Insurance Outlook

Market Outlook May 2021

Since our last market update in January 2021, we continue to see the effects of the Covid-19 pandemic take centre stage with some significant changes both in New Zealand and globally.

April saw the start of quarantine free trans-Tasman travel for the first time in over 12 months. However, we were given a stark reminder of the associated risks of travel when two new community cases in Sydney paused the travel bubble. Events in Melbourne and Perth also caused New Zealand border and health authorities to take action to manage any potential outbreaks here.

While the Cook Islands travel bubble offers the potential of some winter sun, it might be some time until unrestricted travel further afield can resume. Experts anticipate that it could take at least five years for international air travel to return to pre-Covid-19 levels.

Covid-19 vaccination programmes are now underway in excess of 200 countries with more than 390,000 doses administered in New Zealand at the time of writing and 1.4billion doses given worldwide.

Economically, the world seems to be recovering faster than expected. Overall growth is being reported in the region of 6.3%, led by China and Asia. This is supported by strong GDP growth forecasts in the United States of America and the United Kingdom. In the UK successful vaccination programmes are contributing to growing confidence in the economy.

Locally, the May 2021 ANZ Business Outlook Survey reported that business confidence is up 9 points to +7% and that the unemployment rate has declined to 4.7%. The survey also highlights a general rise in costs that are expected to increase further as the economy tries to grow faster than it physically can, given the shortages of both goods and labour.

Source: ANZ New Zealand Business Outlook May 2021

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The macro view

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

We have previously advised the global insurance market has experienced rating increases, as a response to losses arising out of the pandemic and natural disasters mainly attributed to climate change, and this has led to premiums increasing. Reports from global markets indicate that the trend of increasing rates is showing signs of slowing with the percentage of rate increase easing.

One of the world's largest insurers, Lloyd's of London, announced its full year results for 2020 including claims of $6.55billion relating to Covid-19. Combined with the impact of a "high frequency of natural catastrophe claims", Lloyd's posted a loss of $1.7billion against a 2019 profit of $4.8billion.

However, despite reporting a combined ratio of 110.3% (essentially paying $1.10 in claims and expenses for every $1 of premium received), Lloyd's said that excluding losses from the pandemic they would have delivered an underwriting profit of $1.5billion.

It is anticipated that the 2021 impact of Covid-19 will put significantly less strain on the global insurance market and this has been confirmed in Munich Re's Q1 2021 result announcement. The global reinsurer announced a year-on-year operating result that increased to $1.3billion from $0.66billion in Q1 2020, which was attributed to a considerably lower burden arising from Covid-19 losses – especially in property-casualty reinsurance.

It also appears that the US domestic insurer market is nearing the end of rebalancing portfolios to improve performance and the London direct and facultative markets are beginning to see the entry of new insurers as fresh capacity is enticed by attractive pricing models.

In spite of this positive news, the impact of climate change is still a major concern for the global insurance market as was recently demonstrated when Australia announced a proposal for a cyclone reinsurance pool for northern Australia backed by a $10billion Government guarantee. The Australian Government believes that this will reduce insurance premiums by more than $1.5billion over 10 years in a sector that has seen crippling insurance costs or the inability to buy any cover at all.

The New Zealand market

In New Zealand, insurers are generally looking to obtain growth through writing more risks rather than raising rates however, we are seeing a divided market. Insurers have differing approaches depending on the class of business being written i.e. property or liability and/or the location and occupation of the insured. In certain sectors, insurers have rebalanced their portfolios and are now seeking growth opportunities, whereas in others they continue to focus on remediation and a return to profitability.

The impact on the local market is that we are generally seeing quite a stable market with modest rating increases in most cases for attractive risks with good loss experiences.

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As with every other sector of the economy the insurance market is suffering from supply chain and labour issues. Increased costs and shortages of supply of both of these mean claims are taking longer to settle and the costs of settling are increasing. Insurers are now pricing these additional costs into their rating models.

One aspect that seems to be common across all classes of insurance is that insurers have now become much more granular in their underwriting and are requesting far more detailed information from clients prior to providing terms. In addition, insurers are now more insistent on compliance with risk control recommendations. It is therefore important that negotiations are started early with insurers whether it be for new or renewal business.

Material Damage and Business Interruption

New Zealand largely escaped the Covid-19 losses incurred by insurers in Australia and the UK where legal challenges to policy coverage have gone against the major insurers.

However, globally insurers are imposing across-the-board clarifications and exclusions, particularly related to silent cyber, infectious disease and contingent business interruption risks. All local insurers because of their own reinsurance requirements are imposing these new clauses.

The key areas of difficulty in New Zealand continue to be around capacity for Wellington earthquake risks and risks with insulated panel construction (EPS).

Both of these categories of risk are areas where insurers have been rebalancing their exposure in recent years by increasing premiums and reducing their capacity. The good news is that generally we are seeing a relaxing of increases for well managed risks with good claims records.

Motor vehicle

This is a class that has suffered from significant “claims creep” in recent years as new technology in vehicles has resulted in increased repair costs. As a result, premiums have been increasing however insurers are now getting to a more stable pricing position.

The new technology has also added to the time it takes to repair a vehicle and managing the claim process is important to ensure that the vehicle can get back on the road as soon as possible.

This has been further compounded by the supply chain issues resulting from the pandemic.

Marine

Capacity in the marine market in New Zealand remains strong. However, it is evident that current marine cargo premiums are unsustainable and we expect we will see pressure from insurers to achieve gradual year-on-year rate adjustments to offset growing industry losses.

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2020 was a particularly bad year for marine claims across both Hull and Cargo categories. Losses included the Beirut port explosion with a total insured loss of US$2billion and a large number of storm-related claims including the tragic loss of Gulf Livestock 1 en-route from Napier to China.

More recently, the well-publicised incident involving the 'Ever Given' that ran aground in the Suez Canal is likely to cost the insurance market in excess of US$1billion.

For marine cargo business, the expectation for clients without claims is that insurers will be seeking rate increases of 5-10% and where clients have poor loss records insurers will be looking at increasing rates by over 10% and may also look at applying higher excesses.

As with many classes of business, insurers are requesting more detailed underwriting information for both new and renewal business.

Corporate travel

With the prospect of quarantine free international travel now a reality, many businesses will be looking forward to once again conducting face to face meetings with, initially, Australian connections. Whether using an existing travel insurance policy or taking out a new policy it is important to understand that coverage relating to claims based on Covid-19 may vary.

For claims relating to Covid-19 cover is very limited. On the plus side, most insurers are still providing full medical cover and additional expenses if a traveller contracts Covid-19 prior to travelling or whilst overseas. However, if travel is interrupted due to a Government or local body changing its travel rules (i.e. implementing border/state closures, or a 'pause' in flights) then insurance is unlikely to respond. For example, loss of deposits for pre-paid flights and accommodation would not be covered, and if an employee gets stranded in Australia then their additional expenses etc. would also not be covered. We expect this to be an area which will develop as travel returns to some form of new normal.

Note: Non Covid-19 related claims, such as lost bags or general illness etc. will remain covered.

Forestry

Recent years have seen a significant increase in the frequency and severity of forest fires globally. The result of the deteriorating performance of the forestry portfolio has resulted in several insurers withdrawing capacity from the sector. Those insurers who do remain actively writing new or renewal business are generally reducing the amount of capacity that they will deploy on an individual risk and increasing premiums and excesses – often significantly.

There are no New Zealand based insurers now offering cover for forestry. Therefore, to source cover sufficient time needs to be allowed to engage with offshore insurers to negotiate terms.

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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 rates 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 higher rate increases and require more comprehensive underwriting information. An example of this is risks that have exposure in the US, either physically or through product exports.

Directors & Officers Liability (D&O)

The market correction that has been taking place in the D&O space appears to be slowing and whilst we are still experiencing rate increases, they tend to be lower than in 2020 and 2019.

Over recent years insurers have been reducing their exposure to individual risks, particularly on bigger businesses. This exercise now seems to be largely completed and so capacity levels now appear relatively stable.

The improving state of the New Zealand economy is also helping D&O insurers gain confidence in offering quotes to new clients and considering increased limits to existing clients.

The environment for listed companies however is a little different. The class action activity on both sides of the Tasman continues to be a concern. The impact for both ASX and NZX-listed companies is that insurers continue to seek rating increases, although again the increases tend to be lower than in 2020 and 2019.

It is vitally important to allow plenty of time for arranging D&O cover. Insurers are looking for a lot more detail into how the company is managing its exposures to the economy and Covid-19.

Professional Indemnity

The market appetite for Professional Indemnity in New Zealand varies significantly depending on the activities of the insured.

For specific industry sectors, market conditions remain challenging with insurers still remediating the performance of 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 local market appetite. Generally, insurers are seeking additional information and more time needs to be allowed for negotiation.

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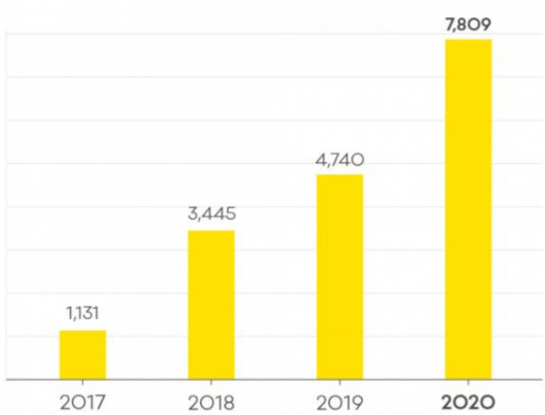
Cyber

The cyber market in New Zealand remains fragmented. At the SME business end there is still good market appetite for new and renewal risks and both rates and coverage remain relatively stable.

However for mid-market and larger businesses, rate increases are gaining momentum because of a significant uplift in claims activity. We are experiencing rate increases in the region of 10% to 30% for cyber cover.

There have been a number of large, well-reported cyber breaches in New Zealand but there is also a general increase in both the frequency and severity of cyber breaches in all sectors of the community from individuals, SME businesses and large organisations. In their 2020 Summary Report, CERT NZ reported a 65% increase in reported incidents in 2020 as shown below.



New Zealand is following the global trends where phishing, data harvesting and malware incidents are increasing dramatically, as shown below.

Source: Cert NZ 2020 Summary Report

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The Privacy Act changes came into force in New Zealand on 1 December 2020. The Privacy Act 2020 puts far more onus onto the holder of personal information to prevent loss, misuse or disclosure of this information. With a new legal framework setting out these obligations we expect that insurers will start to request more information on client data security measures when requesting cyber cover.

Conclusion

Overall, the insurance market appears to be in a more stable position than in 2020.

Covid-19 has changed the environment for many years to come. However, the commercial impact of Covid-19 on the insurance market appears to be slowing. In addition, the faster than expected global economic recovery is giving the market confidence to start accepting wider risk once again.

The pandemic has caused the insurance world to look closely at how it operates and this has resulted in insurers wanting to take a more granular look at each individual client and request more information before providing terms.

Clearly, this means that the underwriting process needs more time in order for a favourable outcome to be achieved.

Climate change still remains a significant issue for the market and we expect that this will be a dominant driver of future market trends. We anticipate that insurers will continue to use data to drive more risk based pricing using climate change models. We are already experiencing this in the insurance market for personal lines business where pricing models vary markedly between New Zealand regions. We expect that this will be a major factor in future rate movements, particularly in the business sector.

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