Finity Market Report

May 2020

This publication provides Finity's half yearly FY20 view of the Australian General Insurance market for brokers

In this edition we:

- Deep dive into the impact of COVID-19 and how businesses and insurers are responding.
- Provide our view of rate changes, capacity and profitability across various classes of business.
- Analyse recent experience and provide a "Finity forecast" for the next 6-12 months.
- Discuss other topical issues such as the recent bushfires and climate change.
- Provide a regulatory update.

Steadfast
THE STRENGTH YOU NEED

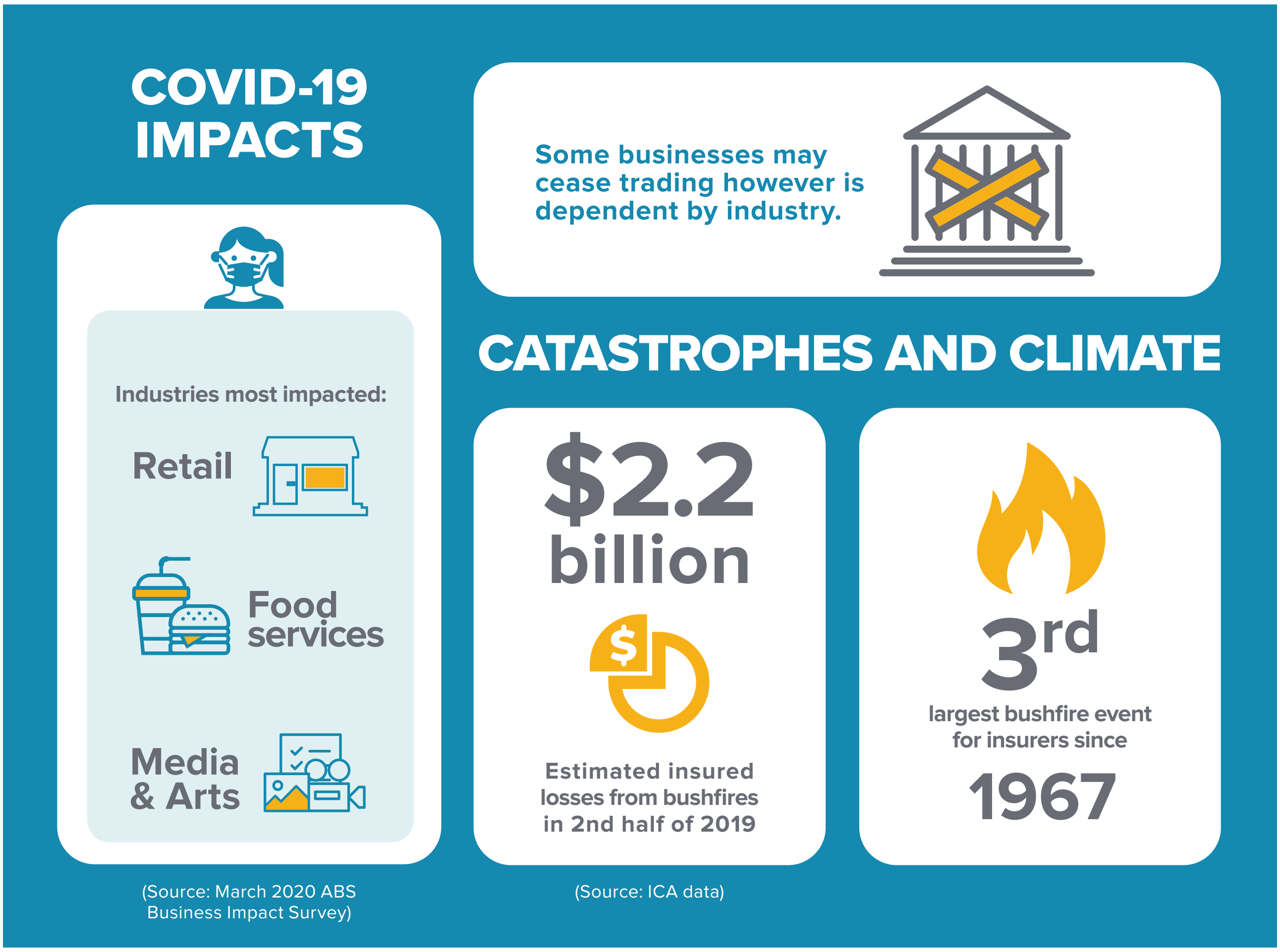
Finity's key messages:

COVID-19 is expected to have a wide range of impacts on the whole general insurance market. The situation is constantly evolving, and the ultimate impact is extremely uncertain. In this report we incorporate our understanding of events to mid-April 2020 and provide our view on the possible future impact for the general insurance industry.

In the immediate term, we expect there to be some reductions in exposure and therefore premium variations, particularly for the SME market. New working arrangements, changing methods of service delivery and creation of new products will mean businesses risk profiles and therefore insurance needs will also change. However, the network reports an increase in demand for cyber, trade credit and a focus on insurance protection and premium funding. Contrary to the GFC, transport is booming and fleets rather than diminishing are being expanded. Brokers are crutial in the implementing of these changes and guiding clients through this period.

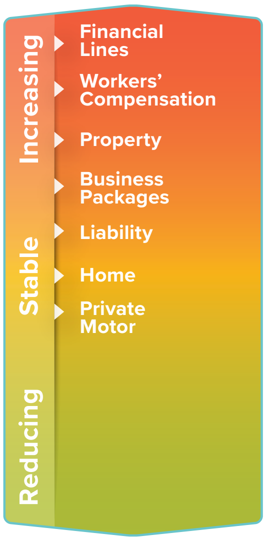
We don't expect large rate increases for SMEs in the near term, as insurers have pulled back on their rate increases previously targeted and capacity changes. At this stage, there is still significant uncertainty around how premium and claims will play out.

Adding to the challenges for the industry were the recent summer bushfires. Whilst we do not expect these events to trigger industry-wide increases in pricing, locations exposed to natural perils may expect increases. However, the long-term trends of a warming climate present longer-term premium rate pressures. Existing affordability issues will be exacerbated given the recent impacts of COVID-19.



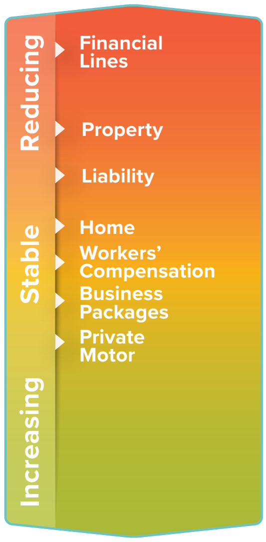
Finity forecast

Rate change



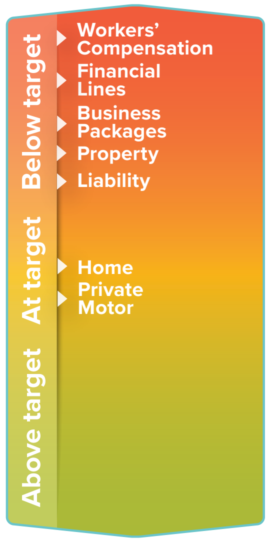
COVID-19 will dampen short term rate increases for most classes; however some increases are still expected for certain commercial lines classes for the next renewal period.

Capacity



Capacity remains similar. Some classes and segments still remain challenging, but capacity is generally available at a price or with exclusions.

Profitability



Significant uncertainty exists around the impact of COVID-19. Some classes may be adversely impacted by direct COVID-19 and consequential claims impacts, exacerbated by the low yield environment. Motor may be an exception.

Our forecasts cover the next renewal period however we note that given COVID-19, there is more uncertainty than usual surrounding our forecast.

Impacts of COVID-19

Finity COVID-19 Insights Centre

COVID-19 business impacts

Businesses are quickly shifting their focus in response to the changing environment:

- **new products and processes:** by creating new products (10% of businesses) and/or are changing the method of delivery of services (38%).

- **changing financial arrangements:** renegotiating property rent arrangements; deferring loan payments; bringing investment plans forward and changing payment terms.

In the immediate term, this will result in reductions in exposure and therefore premiums, particularly for the SME market. New working arrangements, changing methods of service delivery and creating new products will mean businesses risk profiles and therefore insurance needs will also change.

As discussed in the sections below, insurers have started to respond to this changing environment, with a clear need to engage with clients to help them navigate through these changes.

Trading impact

Small reduction

- Professional, administration, finance and insurance.
- Transport, postal and warehousing.
- Utilities.
- Construction.
- Healthcare and social assistance
- Manufacturing.

Material

- Education and training
- Wholesale trade
- Mining

Large reduction

- Retail trade.
- Accommodation and food services.
- Information, media and telco.
- Arts and recreation.

Source of business statistics: March 2020 ABS business impact survey

Insurer impacts and response

Premium terms and product coverage
A range of measures have been announced by insurers including IAG, Zurich and Hollard. There has been a joint response from Suncorp, QBE and Allianz.

Responses are largely focused around personal lines and the SME market, with limited responses aimed at the corporate end so far.

Responses broadly include:

- premium assistance for hardship.
- providing coverage for closed premises with no change to premiums.
- softer terms on refunds and fees.
- specific product changes – e.g. temporary removal of contents and adjustments to business interruption (BI) terms.
- tailoring options for individual customers – e.g. deferred premium payments and increasing excess amounts.

US insurers are focusing on providing strong customer support. Some states are proposing legislation to require insurers to cover BI losses from COVID-19. In addition, there have been regulatory orders to provide customers with premium credits or refunds in some states, and several insurers have done so voluntarily across the country.

Chinese insurers have started to provide COVID-19 related products at the direction of the Chinese Government, including liability and BI cover.

Pricing and underwriting

Capacity has generally remained stable, with some notable exceptions - Landlords and Travel. However, there has been a slowdown in movement from new entrants.

For SMEs we have observed insurers pulling back on rate increases previously targeted. Insurers have considered the financial pressure businesses are under. Some insurers are avoiding underwriting heavily impacted segments for Liability and Financial lines.

At the corporate end, the response is probably more mixed and rate changes are generally not moderated.

For Personal lines, insurers do not appear to have changed premium rates, despite early evidence of reductions in claim frequency.

We expect insurers pricing to respond to the experience as it emerges in the medium term. Refer to the class of business commentary on the following pages for more detail.

Operational impacts
Disruption to a number of services is likely to result in slower processing and more costly claims settlements.

How brokers can support clients
- over the next six months

Review exposure to adjust premiums and coverage:

- **review current coverage – e.g. pandemic or other exclusions.**
- **reconsider turnover and sum insured and seek premium reductions from insurers.**
- **reduce coverage which is no longer relevant, e.g. BI, lower contents or stock levels and liability exposure.**
- **adjust policy terms to reflect changing business needs – for example sub-limits or excesses.**

Understand new exposures as a result of changes to business practices and seek changes in insurance terms:

- **is additional cyber cover required due to working from home arrangements?**
- **new products, activities performed, or services provided, e.g. is the business now selling or delivering advice solely online or changed to manufacturing healthcare supplies.**

Assist with risk mitigation:

- **assisting clients with understanding their duty of care to the public or employees.**
- **resources to help with remote working.**

Topical issues

Catastrophes and climate change

Recent bushfires created widespread geographical devastation, however the financial cost was not 'catastrophic' for insurers

- the second half of 2019 saw several cyclical climate patterns converge to create conditions conducive to high bushfire risk. Insured losses from these bushfires are estimated to be $2.2 billion according to ICA data.
- these bushfires burnt the largest area of vegetation out of all historical bushfires events by far. However, it's estimated to be the third largest bushfire event for insurers since 1967 (on a normalised basis).
- there was also a large hail event in late January, which ICA reports as being $1.2 billion of insured loss; as with the bushfires the loss is large, but similar to other historical insurance catastrophes.

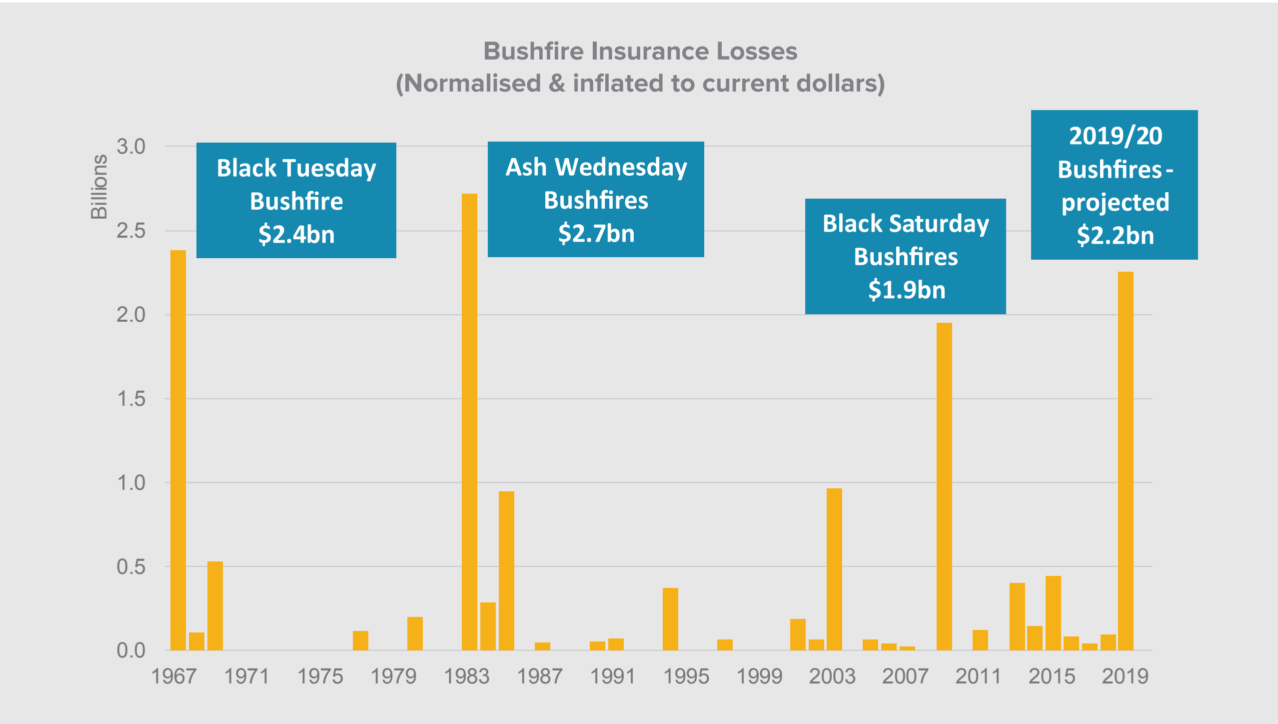
Recent catastrophes may trigger some premium rate increases for natural peril exposed locations, although climate change presents longer-term pressures

- generally we expect some premium rates to increase as insurers implement improvements in perils modelling. However, given the events are not outside of historical experience, more sophisticated insurers may have already priced this into current rates.
- whilst we don't consider the recent bushfires to be the 'new normal', their impact has been exacerbated by long-term trends of a warming climate. Studies show that Australia will be exposed to longer and drier summers, thereby "loading the dice" for seasons like this, making them more likely in the future.
- it's expected that overall natural perils risk will increase, although the impact may vary by region - some locations seeing higher costs and others lower costs. Adaptation measures (building standards, coastal defenses etc.) can help mitigate some of these increased risks.

Helping to understand and manage client's risks

- it will be important to understand and explain price changes to clients in high natural peril risk locations. Knowing how insurers are adjusting rates or coverage in response to events is important to help ensure clients have appropriate cover to suit their needs.
- existing affordability issues will be exacerbated given the recent impacts of COVID-19. Clients may like to know what actions they can take to mitigate risk and whether insurers will recognise this with reduced premiums. Brokers will need to engage with their markets to respond.

To learn more, please visit our climate risk blog.



Regulatory changes

Given the impacts of COVID-19, the Federal Government has announced a six month deferral to the implementation of commitments associated with the Royal Commission.

This means that:

- Commencement of the Design & Distribution Obligations will be pushed back to 5 October 2021.
- Measures that the Government had planned to introduce into Parliament by 30 June 2020 will now be introduced by 31 December 2020. These include Anti-hawking, the Deferred Sales Model, Commission caps on Add-on products, Claims Handling as a financial service, Duty of Disclosure changes, Breach reporting and Enforceable Code provisions.
- Measures that the Government had planned to introduce into Parliament by 31 December 2020 will now be introduced by 30 June 2021.
- The proposed commencement dates for all of this legislation would also be extended by 6 months.

For more information about the key considerations and changes required to meet these obligations, please refer to our detailed response.

General Insurance Code of Practice: transition to the new code is currently underway, with all signatories to be compliant by 1 January 2021 (with family violence policy provisions taking effect 1 July 2020). Code will be mandatory and enforceable, with sanctions for code breaches.

Steadfast

Class breakdown – Commercial lines

History = Reported statistics to Dec 2019; however includes consideration of COVID-19 impacts up to April 2020.
Outlook = next renewal. Unshaded profitability traffic lights indicate classes where profitability outlook is particularly uncertain due to COVID-19.

Property

	History	Outlook	
Rate	↑ 12.5%	↑ 5-10%	• The hard market continues as insurers focus on improving profitability, even at the cost of market share. Recent catastrophes have put greater focus on this, and COVID-19 has not changed insurers strategy for large rate increases. • Strong rate increases are required to cover costs, so expect rate changes to vary depending on factors such as the exposure to natural perils, occupation type or individual account performance.
Capacity	◕	◕	• Large corporates, high hazard risks and natural peril exposed locations have had difficulty finding cover.
Profit	● (amber)	● (amber)	• Recent rate increases is bringing this class towards target profitability. However further rate increases are still needed by insurers to cover significant costs of catastrophe and excess of loss reinsurance. • COVID-19 BI coverage issues are still unfolding. Losses not expected to be widely covered. Coverage will come down to specific policy wordings, with record keeping of key events and costs being important.

Liability

	History	Outlook	
Rate	↑ 3%	↑ 3%	• Low rate increases across the market, with larger increases generally focused on construction or specific portfolios with poor experience (i.e. construction). • Expect limited rate movement in general. Clients with direct COVID-19 exposures or high exposure to the public may see stronger increases. Reduction in the yield curve will continue to put upwards pressure on rates across the board.
Capacity	◕	◕	• No major changes in capacity recently, with reducing capacity for construction, utilities and labour hire exposures, as well as poor performing portfolios. • Competition in the market will keep capacity relatively strong. Expect continued withdrawal in sectors highlighted above.
Profit	● (amber)	○ (amber, unshaded)	• Profitability over the recent year has been impacted by the low yield environment. More rate strengthening is needed by insurers to get back to target profit levels. • A high amount of uncertainty in the profit result for the coming year due to COVID-19. Expect drops in premium volumes, and a variety of potential claim impacts – more claims or even class actions arising from breach of duty of care for sectors with high exposure to the public; however partially offset by reductions in 'trip and slip' style claims.

Financial Lines

	History	Outlook	
Rate	↑ 25%	↑ 15%	• The market has continued to harden significantly with insurers continuing to scrutinise their renewal book and take a cautious approach to new business. Financial institutions, D&O and construction professionals reported the strongest increases, with more pressure on primary and mid-level limits. • Expect further increases at the next renewal with higher increases for segments with direct (healthcare or aged care providers) or consequential (travel, entertainment, retail) impacts to COVID-19.
Capacity	◑	◑	• Local and Lloyd's players have materially reduced their capacity and overseas insurers (particularly Singapore), have stepped in. Placement at lower limit levels are proving challenging - flexibility around program structure, panel and price required to ensure placement, particularly for high risk profile accounts. • Expect more difficulty getting cover for finance, listed entities and construction professionals. Do not expect cover to be available for cladding, Royal Commission or remediation.
Profit	● (red)	○ (amber, unshaded)	• Despite 2 years of strong rate increases, this class is still in loss-making territory, with prior year deteriorations continuing as a common theme across the market. The reduction in the yield curve has made things even worse. • There are some signs of profit in the horizon, although below insurers target levels. Potential claim impacts from COVID-19 directly or the consequential claims from an economic downturn is likely to place even more pressure on profitability in the short term.

Business Packages

	History	Outlook	
Rate	↑ 3%	— 0%	• Small rate increases achieved across both property and liability covers. • Insurer support packages expected to limit any rate changes over the short term given the financial strain businesses are facing.
Capacity	●	●	• A large number of new entrants has increased competition and capacity, taking market share off the larger insurers. These new entrants are offering fresh approaches in a low expense environment, aided by technology. • Early signs that new entrants are 'on hold' over the next six months as COVID-19 unfolds. However, insurers supportive response to COVID-19 suggests capacity will remain strong.
Profit	●	●	• One of the better performing commercial lines classes, with liability performance subsidising property however, is still not meeting target returns. • Potential for drop in premium volumes and claims impacts due to COVID-19, impacting certain sectors in travel, entertainment, hospitality and construction.

Workers Compensation (Private)

	History	Outlook	
Rate	↑ 13%	↑ 5-10%	• Most underwritten states had premium increases, with WA having the highest. Current rates are still below the rates recommended by scheme regulators so more rate increases are required. • Once claims impacts are further understood, this may flow through to premium rates.
Capacity	●	●	• There is adequate capacity in the market and is expected to continue, despite rates being lower than required.
Profit	●	○	• Losses have been made by insurers in recent years, compounded by the yield curve impacts. • COVID-19 claims impact is uncertain, with impacts likely to be portfolio specific. As well as direct COVID-19 claims for 'essential services', expect slowdowns in return to work rates and changing work environments opening up new challenges (such as more psychological injury and work from home claims). • COVID-19 is likely to exacerbate profitability challenges; however the magnitude of impact is very uncertain at this stage.

Class breakdown – Personal lines

Private Motor

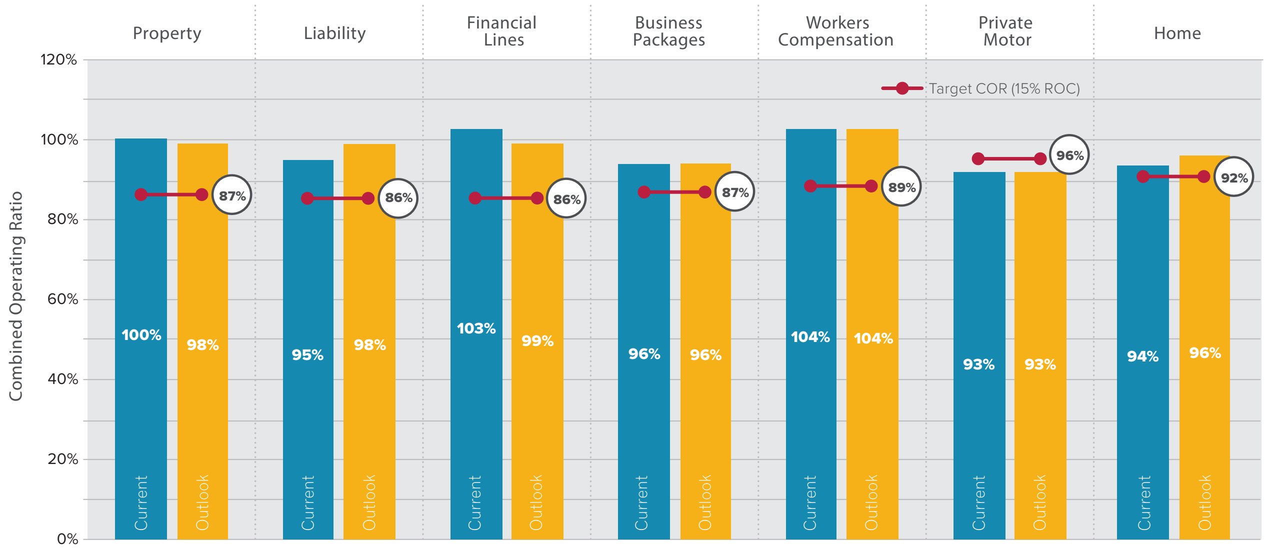
	History	Outlook	
Rate	↑ 3%	— 0%	• Insurers have been successful in achieving price increases to counter claims inflation, despite the competitive environment. • COVID-19 is likely to result in a lower claim frequency given the materially lower use of vehicles. However, the drop in the Australian dollar and increases in the cost of labour and parts may reverse this benefit and put pressure on premium rates. • Some insurers may offer discounts in premium as a result of the lower exposure.
Capacity	●	●	• Abundance of capacity currently and expected going forward. • We expect the landscape to continue to be competitive, with auto clubs increasing market share, and traditional commercial players (via intermediated channels) and challenger brands moving more actively into the personal lines space.
Profit	●	●	• This class continues to improve, with its best result in five years. Whilst event costs were high, this did not impact the net result. • Continuing claim inflation pressures and increasing cost of labour and parts will limit further improvement in profit. However, expect a short-term reduction in claim numbers with increased working from home and fewer discretionary trips.

Home

	History	Outlook	
Rate	— 0%	— 0%	• While average premiums increased by around 3-4%, this reflects increased sum insured rather than rate. Building rates have been flat, with contents rates slightly reducing. • Very little upward movement in premium rates expected in the coming year, particularly as individuals are under financial pressure.
Capacity	◕	◕	• Indefinite suspension of new business landlords' insurance (or at minimum the rent default cover) by the market. Understanding policy wordings will be important, as the Government's freeze on evictions may make it difficult to claim on existing policies. • Abundance of capacity for Building and Contents. However affordability remains a key challenge with no real progress made in the last 12 months on key issues including ESL and Northern Queensland.
Profit	●	●	• Bushfire events over the summer have moved this class into loss making territory. • Buildings claims inflation, limited rate growth and heightened competition will inhibit the ability for this class to move towards target profitability. There may be some claims relief from the COVID-19 lockdown environment as theft is expected to reduce.

Source APRA statistics, Finity analysis

Combined operating ratio - with no explicit allowance for COVID-19 impacts



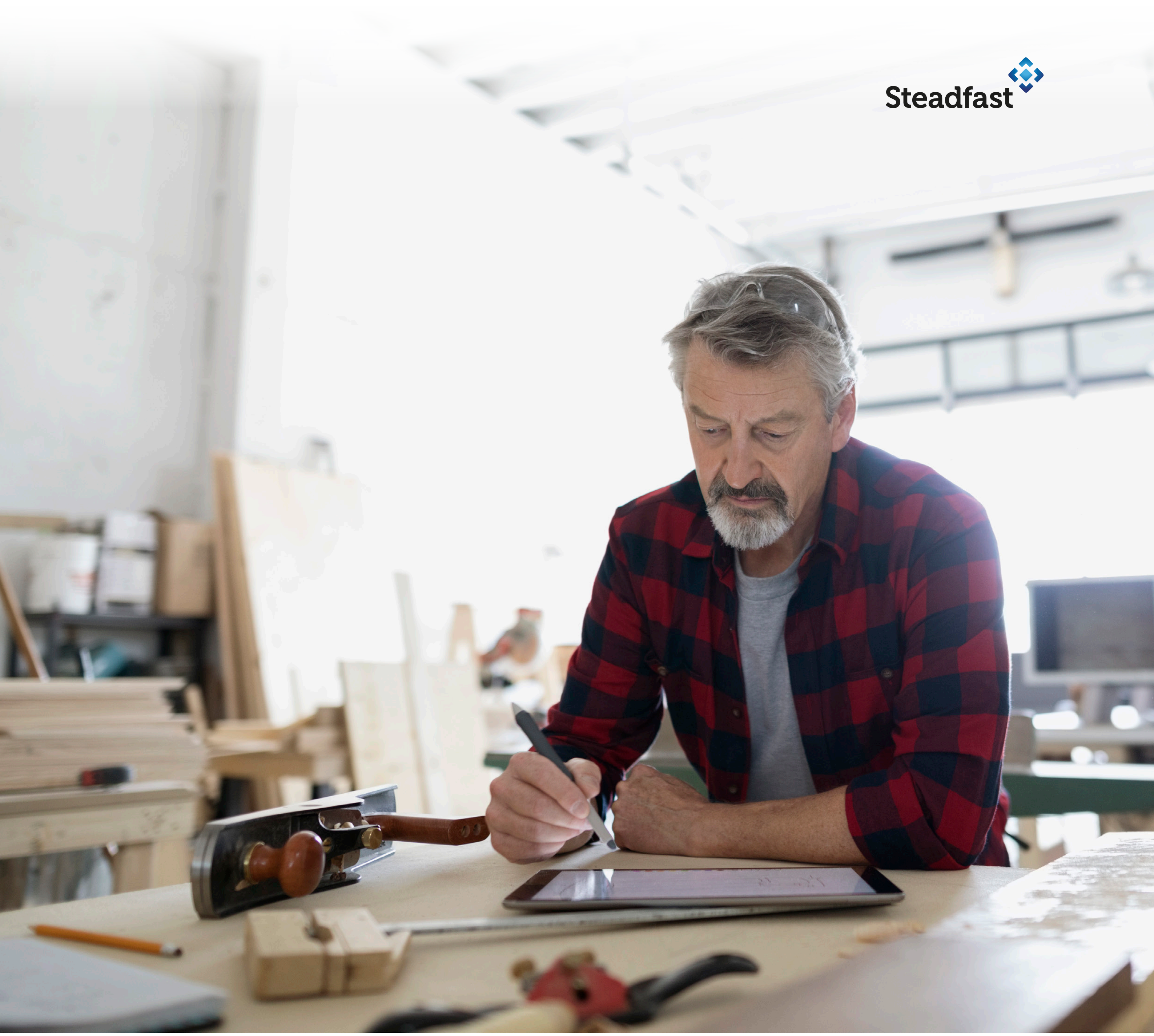
Total required	↑ 15%	↑ 10%	↑ 20%	↑ 10%	↑ 20%	→ 0%	↑ 3%
Rate at next renewal	↑ 5%-10%	↑ 3%	↑ 15%	→ 0%	↑ 5%-10%	→ 0%	→ 0%

Possible COVID-19 impacts on claims costs

Offsetting impacts		Increases	Offsetting impacts	Increases	Reductions	
• increase in theft and fire claims. • increase in cost of building supplies. • reduction in BI given general exclusions for pandemics.	• breach of duty claims from those under care. • class actions from negligence in COVID-19 response. • lower slip and trip claims.	• E&O and D&O claims from inability to perform role or operations appropriately. • claims from economic downturn. • increase in cyber claims from less security in the working environment.	See Property and Liability sections for details.	• workers directly exposed to COVID-19. • lower claims from industries impacted by lockdown. • delayed return to work. • working from home impacts. • psychological claims.	• reduction in claim frequency. • partially offset by increase in claims size from supply pressure and limited salvage opportunities.	• reduction in frequency of theft and water damage claims. • partially offset by an increase in cost of goods due to supply pressure.

Source Finity estimates from APRA statistics.

Note The COR includes an estimate of unallocated expense relating to each class. Industry target ROCs can range from 10%-15%.



About Finity

Finity Consulting is a leading independent actuarial and analytics firm. Market leading analysis is a core part of everything we do, underpinning our track record navigating industry trends. Finity is a seven times ANZIIF award winner and has been inducted into the ANZIIF Hall of Fame.
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