significant financial losses and remains a key insurable risk. Marine companies are better prepared for this by the very nature of the sector, but events such as the Tianjin port explosion of 2015 are a stark reminder that even the best-run business can be adversely affected by events beyond their control.

Weather phenomenon, including El Niño and 'super storms', represent a tangible risk to shipping and logistics businesses. All the evidence points to an increase in weather-related catastrophe events in the APAC region in years to come. If these lead to increased losses it will impact on premiums across the sector.

Piracy is also a threat to Australian shipping. The South East Asia region, through which most of Australia's international trade is shipped, now accounts for **60%** of all piracy attacks[1]. But while that risk shouldn't be underplayed, it's small in comparison to the rising cyber threat.

Sophisticated cyber criminals are arguably the most effective pirates in the world today. They're sitting at a computer rather than sailing the seas, and they have the ability to hack into systems and literally take over whole vessels, reallocate cargo and cause considerable disruption to the logistics process.

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How hackers have targeted the marine sector

CASE STUDY 1: A logistics company's system was hacked and an email was sent to a truck driver redirecting them to a different depot. The email came from a known contact within the business and was accepted at face value by the driver, whose truck was then hijacked at the alternate depot.

Incidences of this type of crime are on the increase, but they can be avoided. Any request to switch to a different depot should sound alarm bells. As long as there is a confirmatory process in place that is strictly adhered to, this risk can be minimised.

CASE STUDY 2: A client owning a customs area received notification that they had received a fine for contravening Australian customs legislation around processing goods. The notification appeared genuine, however the client was adamant they were not in breach of regulations.

Upon further investigation the fine notification was found to have been issued by a hacker who had infiltrated their systems. Their insurance policy would have covered them for this breach, but this is a good example of the importance of being extremely vigilant around all digital notifications, even if they appear to be coming from a reputable source or contact.

Source

1. *2016 Allianz Global Corporate & Specialty Safety and Shipping Review*

Trade credit insurance

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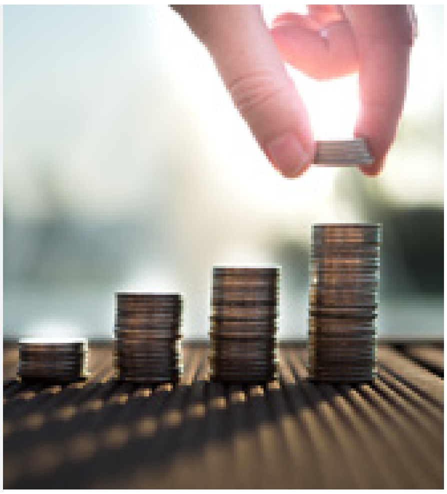

Companies of all sizes, across all industries, should look to mitigate credit risk exposure in an uncertain business environment.

Last year was a very busy period for claims in trade credit insurance. The most recent insolvency statistics released by the Australian Securities and Investments Commission (ASIC) showed 2299 companies had external administrators appointed in Q3 of 2016, representing a **0.7%** increase on the previous quarter.

The most significant increases in 2016 were experienced in Western Australia (up **14.5%**) and Queensland (up **11.3%**). This isn't surprising given these states are experiencing the after-effects of the mining boom; for the year 2015-16, both Western Australia and Queensland reported a meagre **0.7%** growth in Gross State Product (GSP) per capita.

Most of the losses we've seen recently have been in service-related businesses – contractors, labour hire firms, equipment hire firms – within the construction and mining industries. This, again, is not surprising as these firms are further down the contracting chain and therefore bear the greatest exposure to insolvency risk.

While we're not seeing a slowdown in trade credit claims yet, we do expect the situation to improve throughout the remainder of this year. However, companies will continue to face an increasingly volatile business environment; Atradius Economic Research forecasts insolvency growth in Australia to reach **1%** in 2017.

This means that all businesses need to consider trade credit insurance. Though it is true that companies in the construction and mining industries have the highest exposure to insolvency risk, the reality is that any company that sells goods or provides services on credit terms is exposed to the risk of non-payment.

Even the companies with the most sound credit control processes cannot avoid the risk of a customer defaulting on payment, so we encourage all businesses – regardless of size or industry – to mitigate their credit risk exposure and use the risk transfer market through trade credit insurance.

* **14.5%**
Increase in insolvencies in WA in 2016

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Workplace risk

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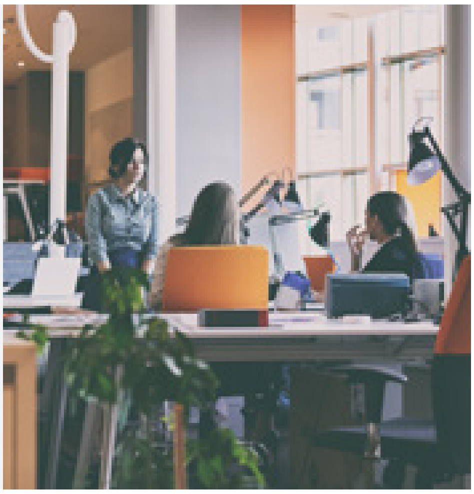

Regulation and the challenge of keeping pace with the needs of today's flexible workforce are the key drivers of change in the workplace risk space.

In February, icare introduced a multi-channel self-service platform that enables NSW businesses to purchase insurance and access customer support. In response, CGU announced that it will withdraw from the reformed scheme once its agreement with icare ends on 31 December 2017. Insurance brokers will remain a key part of icare's delivery model in the state, however.

The impending Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 is part of a concerted effort to protect the Australian workforce through increased penalties and more stringent compliance arrangements. One aspect of this reform focuses on avoidance tactics, taking a hard line on business owners who elect to wind up their operations to avoid being fined for underpayment.

The model Workplace Health and Safety (WHS) regulations were amended in late 2016. Amongst other things, the amendments focus on use of hazardous chemicals and transportation of dangerous goods by road. To date these amendments have not been implemented in any Australian jurisdictions.

The changing workforce

With global mobility expected to increase by **50%** over the next three to five years, there is a pressing need to reshape the Australian workplace to fit future expectations and evolving customer needs. This heightens the need for boards to focus on greater cyber resilience, data privacy and network security, as well as frameworks that can align to multiple workplace risk scenarios.

This year will see the rise of the 'on-demand' workforce – a product of the 'gig economy', where workers are paid on a task-by-task basis. Flexible working has advantages. Reductions on overheads, including employee benefits and office space, are the tip of the iceberg. Enhanced productivity and revenue growth can be earned through easier access to specialist capability, on a flexible basis.

The flexible gig currently appeals to more than **30%** of our workforce, a number expected to rise to **50%** by 2020. Technology has been a key driver by making it easy for organisations to connect with talent on demand. Tailored insurance solutions to cater for this market are highly likely within two years.

On the downside, the gig economy may exacerbate downward pressure on wages, whilst the emerging gap between the certainty of contracted hours versus zero hours contracts could signal worsening conditions for Australian workers.

Informal work patterns are only part of the problem, though. With many workers employed on a casual basis, paid cash in hand and not appearing on the books, the emergence of digital apps as a 'virtual' employer adds a further layer of complexity to the underemployment challenge.

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Enquiries
We hope you have found this report helpful and it has provided useful information on important events that are topical from an insurance as well as a commercial perspective.

If you would like to use this report inside your organisation or reference it in your research, please get in touch.

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