

How secure are your contractors' insurers?

There are mechanisms in place to safeguard people and organisations which rely on Insurance companies but this entails checking the available information and ensuring that you are satisfied that the risk carrier will be there when you need them. The trouble is that many people are unaware of how to access and use this information.

Australian Regulation

Safety and soundness requirements for general insurers - codified in the Insurance Act 1973 are the responsibility of The Australian Prudential Regulation Authority (APRA) which was established in July 1998 and which licenses ("authorises") insurance companies to write insurance business in Australia.

The industry's safety is important not only for the protection of individual policyholders, but also for stability and confidence in the wider economy.

APRA claims that there are three key aspects of the general insurance reforms which took effect on 1 July 2002 which are intended to improve public confidence in industry soundness. These are:

1. Risk-based capital adequacy requirements;
2. Checks and balances created by strong governance standards; and
3. A universal 'health check' on all companies under the re-authorisation process.

APRA assesses all authorised insurers against these (and other) criteria and maintains 4 registers.

- Insurers Authorised to Conduct New or Renewal Insurance Business in Australia
- Insurers only authorised to conduct Run-Off business
- Insurers that have had Insurance Authorisations revoked (since 1st January 2002)
- Authorised non-operating Holding companies.

This information is published on its website which can be accessed at:

<http://www.apra.gov.au/General/General-Insurers.cfm>

Direct Offshore Foreign Insurers (DOFIs)

Foreign insurers who conduct 'insurance business' (as defined in the *Insurance Act 1973*) in Australia must establish a subsidiary company or branch in Australia and apply to APRA for licensing under the provisions of the Insurance Act.

However, foreign insurers (insurers operating from outside of Australia) can still sell insurance to Australians via an insurance agent or broker licensed in Australia, without establishing a subsidiary or branch in Australia.

These foreign insurers, known as DOFIs (Direct Offshore Foreign Insurers), are not subject to the provisions of the Insurance Act because they are not underwriting insurance business within Australia. It is extremely

important to understand that insurance arranged with a DOFI does not have the protection of the Insurance Act or APRA scrutiny.

APRA issued a media release Thursday 8 May 2003, 'APRA again cautions against unauthorised foreign insurers' that may be of interest to you. View this at: http://www.apra.gov.au/media-releases/03_44.cfm.

It should be noted that Underwriting Agencies are not insurers for the purpose of Australian legislation and they could be placing insurance business with a DOFI, so to protect yourself, make sure you can identify the party which is actually carrying the risk, where they are domiciled and their rating.

Additional comfort can be gained by making sure that the country of domicile of the DOFI has a scheme of financial supervision similar to Australia, adequate paid up capital and last but not least, ensure that the insurance contract contains a clause which stipulates that disputes will be handled in accordance with Australian Law.

Commercial Rating companies

There are several independent companies that provide reliable ratings on the financial stability of insurance companies. These ratings help to determine the likelihood that an insurance provider will be solvent in your time of need. Five major raters operate in the US:

- A.M. Best
- Duff & Phelps
- Moody's Investors Services
- Standard & Poor's (S&P)
- Weiss Research

Although many insurers around the world are rated by these agencies, not all of them provide ratings for Australian insurers.

Making the grade

When evaluating an insurance company, raters base their grades on several factors. These include:

- How widely the company spreads its risk
- Size of its surpluses and reserves
- Quality of management
- Profitability
- Investment returns
- Mortality experience
- Expense ratios
- Debt levels
- Cash available to pay claims
- Quality of assets

After assessing these criteria, a rating is assigned and a company will be given one of the following marks:

- Superior
- Excellent
- Very good and good
- Fair

- Marginal
- Below minimum standards
- Under state supervision, in liquidation, or failed

Keep in mind that there are many companies that fall into the superior and excellent categories, so buyers shouldn't feel they have to go any lower in order to get a reasonable package. Also, when looking at a company's ratings, realize that some rating companies are more subjective than others even though they may have one or more quantitative elements. Ask to see their ratings criteria before reading their report.

One more step

Unfortunately, it's not as simple as that. Each rating company assigns different symbols to signify each of these marks, so at first glance a company's report card can be deceiving. Take a careful look at the following – it'll help you weed through the symbols and get a clearer indication of how a company has scored.

Superior

A superior rating signifies overall superior performance relative to industry averages.

- A.M. Best: A++, A+
- Duff & Phelps: AAA
- Moody's Investors Services: Aaa
- Standard & Poor's (S&P): AAA
- Weiss Research : A

Excellent

An excellent rating signifies overall excellent performance relative to industry averages.

- A.M. Best: A,A-
- Duff & Phelps: AA+ to AA-
- Moody's Investors Services: Aa
- Standard & Poor's (S&P): AA
- Weiss Research: A

Very good and good

A very good or good rating signifies overall performance relative to industry averages.

- A.M. Best: B++ to B+
- Duff & Phelps: BBB+ to BBB-
- Moody's Investors Services: A
- Standard & Poor's (S&P): BBB
- Weiss Research: B

Fair

A fair rating signifies fair overall performance relative to industry averages.

- A.M. Best : B,B-
- Duff & Phelps: BB+ to BB-
- Moody's Investors Services: Baa
- Standard & Poor's (S&P): BBB to BB
- Weiss Research: C

Marginal

A marginal rating signifies marginal overall performance relative to industry averages.

- A.M. Best: C++ to C-
- Duff & Phelps: B+ to B-
- Moody's Investors Services: Ba to B
- Standard & Poor's (S&P): BB to B
- Weiss Research: D

Below minimum standards

A company given the below minimum standard rating does not meet minimum standards for financial strength.

- A.M. Best: D
- Duff & Phelps: CCC
- Moody's Investors Services: Caa to Ca
- Standard & Poor's (S&P): CCC to CC
- Weiss Research: E

Under state supervision, in liquidation, or failed

Companies given an under state supervision, in liquidation, or failed rating have been placed under supervision, control, or restraint by a state insurance regulatory agency.

- A.M. Best: E or F
- Duff & Phelps: CCC or DD
- Moody's Investors Services: C
- Standard & Poor's (S&P): R
- Weiss Research: F

In conclusion

Consider whether your contracts should contain a clause which requires your contract partners' insurance carriers to hold a minimum rating from a recognised rating agency as an objective, measurable level of security instead of the vague expression, "an insurer approved by the Principal".

You may consider whether you will only accept insurance from APRA-approved insurers or whether you are prepared to accept cover from an offshore insurer.

If you are considering an Australian Insurer, you may also want to review whether their license restricts the type of business they are approved to underwrite etc.

See the APRA website:

<http://www.apra.gov.au/General/General-Insurers.cfm>

If you are contemplating an offshore insurer, you should be satisfied that they are domiciled in a jurisdiction that provides a level of scrutiny similar to Australia, that they have been rated by a recognised rating authority and that you are satisfied with the level of the rating.

Protectus can provide an insurer security review as part of our tracking service.

For information on the Protectus document tracking and verification service, view our website at www.protectus.com.au