Rural Affinity PD Day: The Insurance Environment in 2019

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The Australian Market: Snapshot: 2018

Class of Business	Approximate Premium Pool	Premium Growth on 2017	Profitability Outlook
Motor	$12.1b	+8%	Improving gradually
Householders	$8.5b	+5%	Around target
Commercial Fire	$4.2b	+9%	Remains unprofitable
Liability	$2.3b	+4%	Around target
PI / D&O	$1.6b	+15%	Unprofitable overall

*Source Finity Optima General Insurance Highlights 2018

Motor Insurance – Key Risks & Topical Issues

- The impact of claims inflation has challenged the Motor Insurance approach of straightforward experience rating where the inflationary impact of technological enhancements to vehicles has impacted the claim costs.
- Motor will always endure a burden of attritional loss activity thereby leaving a minor residual margin for catastrophe perils.
- It is currently projected that motor losses will constitute around 40% of the December 2018 Hail Event constituting a rough market loss of +$700m. The Townsville event is also likely to be a +$100m market wide motor loss.
- Challenger brands continue to impact the motor market with market shares among the challengers ever increasing consequently placing pricing pressure on established markets.

Householders – Key Risks & Topical Issues

- Recurrent weather events are challenging the available underwriting margins on what for some time has been largely profitable business in Australia.

- The aforementioned catastrophe events of Townsville flood & Sydney hail are expected to generate approximately $1.7b of losses to the Householder sector.

- Affordability of insurance in higher risk zones could see the dual impact of increased regulation & emergence of challenger style solutions to the affordability question.

- Impact of Royal Commission with a focus on claim settlement fairness & implications for increasing operational expenses / paying “grey” claims, therefore margin leakage.

Commercial Fire – Key Risks & Topical Issues

- Also susceptible to catastrophe events with approximately $750m projected from the aforementioned catastrophe events.

- Per risk loss volatility further pressurising working loss allowances with severe events in recent times, e.g. Thomas Foods loss.

- Whilst rate correction has been steep the segment standalone remains unprofitable & has relied upon subsidy from other classes most notably Liability and Domestic Lines, which have their own challenges.

- The retraction of market capacity (including Lloyd's) is likely to see a further trajectory of rate increases.

Liability– Key Risks & Topical Issues

- The consistent achiever in the Australian market, however clouds are on the horizon with Australia's ever more plaintiff friendly class action regime.

- Currently Australia's balanced tort environment (proportionate liability, ban on lawyer contingency fees) have warded off a US style tort environment, but certain classes are seeing some concerning signs, e.g. Labour Hire

- Australia remains susceptible to catastrophe Liability scenarios e.g. dam collapse and bushfire liability. The 2009 Black Saturday Liability on an inflation adjusted basis were it repeated today would constitute 45 loss ratio points against the entire Liability market.

- A recent negative trend in premium movements has been corrected however as the overall market looks to achieve more robust pricing across the board.

PI / D&O – Key Risks & Topical Issues

- The increasingly liberal class action regime has seen the D&O market record consistently high loss ratios with an average frequency of actions in the last 5 years triple the long term average.
- PI remains highly segment specific with Financial Lines in particular vulnerable to findings from the Royal Commission.
- The topic of combustible cladding is a highly challenging one from the perspective of occupations involved e.g. builders, surveyors, certifiers.
- Lloyd's has been significantly represented in the Australian market & the evident contraction in this segment is allowing the local market to pivot towards genuine hard market conditions on both pricing & coverage.

Local Topic- Recent Catastrophes > $500m*

- 2019 Townsville Flooding: $1b
- 2018 Sydney Hail: $1.2b
- 2017 Cyclone Debbie: $1.8b
- 2017 Sydney Storm: $0.6b
- 2016 Victorian Hailstorm: $0.6b
- 2015 East Coast Low: $1.2b
- 2015 Cyclone Marcia: $0.7b
- 2015 ANZAC Day Hailstorm: $0.6b
- 2014 Brisbane Hailstorm: $1.8b
- 2013 Cyclone Oswald: $1.3b

Average of over $2b in Insured losses per year from larger Catastrophe Events

On the back of 2011, which saw insured losses over $5b from 4 large events over $500m

Indexed to 2019 values, Source ICA Met Data

Local Topic – Profitability Strain on Commercial Property

	2016	2017	2018	2019 (Forecast)*	2020 (Forecast)*
Industry Loss Ratio	73%	71%	65%	61%	63%
Expense/Commission Ratio	43%	42%	40%	40%	39%
Combined Ratio	116%	113%	105%	101%	102%
Premium Rates	-3%	+5%	+9%	+11%	+7%

*Source: JP Morgan Taylor Fry General Insurance Barometer

Local Topic – Royal Commission possible consequences

- Proposal to categorise claims handling as a financial service within the Corporations Act thereby increasing the emphasis on transparency. Economic consequences for Insurers involve expanding expense base and cost of regulation.

- Consequences for PI / D&O Insurers where Insured's involved in provisional of Financial Services are extremely susceptible to claims, "Royal Commission Exclusions" are being mooted by some Insurers.

- Whilst non-life insurance was not disproportionately singled out, the findings provide opportunities for disruption in the way insurance is supplied, e.g. peer to peer, mutualisation.

Global Topic: 2018 was a costly catastrophe year*

- At USD85b 2018 is the fourth costliest year on record for insured losses arising from catastrophes

- The November Camp Fire loss in California was the costliest insured loss of 2018 with latest estimates of >USD11b. It is worth noting that California Wildfire is not historically considered and modelled as a major potential event.

- This major event was closely followed by Typhoon Jebi, which hit Japan and was the strongest storm (by windspeed) to affect Japan in 25 years. Insured losses are estimated at around USD10b and the “loss creep” impact is emerging as quantification of loss has proved challenging

***Source: Swiss Re Sigma 2/2019**

Global Topic: 2018 followed 2017, which was the worst year on record for catastrophes*

- Insured losses from catastrophes of USD143b were experienced in 2017 across a range of territories and perils.
- The major contribution emanated from the Hurricanes Harvey, Irma and Maria, which had a rough combined insured loss of USD75m.
- In addition California Wildfires, Mexico Earthquake and Cyclone Debbie contributed to a significant loss affected year.

Source: Willis Re Summary of Natural Catastrophe Events 2017

Global (and local) Topic: Lloyd's in Australia

- Australia is a significant market for Lloyd's with close to 200 Coverholders and $2b in written premium*

- 2017 saw Lloyd's report a combined ratio of 114% representing a GBP3.4b Underwriting loss, which followed a combined ratio over 100% in 2016, which has seen Lloyd's reassess its position in a number of classes and markets.

- Australia has been a major market for Lloyd's and it has been the solution for more challenging opportunities. It has managed to maximise hard market conditions to find a solution for most things historically. The review undertaken by Lloyd's will potentially see a number of opportunities without a solution as certain syndicates will seek to scale back rather than price a solution.

*Source Lloyd's Australia Global Brochure

Global Topic: New and Altogether Different Suppliers

- In reinsurance, the market has usually experienced similar harder & softer cycles similar to the traditional insurance cycle. However the entry to the marketplace of alternative providers (Interest Linked Securities, Pension Funds) have seen an influx of capital seeking higher yields that the volatile business of reinsurance provides.

- In primary insurance the demands for yield (underwriting return) has seen price fluctuation & availability of insurance become challenging in certain segments/areas. This has opened the door for alternative ways to provide insurance such as mutualisation and peer to peer solutions.

- Insuretech, Blockchain as examples are causing a reappraisal of the value chain.

Summarising Thoughts

- The Australian market is experiencing pricing increases across a number of lines, whilst certain segments will benefit short term, certain lines (Commercial Property / PIDO) have more a fundamental challenge to return to profitability.
- Australia is increasingly being looked at globally as a challenging natural catastrophe market with an ever higher component of loss costs needing to be allocated to the catastrophe component.
- Noting recurring higher loss costs, the expense component will also potentially become further strained as outcomes from the Royal Commission will place Insurers under greater pressure to ensure adequate resources to service claims (potentially through possible additional regulation)

Summarising Thoughts

- Global insured catastrophe losses are in an extreme phase with a recurrence of major events pressurising overall industry profitability.

- The supply of (re)insurance is in a particularly interesting phase with certain established markets looking to reduce exposures to loss making areas where non-traditional markets are increasingly looking at opportunistically accessing yield, thereby adapting the traditional cycle.

- New and innovative ways of supplying insurance are emerging rapidly, traditional measures for success for insurers (such as sound underwriting) will not be enough in the coming years. A willingness to rethink insurance conceptually and embrace technological enhancements will be as important as the traditional disciplines.

Thank You

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