Insurance Outlook

Market Outlook September 2021

When we issued our May 2021 update, New Zealanders were enjoying a buoyant economy, starting to enjoy a trans-Tasman travel bubble and were beginning Covid-19 vaccinations. Fast forward four months and at the time of writing, the trans-Tasman travel bubble is on pause, the vaccination programme is well underway, Auckland experienced its longest Level 4 lockdown to date and the rest of the country is also enduring Covid-19 related restrictions.

Economic summary

The ANZ's September Quarterly Economic Outlook titled "Two steps forward, one step back," highlights that our spectacular economic recovery has been brought to a sharp stop by the Delta variant of Covid-19.

Pre-Delta, our economy was running hot; GDP growth in Q1 exceeded pre-pandemic levels at 1.6%, unemployment was at a post-2008 low of 4%, and inflation was above 2% for the first time since the GFC.

It is clear that Delta is a game changer and how our economy will respond following the latest lockdown will not necessarily be the same as after the 2020 lockdowns and we could be in for a rollercoaster ride.

ANZ notes that a key driver of the 2020 recovery was the housing market. Building activity surged and money that had been earmarked for overseas travel was spent on renovations. However, in 2021 the construction industry is facing problems such as labour shortages and lack of raw materials, which is driving up building costs and increasing project completion times. ANZ also notes that "there is just no way house prices are going to rise another 30%" with the probability of rising interest rates starting to play out.

In May we reported that the global economy was also strong. However, many countries are experiencing their own battles with Delta and this is having a negative economic impact in many regions. Australia's economy is forecast to contract by 3.3% in Q3, mainly as a result of their extended lockdowns. In China retail sales have fallen and investment growth has slowed, again mostly attributed to the impact of Delta.

Global commodity prices are also softening and even dairy prices have reversed some of their 2020 gains, although still remain higher than pre-pandemic levels.

For exporters and importers alike, it's not just commodity prices that are of concern. The cost of shipping has sky rocketed and there are also significant delays at many key ports around the globe. This disruption to the global supply chain is also having a knock-on effect on the New Zealand insurance market, which we will discuss later in this outlook.

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The macro view

(All figures are converted to NZ$ at current exchange rates)

The global insurance market now has a better grasp on Covid-19. Whilst not all claims have been settled, and there is still a reasonable amount of litigation underway in a variety of jurisdictions, insurers and reinsurers have a good understanding of their overall exposure and have made the appropriate provision in their results.

During late 2020 and early 2021, the global insurance market moved to ensure that a hard line was drawn under potential insurance coverage from pandemic related claims. We have seen new, stricter Infectious Disease Exclusions being imposed on all classes of insurance policy as a mandatory policy condition.

Whilst in New Zealand very few insurance policies provided cover for Covid-19 related claims, there have been legal challenges to coverage elsewhere in the world. In Australia errors in policy wordings have led to insurers needing to provision for unexpected and unintended Business Interruption claims. For IAG (NZI in New Zealand) alone this has meant positing $1b in claims reserves.

Nevertheless, insurance market results seem to be improving. Lloyd's of London announced their half year (HY) report for 2021 and has seen 2020's HY underwriting loss of $2.5b turn into a 2021 HY profit of $1.9b.

All insurance companies rely on reinsurance to operate and there were some pleasing improvements in this sector too. Willis Re reported that global reinsurers performed well in the first half of 2021. Their weighted average reported combined ratio (a measure of underwriting profit) was 94.1% for the period. This ratio is a big improvement from the Covid-19 impacted 104.1% result for HY 2020. Essentially this means they are now making nearly 6 cents for each dollar written. AM Best reported that "after several years of struggling to meet their cost of capital, key players (reinsurers) have started to turn the corner."

These results mean that the global "hard market" is showing signs of prices flattening out. Unlike the New Zealand market in recent times, international pricing has significantly increased across many risk classes. Reports now indicate that more moderate price adjustments are being applied.

However, it is not all plain sailing and climate issues continue to play havoc with insurance claims. Swiss Re reports that insured natural catastrophe claims at HY 2021 are above the previous 10-year average at $56b and are exceeded only by HY 2011 when major earthquakes in Japan and New Zealand pushed the six-month total to $146b.

More recently, Goldman Sachs' analysts estimate the insured loss from Hurricane Ida in August is between $42b and $56b. This further demonstrates the impact of climate change on global insurers and reinsurers and the challenge for the global market to create sustainable pricing models that cater for the changing environment, whether the losses are man-made, related to pandemics, natural disasters or climate change.

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The New Zealand Market

The major insurance companies in New Zealand have also recently announced more positive financial results, despite the substantial impact from weather-related claims.

The Suncorp NZ (Vero) result for 12 months to June 2021 is one such example. CEO Jimmy Higgins said that their result had been "significantly impacted" by a big spike in natural hazard claims. For Suncorp NZ this meant an 18% increase ($45m) in claims driven by events such as the Auckland tornado as well as floods in Napier, Northland and Canterbury.

The table below shows data from the Insurance Council for the insured cost of claims from major natural disaster events in New Zealand in 2021.

Date	Event	Category	Cost
Jan 2-3	Canterbury southwards Rain & Hail	Hail, Rain, Storm	$3.84m
May 29 – June 1	Canterbury Flooding	Flood	$43.81m
June 19	South Auckland Tornado	Tornado	$32.03m
July 16-19	Upper South Island Floods	Flood	$16.72m
July 16-19	Wellington Floods	Flood	$15.36m
July 16-19	North Island Floods (ex WTN)	Flood	TBC
July 16-19	West Coast Flooding	Flood	$85.41m

Source: www.icnz.org.nz

It is not only wet weather that has been causing havoc. Annual rainfall in New Zealand for the five years 2016–2020 was actually 10.7 % below the average and wild fires are becoming more frequent. The fires at Lake Ohau in October 2020 cost the New Zealand insurance market $35.18m in insured claims. 93% of these claims came from domestic home and contents insurance.

As we previously noted, the global supply chain has been impacted by the effects of Covid-19 and this too is having a considerable impact on the New Zealand insurance market.

The increased costs for shipping are causing price increases to both building materials and consumer products. These increases filter through to escalating costs of repairing insured damage or replacing lost or damaged goods.

Higher prices are further compounded by the time delays in getting materials and goods into the country. A longer settlement for an insurance claim increases overheads such as having to pay for alternative accommodation, additional costs to operate the business or supply of temporary vehicles. The current tight labour market is also not helping this situation.

Overall however, the New Zealand insurance market is in good health and stable. Capacity is still readily available for most sectors and insurers are very much open for business. Pricing remains firm with insurers seeking sustainable pricing models.

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Material Damage & Business Interruption

Despite several large weather-related events, this sector remains largely profitable for insurers. Covid-19 does not have a direct impact on claims as the Infectious Disease exclusions removed cover from Business Interruption policies.

However, the New Zealand market, like all insurance markets, relies heavily on reinsurance to be able to operate. Therefore insurance companies' pricing models have to allow for reinsurance costs and all insurance companies report these costs are still increasing.

Therefore we expect to see a continued effort from insurers to achieve overall premium/rate growth across their portfolio. It is anticipated this will be between 2% and 5% depending on the insurance company.

This does not mean that all sectors of the market will be treated equally. There is still more pricing pressure on certain areas of the market and the key difficulties in New Zealand continue to be around capacity for Wellington earthquake and risks with insulated panel construction (EPS).

We also note a growing reluctance from insurers to accept risks that are involved with the recycling and waste management industries.

Where risks fall into these more challenging areas it is imperative the market is engaged early and solid underwriting submissions are presented to ensure the best outcomes can be achieved.

Commercial Motor Vehicle

Commercial Motor Vehicle has probably been the insurance class most directly affected by the pandemic in New Zealand. Essentially the pricing of motor vehicle insurance is set by claims performance. Fewer numbers of vehicles on the road during the various 2020 and 2021 lockdowns have dramatically altered the claims picture.

This means when insurers price a fleet at renewal they have to factor in a distorted 2020 and 2021 claims view and then overlay this with other dynamics impacting claims. Elements such as the escalating costs of repairing or replacing vehicles (including time delays from the supply chain), the impact of a tight labour market where the availability of experienced commercial drivers is challenging and weather-related issues that have made driving conditions difficult.

Most insurers report their commercial motor books are performing well but all note the increasing costs of claims as a growing concern.

In fact, we have seen one or two insurers which were using aggressive pricing to grow their market share pull back from this approach in the last month due to ballooning claims as a result of this strategy.

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Marine

Claims for a combination of weather-related losses and other catastrophic claims have influenced the overall performance in the marine sector. However, capacity in the New Zealand market remains strong.

We previously reported that the current Marine Cargo premiums are unsustainable and insurers continue to look for gradual year-on-year rate adjustments to correct ratios and offset growing industry losses.

For Marine Cargo businesses, the expectation for clients without losses is insurers will seek premium increases of between 5% to 10% and where clients have poor loss records, insurers will look to increase premiums by over 10% and may also consider applying higher excesses.

As with many classes of business, insurers now request more detailed underwriting information for both new and renewal business. Sufficient time therefore needs to be allowed to negotiate terms.

Directors & Officers Liability (D&O)

The New Zealand D&O market had shown signs of growing confidence as the country emerged from the 2020 lockdowns and the economy bounced back strongly. Insurers were becoming more willing to look at writing new business and extending existing policy limits. Time will tell how Delta will impact this confidence.

It remains vital that when seeking D&O insurance, a company is able to demonstrate its financial viability and the measures it has taken to mitigate potential impacts of the pandemic. It also continues to be important to allow plenty of time for arranging D&O insurance.

Premiums for D&O policies in New Zealand are still rising and increases of 10% or more are commonplace.

In August, a change in Australian legislation means directors will only be liable for civil penalty proceedings in respect of continuous disclosure obligations where they have acted with “knowledge, recklessness or negligence” in respect of market sensitive updates.

Although New Zealand has seen a growth in litigation-funded class actions, there is no doubt that the litigation scene in Australia has influenced D&O underwriting and pricing in this country as well.

This legislative change should have the effect of slowing down the number of shareholder class actions in Australia. In time this will hopefully see insurers ease the massive premium increases that have been the norm in Australia of recent times. These positive developments in Australia are good news for New Zealand.

Professional Indemnity

Overall the Professional Indemnity market in New Zealand is strong and healthy. There continues to be a number of insurers which are able to compete for business and capacity remains available.

However, the market appetite for Professional Indemnity does vary significantly depending on the activities of the insured.

For specific industry sectors the market conditions remain challenging with insurers still remediating their portfolios through a combination of rate increases, capacity reductions, higher excesses and coverage limitations. These sectors include construction, financial institutions, financial advisers, solicitors and valuers.

For most other professions and occupations there is good appetite from New Zealand insurers. However, often insurers want additional information and more time needs to be allowed for negotiation.

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 sought modest premium increases in recent years, however where an insured is able to demonstrate effective risk management and a clean claims record, rate increases can be minimised.

There are certain industry sectors where insurers are seeking larger premium increases and requiring more comprehensive underwriting information. An example is risks that have exposure in the United States of America either physically or through product exports.

Cyber

Cyber is probably the most volatile class of insurance and the fastest growing by both policy count and premium volume.

Globally the frequency and severity of losses such as those resulting from ransomware attacks have had a huge impact on the financial results of insurance companies. Despite increasing premiums, the Best Market Segment Report published in June 2021 noted that 14 of the top 20 cyber insurers' loss ratios had worsened in 2020.

The result is that we are seeing many insurers:

1. Increase premiums
2. Restrict coverage
3. Demand much more information.

In New Zealand, premiums have been increasing anywhere from 20% upwards. Sub limits are sometimes being applied for ransomware claims and new exclusionary language being applied to end-of-life software is becoming the norm.

Virtually every insurer will require verification of at least some preventative controls, which will likely include multifactor authentication, remote desktop protocol, data backup practices, segregation of networks, encryption, patch management, privileged account management, employee training and a host of others.

Applications often require additional ransomware questionnaires that may include dozens of questions on controls specially designed to prevent or mitigate ransomware attacks.

Without some of these controls in place, many insurers are refusing to quote. It is therefore paramount to start the application process for Cyber insurance as early as possible.

Conclusion

The New Zealand insurance market remains in a stable condition.

Pricing is firm as insurers seek sustainable pricing models and almost without exception insurers would like to see premiums increase, albeit modestly, to offset their growing claims costs.

To negate these increases, early engagement with the insurer is recommended and it is vital that all pertinent information required to present a risk in the best light is provided.

An old industry adage that "insurers fill gaps in information with premium dollars" has never been more appropriate in a market where insurers want to take a more granular look at each individual client.