

Newsletter

January 2010

2 ways to save premium

Insurance is typically viewed as a necessary evil and the less paid for it the better. I have outlined below 2 ways an Investment Manager can potentially save premium:

a) Review your need for Crime cover

Most Investment Managers purchase a package policy: Professional Indemnity, Crime and Directors Liability Insurance. Crime cover provides cover for where the Investment Manager's own money or the clients money is stolen (either by internal staff or external parties).

- **Client money:** Most clients I meet outsource the handling of all client money to a custodian. So, what really is the exposure? Take a few minutes, and with your most nefarious hat on, work out if it's really possible to steal the client's money. If there are 3 or 4 ways, then as a first step think about 'plugging' those gaps. You may bear ultimate responsibility for any money lost, but your rights may be heavily protected when dealing with a reputable custodian.
- **Your own money:** take time to work out who has control of the funds. Can anyone actually complete a transaction from start to finish without reference to you? You might find, particularly in a small boutique operation, that it's almost impossible for someone to steal money. In fact only the directors might be able to, and even then, most policies have only limited cover for crime claims committed by directors.

I'm not advocating dropping Crime cover as a standard position. My experience from my previous role demonstrated that Crime claims do occur, and whether you're a big or small organisation the cost can be tremendous. However, if you spent some time working out how it might occur, and then fixed the gaps, for some clients, where it's not legally required, dropping the cover might be a risk worth taking. You should typically save 15%+ from your premium by removing this cover from a package policy.

b) Meet your Insurer

You could send your insurance submission/proposal form to 5 different underwriters at the same insurance company, and get back 5 different sets of terms. This happens because an individual underwriter makes both an objective and subjective assessment of your risk. Most clients would be surprised by the level of discretion that an individual at an Insurance company can bring to bear in order to prepare terms.

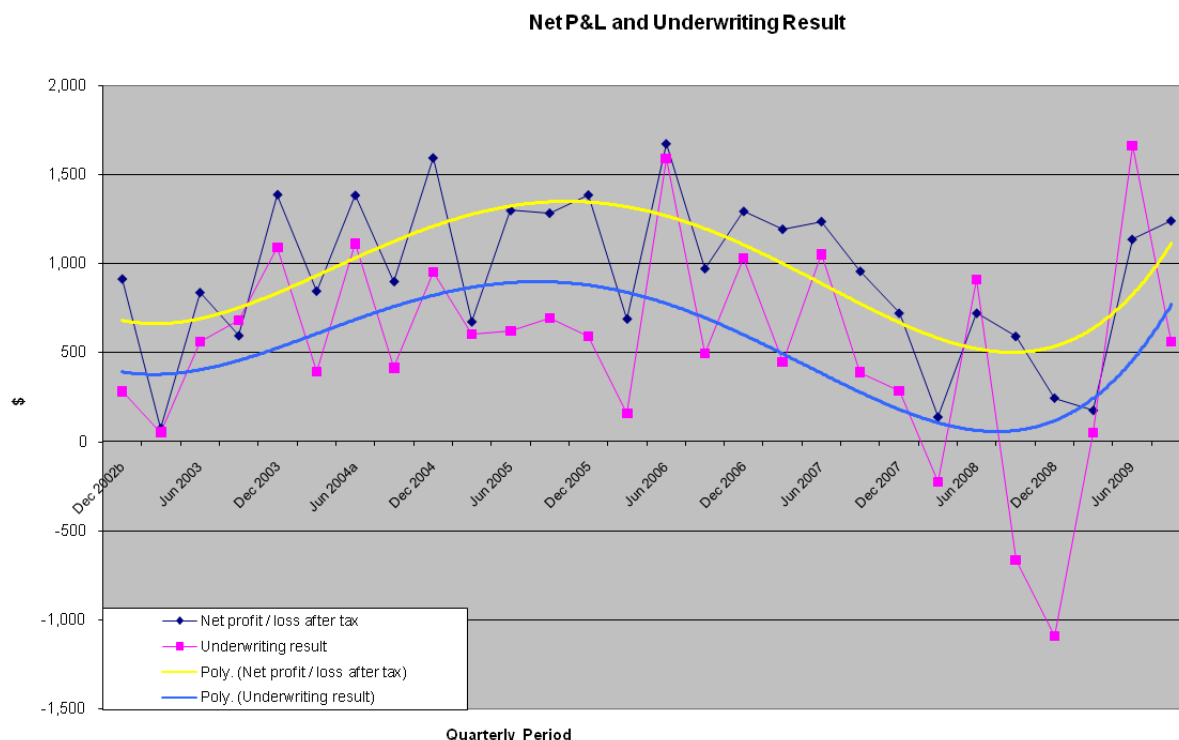
The key is to recognise the fact that there is both an objective and subjective assessment being made in considering your risk, and that both elements can be influenced.

- **Objective factors** are easily explained: what your revenue is; how many employees you have; what the FUM is; how many clients/mandates you have; claims history etc. There will be guidelines that specify exactly what the outcome is depending on each variable. However, if you only deal with the objective part of the process, then an underwriter will literally provide you with the average outcome.

- **Subjective factors** are also crucial: does the underwriter like the client; do they trust them; does the business process make sense to them; do the risk management processes make sense; ultimately would they invest their own money in your business. If you can get an underwriter feeling positive towards your risk then you will be better positioned against all the other risks that don't make the effort.

Focusing some time and attention on how to influence both the objective and subjective elements will invariably lead to better outcomes around coverage, service and price. The more complex the risk, the greater the benefit from meeting with the Insurer. There is absolutely no hard and fast rule, but for most risks it's probably worth 5% of the premium.

Is the Australian Insurance industry making money?



Data from the latest APRA statistics: General Insurance Quarterly Performance– Direct Insurer Key Performance Ratio's.

The market had been softening (reducing premiums/broader coverage) for several years from around late 2004/2005 to mid 2008. In late 2008 and early 2009, this came to an abrupt end, when there was insufficient premium to cover rising claims (GFC and natural occurrences) and underwriting expenses, compounded by poor investment returns. However, after dramatic corrective action and a resurgent investment market, there are a range of positive signs for the Australian insurance market at end of Sept 2009:

1. Underwriting Results (net premium revenue less net incurred claims & underwriting expense) are improving. Expenses have held steady, so it more a function of increasing premium and reduction in incurred claims
2. Net P&L up. Factors in improved investment returns.

Overall, the insurance market appears to have stabilised, and certainly return on assets has steadily risen over the last year. However, the big question for Investment Managers is what is the situation for the discrete Financial Institution (FI) premium pool? The FI market is still underperforming, but I believe a two tier FI market has evolved, which, if handled correctly, enables some clients to still achieve good results.

Claim Example provided by Chubb Insurance Company of Australia Limited

Industry	Funds Management
Coverage Section	Unit Trust Asset Protection – Investment Managers
Cause of Action	Misrepresentation
Type of Organisation	Investment Managers and Trustees
Number of Employees	40
Revenue	\$50 million
Comment	Actual claim with identities changed

DESCRIPTION OF EVENT

Trusted Trustees are the trustees and investment managers of a number of funds, including a fund which markets to superannuation funds and invests Australian dollar amounts in US based hedge funds. Those hedge funds are US dollar based and the Australian dollar amounts invested are converted to US dollars then those US dollars hedged back to the AUD. Trusted Trustees undertakes marketing of this fund together with the US based hedge fund manager. Part of that marketing material stated that all currency invested would be fully hedged back to the AUD at all times.

Changes in the global economy led to the rapid fall in value of the AUD in late 2008. The US based hedge fund manager chose to lift the hedging contracts as they believed they lacked the liquidity to meet calls on the contracts should they be made.

When advised that the hedging contracts had been lifted, investors placed their own contracts. Fifteen investors suffered losses under those contracts, totalling some \$AU30 million. Each made demands for those losses on Trusted Trustees claiming, inter alia, misrepresentation and stating that they only invested in the fund because the risk management of currency hedging met the mandates for their own funds.

RESOLUTION

The Insured engaged legal counsel to act on their behalf in defending the claims. Negotiations were entered into with the US based fund and investors and the matters settled for two thirds of the sums lost, \$AU 20 million with the US based fund paying \$14 million the Trusted Trustees \$6 million. The \$6 million was recoverable under the Chubb Policy, less the \$100,000 deductible. A further \$400,000 in Defence Costs was paid.