Client Advisory

Insurance Market Commentary

Market Outlook 18 September 2020

Since our last market update the world has become used to living with the social and economic impacts of Covid-19, with the appearance of second wave outbreaks having a significant effect on how we go about our lives.

Some six months after the initial lockdown in New Zealand we are seeing that many businesses are showing resilience and finding ways to adapt how they can continue trading in the new environment. This has been helped by no community transmission in most areas of the country.

In September the ANZ Bank's review of New Zealand's business confidence showed that companies were markedly less pessimistic about the broad outlook for the economy. This was supported by ASB's forecasts that showed a reduction in the previously predicted numbers for shrinkage of the economy, growth in unemployment and a fall in house prices.

Treasury's Pre-Election and Fiscal Update (PREFU) revealed that the New Zealand economy is currently doing better than what had been forecasted. The Government's Covid-19 response spending was $4b less than expected and unemployment is now forecasted to peak at 7.8% in the March 2022 quarter (2% lower than what as predicted in the May Budget) but it will remain higher for longer, reflecting a slower recovery than first thought.

Nevertheless, significant global events have had an impact on insurance companies' results and this will have a flow on effect to the New Zealand insurance market.

The Macro View

(Note all figures are converted to NZ$ at present exchange rates)

Insurance is a global industry. In order to function efficiently 'risk sharing' across a global portfolio is a central element. To facilitate this, most insurance companies rely on some form of reinsurance which enables them to pass off part of the risks that they accept in order to reduce their own exposure. Large international reinsurance companies such as Swiss Re and Munich Re will have some level of participation in risks from every country around the globe.

A significant loss in, say, South America will most likely impact a reinsurer who is providing capacity in New Zealand. In order to recover their loss that reinsurer may then adjust their pricing meaning a rise in premiums for clients in New Zealand.

New Zealand has benefitted enormously from this global spread of risk following the recent earthquake events. The cost of recovering well over $20bn of insured losses was shared across the whole world and would not have been something the New Zealand insurance market could have withstood on its own.

Therefore understanding what is going on in the global insurance and reinsurance markets is important as it will influence to some degree in what happens in New Zealand.

In any normal year a key driver of the performance of the global insurance and reinsurance markets is the Atlantic hurricane season. Generally this runs from June to the end of November.

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Unfortunately the 2020 season is not looking good. At the time of writing there have been five hurricanes and one major hurricane, as well as 14 other named storms (there is a chance, for only the second time in history that authorities may run out of names for new storms and have to revert to using the Greek alphabet). Many of the agencies that track weather events are predicting that this could be one of the most active seasons on record.

The largest hurricane to date has been Laura that caused between $13bn and $20bn of insured losses on mainland USA. An earlier hurricane, Isaias, caused an estimated $6bn of losses.

Munich Re commented that pre Laura the insured natural catastrophe losses for the first half of 2020 were estimated at $40bn compared to a long term average of $30bn.

June 2020 saw most of the large international insurers and reinsurers report on their half year financial performance. Almost without exception each reported significant increases to losses and reductions in underwriting profits.

In addition to the increase in natural disasters, the impact of Covid-19 continues to play a major part in the insurance market performance. It's been estimated that the cost to the insurance market could be over $336bn which puts it in the same category as the impact of the 2017 hurricane season, the worst on record to date.

The New Zealand Market

As we have noted above the insurance market in New Zealand is part of a global system and simply cannot operate in isolation. In addition, all of the major insurance companies that operate here have foreign ownership.

At 30 June 2020 the three largest insurance companies in New Zealand, IAG (owners of NZI), Suncorp (owners of Vero) and QBE declared their financial results to shareholders. IAG reported a 59.6% drop in net profit, Suncorp announced its insurance division had a 34% drop in after tax profit and QBE posted a $750m post tax loss.

Much of the driver for these results is the $4.2bn already paid in relation to last summer's Australian bushfires, floods and hailstorms with Rob Wheelan commenting "This was the worst natural disaster season I have experienced in my 10½ years as chief executive of the Insurance Council."

Closer to home insurers' results have been affected by the November 2019 Timaru hail storm that caused over $130m in insurance claims, Southland floods in February 2020 at $29.6m and the recent Northland floods in July resulting in $37m of insured losses.

All three of these insurance companies are undergoing some form of restructure or consolidation of their businesses in New Zealand to respond to changes in trading conditions. This is most notable with the closure of all of IAG's AMI branded retail stores.

The insurance companies are also reporting to us that they are facing increased reinsurance costs. These additional expenses will put a further strain on their underwriting results and will most likely be passed on to policy holders in the form of premium increases.

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We can make the following comments on individual insurance sectors in New Zealand;

Material Damage & Business Interruption

The result of increased reinsurance costs means that we are expecting insurers to put pressure on the market to achieve rate increases that could result in increased premiums. We expect that this will be inconsistent and may vary significantly from one insurance company to another and also regionally in New Zealand.

When we have an inconsistent market it's vitally important to approach insurers early and with quality information so that the best possible client outcomes can be achieved.

The availability of affordable capacity for earthquake cover in the Wellington region continues to be the major area of concern for the market. All insurers are closely managing their capacity in this region and in particular are looking to get the best return when they do accept a risk. This does not necessarily mean just the highest premium, insurers also look closely at location, construction, age and earthquake strengthening.

Another area of concern is insulated panel construction (EPS). Following a number of significant fire losses (not in New Zealand) reinsurers have put pressure on insurers to increase rates and reduce their capacity on EPS risks.

It is essential for any business with a significant exposure to EPS that they can demonstrate a robust risk management programme to ensure that the exposure is mitigated as much as possible.

Motor Vehicle

The lockdown periods have had a significant impact on the insurance companies' results in this sector. Less vehicles on the road have led to less claims. The reverse side of this is that insurers have received less premium from commercial motor vehicle policies due to fleets being laid up. Of all the insurance classes (with the exception of Travel), Motor is probably the most directly disrupted by Covid-19. As a general rule Motor pricing is driven by losses and so the longer term impact is yet to be seen.

This is also a class of insurance that has suffered from significant "claims creep" in recent years as new technology in vehicles has resulted in increased repair costs. This new technology has added to the time it takes to repair a vehicle and managing the claims process is important to ensure that the vehicle can get back on the road as soon as possible.

Marine

The marine market remains competitive. This is despite Lloyd's of London, who are a major global insurer in this sector, conducting a market review that resulted in several syndicates withdrawing from the class.

There continues to be readily available capacity for Marine business in New Zealand and the market remains competitive.

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General Liability

The lack of exposure to “bodily injury” claims in New Zealand means that capacity is widely available and pricing is generally competitive. Insurers have been seeking modest increases to premium in recent years, however where an insured is able to demonstrate effective risk management and a good claims record, rate increases can be minimised.

There are certain industry sectors where insurers are seeking rate increases and require more comprehensive underwriting information. An example of this is risks that have exposure in the USA either physically or through product exports.

Directors & Officers Liability (D&O)

The D&O market place has been hardening globally for 24 months. This means that premiums have been increasing and insurers are becoming more selective on the risks that they write. In New Zealand we are now also experiencing this change in attitude. It is being influenced by recent Court decisions on the duties of directors including the headline case of Mainzeal. The emergence of litigation funders in New Zealand and the Courts’ confirmation around “opt out” class actions are also cause for concern.

The economic uncertainty generated by the lockdown and restrictions due to Covid-19 has also had an impact on the D&O insurance market place. Insurers are now taking a very cautious approach to writing new risks or offering increased policy limits. Being able to demonstrate the financial stability of a company and the measures taken by the directors to navigate the current issues is essential.

It is generally wise to allow more time for arranging D&O insurance.

Professional Indemnity

The Professional Indemnity market remains fragmented. In Lloyd’s of London over 12 syndicates have withdrawn from writing Professional Indemnity in the last year due to their poor underwriting results. Industry sectors such as construction, financial institutions, financial advisers, solicitors and valuers continue to be challenging with increases in premium and often tougher conditions applied.

Insurers still have an appetite for many other occupations. However, modest premium increases are the norm on most policy renewals.

For the more difficult industry sectors insurers are seeking additional information and more time needs to be allowed for negotiation.

In the past, economic downturns have fuelled an increase in Professional Indemnity claims. As assets and investments lose value so claimants look to their professional advisers for compensation. Therefore there is a possibility that the Professional Indemnity market may deteriorate in the coming months.

Cyber

The media has been full of news surrounding headline Cyber incidents at some of New Zealand’s best known companies. NZX had possibly the most notable of these incidents when it suffered a DDoS (distributed denial of service) attack that took its website down for 6 days.

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Westpac, Stuff, Radio NZ and MetService were other notable businesses reporting incidents.

We are also seeing an increasing number of claims on Cyber insurance policies resulting from attacks on far more modest companies. The table below shows some examples from recent months of real claims from Crombie Lockwood clients;

Industry	Quantum	Type of Loss
IT services	$20,000	Ransomware attack affected customers system
Produce wholesaler/ exporter/importer	$52,529	System hacked and funds stolen
Construction & installation of plant for petroleum industry	$16,542	System hacked
Talent/management agency	$7,017	System Hacked
Manufacturing Distributor	$40,000	Phishing – payments to unintended recipients
High School	$150,000	Ransomware attack

Cyber insurance is a valuable part of a business' response to a cyber-attack and will also be able to respond to privacy infringements resulting from a network- breach (see comments on changes to Privacy Act below).

Privacy Act 2020

A long overdue reform of New Zealand's privacy legislation comes into force on 1st December 2020 when the Privacy Act 2020 takes effect. The new Act delivers an updated legal framework for the protection of information, which includes mandatory reporting for data breaches.

The revised Act states that businesses will need to notify regulators of privacy breaches that cause, or are likely to cause, "serious harm" to affected individuals. Under the Act failure to notify the Privacy Commissioner of a notifiable privacy breach (without reasonable excuse) is an offence with a fine of up to $10,000.

The important thing to remember for all businesses, is that it doesn't matter whether you have a customer database, an employee register with health and salary information on it, or even whether you're a school with student and parent information on file; breach notification obligations will apply to you. In this regard, the Act will not differentiate between a national company with multiple regional offices and several hundred staff, or a local lawn mowing contractor who holds the email addresses of a handful of clients.

It is possible to insure some of the exposure created by this Act under polices such as Professional Indemnity, Statutory Liability, Directors & Officers Liability and Cyber Insurance.

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Employment Relations (Triangular) Amendment Act 2019

This Act came into effect on 27 June 2020 and updates the Employment Relations Act 2000 to provide more robust protections for workers by allowing them to join a "controlling third party" to a personal grievance claim.

Where a business is using labour supplied by a third party labour hire business this new legislation now makes it easier for either the worker, the labour hire business or the Employment Relations Authority/Employment Court to join the original business to any employment dispute litigation.

We are working with insurers to make certain that all relevant insurance policies, such as Employment Disputes will respond to this new avenue for claims as the claimant need not be a true "employee" in the literal sense of the word.

Conclusion

As we approach the final quarter of 2020, it is somewhat difficult to gauge where the New Zealand insurance market is heading.

On the one hand the mainstream insurance companies have suffered a drop in underwriting profits and are facing increased reinsurance costs – a formula that usually leads to a hard market and increased premiums, but on the other hand regulators are keeping a careful eye on insurance pricing for customers feeling the pinch from Covid-19.

We expect that we will see a modest increase to insurance pricing through the rest of 2020. However, we anticipate that this will not be consistent either across insurers or by policy type. A client's occupation, geographic location and claims history will go a long way to dictating market appetite and pricing.

As such it is imperative that insurers are engaged with early and comprehensive information is provided in order to differentiate their risk and attract capacity providers.

The longer term outlook for 2021 capacity and pricing may well be impacted by further natural catastrophe losses if the predictions for the Atlantic hurricane season turn out to be accurate. For the sake of the people that live in the path of these storms, and also the sake of the insurance market, we hope that they are wrong.

We're here to help

One of our responsibilities as a broker is to ensure you have all the information you need to make informed decisions about the risks your business faces. With the effects of Covid-19 being felt in a number of ways by our clients across the country, we wanted to share some proactive advice to help you protect your business during this difficult and unprecedented time.

We hope you find the information above helpful, if you have any questions please talk to your broker.