Insurance Outlook

Insurance Market Outlook January 2021

2020 will go down in history as the year of the COVID-19 pandemic. As we move into 2021, the hope is that the world will eradicate, or at least become better able to manage the virus, enabling a return to some form of normality.

At the time of writing, there have been some 95 million reported cases of the virus with over 2 million deaths. Fortunately in New Zealand, we have so far been able to resist global trends and while numbers of cases have spiked in the United States of America (US) and parts of Europe, there is now hope that the availability of vaccines will help curb the spread of the virus.

Overall, the New Zealand economy has proven to be extremely resilient. Treasury reported that GDP bounced back by 14.0% in the September quarter, resulting in the strongest quarterly growth in GDP on record. The industries that contributed the most to quarterly growth included retail trade and accommodation (up 42.8%), construction (up 52.4%) and manufacturing (up 17.2%).

The November REINZ House Price Index was up 15.3% on a year ago and consumer confidence rose by 10.9 points to 106 in the December quarter according to the Westpac McDermott Miller Consumer Confidence survey. The index is now just below its long-term average.

The global dairy price held up during December's auctions and in China, monthly activity data for November met market expectations, showing further evidence of domestic economic recovery.

However, with the New Zealand border likely to remain closed for much of 2021 the economic outlook for industries that rely on overseas visitors remains challenging.

The macro view

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

Whilst much of the focus for many industries in 2020 was managing the impact of COVID -19, the global insurance market also had to deal with the effects of climate change.

Natural catastrophes caused $106 billion of global insured losses, up 40% from 2019. Overall, insurance industry losses from natural catastrophes and man-made disasters globally amounted to $116 billion in 2020, according to Swiss Re Institute's preliminary sigma estimates. This makes it the fifth-costliest year for the industry since 1970.

This year's natural disasters affected regions with more insurance cover in place. The North Atlantic hurricane season brought a record 30-named storms in 2020, including five named storms making landfall in the US state of Louisiana alone, again the highest on record. However, most US landfalls did not hit densely populated areas in 2020, resulting in relatively low insured losses of $28 billion.

The year also saw Australia and Canada suffer significant losses from hail damage. In January, hailstorms in south eastern Australia caused significant insured losses, while Canada experienced their costliest-ever hail event in Calgary in June. Each event cost the insurance market in the region of $1.4 billion.

Insurance Outlook

Winter storms hit northern Europe in February, causing flooding, power outages and transport disruption, with more than $2.8 billion combined insured losses and severe floods in several provinces along the Yangtze River in China from May, caused industry insured losses of nearly $3 billion.

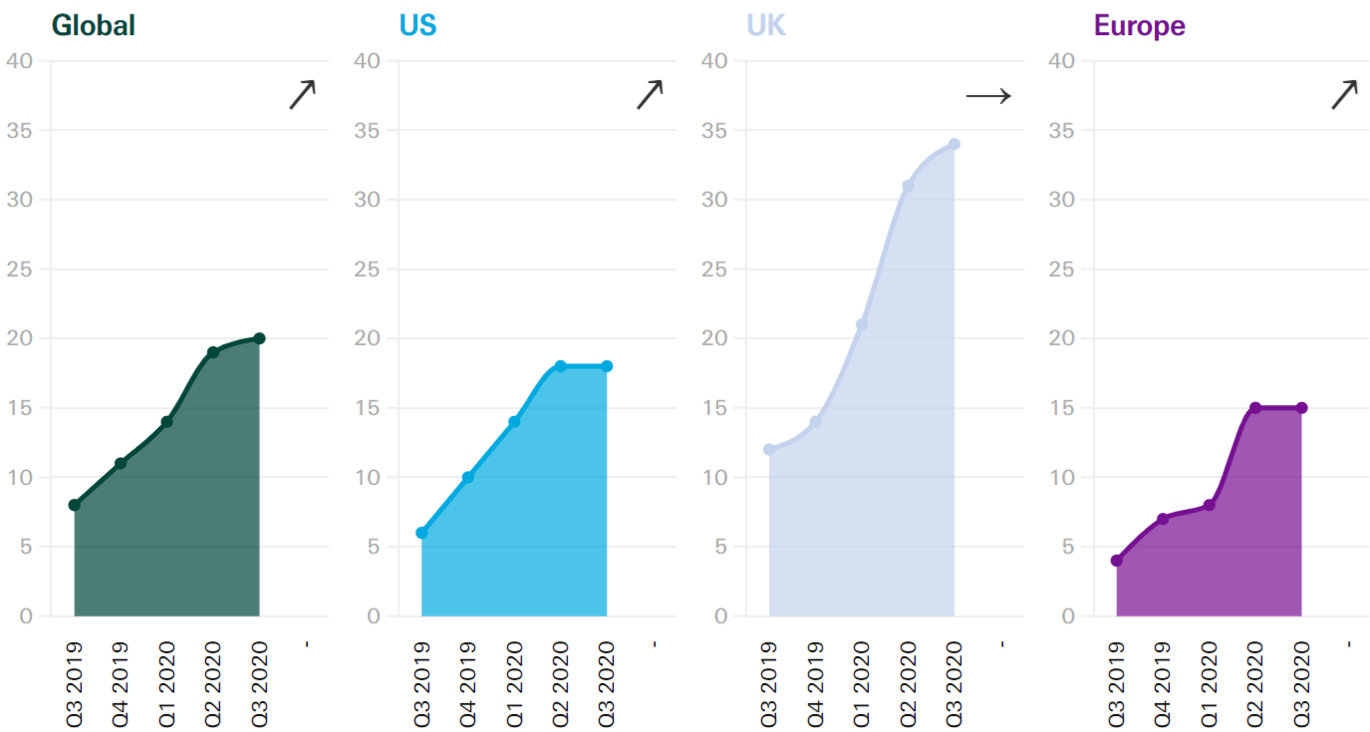
Fires also contributed to losses for insurers. Wildfires in the US from mid-August caused high insured losses, though Australia's 2019 fire season, the longest and most destructive ever recorded, was also burning in early 2020. In the US states of California, Oregon and Washington, more than 800 wildfires burned close to six million acres, destroying thousands of structures and triggering billions in insured claims. Although less than the record losses of 2017 and 2018 seasons, 2020 will be one of the costliest years for fires.

The Swiss Re’s chief economist has made the comment, “As with COVID-19, climate change will be a huge test of global resilience. Neither pandemics nor climate change are 'black swan' events. But while COVID-19 has an expiry date, climate change does not, and failure to 'green' the global economic recovery now will increase costs for society in future”.

Consequently we have already been seeing a “hardening” insurance market globally with prices increasing year on year driven by a growth in losses and reduced interest rates. This trend is most likely to continue in 2021.

The following chart shows the percentage rate of commercial lines insurance around the world.

We expect positive rate momentum to continue through 2021. ↗ Accelerated rate increase → Stable rate increase



Insurance Outlook

The New Zealand market

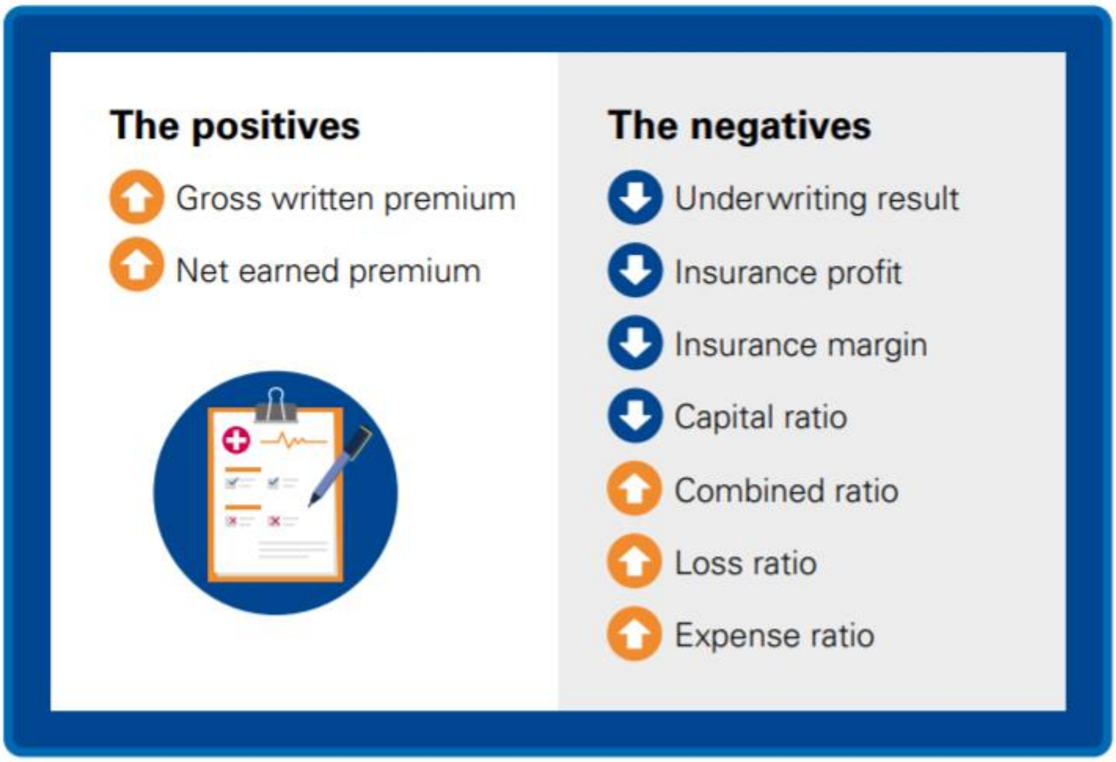
To date New Zealand has escaped the impact of the global insurance “hard market”. Rates across most classes of business have been relatively stable with some exceptions for specific occupations or risk factors such as earthquake cover in Wellington.

However, we expect that 2021 will see the insurance companies operating in New Zealand come under pressure to increase premium rates and carefully manage their exposures.

The insurance market in New Zealand is part of a global system and relies on international reinsurers to operate. Local insurers are reporting that their own reinsurance costs are increasing due to global losses and that they have to pass some of these costs along to the consumer.

In previous Insurance Outlooks we have made mention that the three largest insurance companies in New Zealand, NZI, Vero and QBE have reported falling profits due to increasing claims activity. Much of the claims activity stems from climate related claims such as Australian bush fires.

A recent KMPG report outlined insurer’s predicament in 2020;



In November 2020 insurers received more bad news when the NSW Supreme Court of Appeal sided with policyholders in determining business owners affected by COVID-19 with certain policies should be paid.

As in New Zealand, most insurance policies in Australia contain a Pandemic Exclusion. However, many of the Australian exclusions referred to the Quarantine Act and subsequent amendments.

This Act was repealed in 2016 and replaced by the Biosecurity Act – the correct Act under which quarantinable diseases are notified in Australia.

The Courts found that if the Pandemic Exclusion in the policies did not refer to the correct Act then the insurance companies could not deny the claims.

Insurers QBE and Suncorp (owners of Vero) acknowledged the loss in ASX announcements, but it did not stop an investor sell-off and shares prices at the two companies fell as a result.

Insurance Australia Group (owners of NZI) went into a share trading halt so it could assess the financial impact of the judgment, eventually deciding to raise an additional A$750m in capital and provisioning A$1.24 billion on a pre-tax basis, for its Business Interruption exposure.

While this judgement has no direct effect to claims in New Zealand (as it relates only to Australian law), many of these insurers that operate here are now potentially facing billions of dollars of claims that they hadn't provisioned or priced for. This could well have an impact on their future pricing of New Zealand insurance as they try to recover their losses.

In January 2021, the UK Supreme Court also passed a judgement on several pandemic related Business Interruption claims. Like the Australian cases, the UK judgements also do not directly affect coverage under New Zealand policies and apply directly to the insurers involved. However, recovery of costs does hit some of the insurers writing business in New Zealand and QBE for example announced they had provisioned an additional $260m for their share of the UK claims.

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

Material Damage & Business Interruption

New Zealand continues to buck the global trend of rating increases on Material Damage insurance however; we anticipate that in Q1 2021 most insurers in New Zealand will be looking to achieve a blanket increase to rates across their overall portfolio.

This is the result of increased reinsurance costs and poor financial results. However, we still anticipate that this may be inconsistent and could vary significantly from one insurance company to another and by region until the market establishes its position.

In an inconsistent market, it is vitally important to approach insurers early and with quality information to ensure the best possible 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 and all insurers are closely managing their capacity in this space.

Because of the numerous legal challenges resulting from COVID-19 related claims, we are now also seeing insurers apply tighter exclusions around pandemic coverage, although for most New Zealand policies this merely serves to reinforce that no cover is available.

Silent Cyber exclusions are now also becoming a market standard and have been introduced by most insurers either already or planned during 2021. These exclusions will remove cover from a Material Damage policy where loss is caused by a cyber-event. To varying degrees, insurance policies have provided some limited cover for such claims in the past. Whilst it is quite difficult for most businesses to envisage how such a loss could occur it should be considered.

Motor Vehicle

The 2020 lockdowns had a significant impact on the insurance companies' results in this sector.

Less vehicles on the road led to less claims. The reverse side of this is that insurers have received less premium due to fleets being laid up although the second half of 2020 saw more of a return to a normal environment.

This is 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. It is also possible that delays in the supply chain due to COVID-19 could add time to repairs

Most commercial motor fleet policies' premiums are driven by their claim histories and this will continue to be the case in 2021. Towards the end of 2020, we started to experience some competitive tension between insurers leading to some rate softening on clean portfolios.

Marine

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

One major change to the marine market in New Zealand during 2020 was the withdrawal of Club Marine. From Q3 2020 Club Marine ceased offering renewal or new business quotes. This may have an impact on the pleasure craft market in 2021.

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 but 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 higher rate increases and requiring more comprehensive underwriting information and more time needs to be allowed for negotiation. An example of this is risks that have exposure in the USA either physically or through product exports.

Insurance Outlook

Directors & Officers Liability (D&O)

The D&O market place has been hardening globally for over 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. This is being influenced by 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.

New Zealand insurers continue to be influenced by what they see across the ditch. Reports from Australia highlight that for public companies premium increases in excess of 100% are commonplace. Whilst we are not seeing this trend in New Zealand, it is certainly having an impact on insureds who purchase larger D&O limits using layered programme structures.

The economic uncertainty generated by the pandemic and restrictions due to COVID-19 has also had an impact on the local 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

Insurers continue to look more closely at Professional Indemnity risks. The impact of "social inflation" has had an impact on the profitability of most insurers' portfolios.

Social inflation refers to the rising costs of insurance claims resulting from things like increasingly complex litigation, broader definitions of liability and more plaintiff-friendly legal decisions.

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.

Cyber

Cyber-attacks have increased in frequency during the pandemic with 'bad actors' using the vulnerability of businesses as a means to expose weaknesses in computer networks and we are seeing frequent claims on client's Cyber insurance policies.

The New Zealand lockdowns saw many businesses adapt more flexible work environments with employees remotely accessing the work network. Fortunately, it has been sometime since New

Zealand has had to go into lockdown but many companies are now using remote access for larger numbers of employees as the new way of working.

It is imperative that employees are aware of security measures whether working in or out of the office and businesses have assessed the security of their remote access environments.

Insurance for Cyber is still readily available in New Zealand but with insurers looking more closely at an insured's individual risk profile. This is particularly apparent for larger and more complex businesses where a strong approach to risk management and mitigation of Cyber risks also needs to be demonstrated.

The Cyber insurance industry continues to mature and new products and risk management tools are frequently being introduced. For example, some insurance companies are now offering pre-loss services, network security reports and on-line employee training modules.

Conclusion

2020 will be remembered as an *annus horribilis.*

The continuation of the COVID-19 pandemic globally will likely remain with us for much of 2021, however the rapid development and implementation of several vaccines provides a glimmer of light at the end of what has been a very dark tunnel.

If it is at all possible to put COVID-19 to one side when reviewing 2020 and consider the state of the global insurance market generally, it is clear that the cost to reinsurers and insurers from claims is increasing year on year. The impact of climate change as well as social inflation on liability insurance appears to be driving loss cost higher.

As a result, many countries have been experiencing a hard insurance market for many months as insurers look to recoup losses and average premium increases of 20% and more are commonplace. In New Zealand, we have avoided the pricing effects of the international market up until now; however, it appears that Q1 2021 will see most insurers looking to apply rate increases in the region of 5% to 10% across their portfolios.

In order to minimise any rating increase it is imperative to engage with insurers and brokers early in the renewal cycle with high quality information.