Insurance Market Commentary (September 2023)

Introduction – More Difficult Market Conditions Ahead

The purpose of this commentary is to inform insurance buyers about the factors that influence the availability and cost of fire and general insurance policies. We hope you will find it useful.

More difficult market conditions are anticipated, particularly for property insurance and related policies. Premiums for most policy types will increase over the next year although the rate of increase for non-property insurance will continue to reduce, as they have done for the last six months.

One reason for the premium increases, which affects all policies, is the inflationary environment. This is caused by the increasing cost of materials to repair or replace property and cars. Legal fees and settlements paid for liability claims and any other fees that need to be paid to assess an insurance claim are also increasing.

Other inflationary influences can be attributed to the typical operating expenses incurred by many businesses across New Zealand:

- Additional resources and expenses to achieve compliance with regulations, particularly the new regulations affecting the insurance sector; and
- Additional staffing costs required to respond to larger than expected events; and
- Wage and salary increases in response to inflationary pressure on employee households.

The reality of New Zealand's risk profile as a country exposed to earthquakes and severe storms is beginning to have a significant impact on the insurance markets across all commercial and residential property related products.

Historically, the negative elements of our risk profile were attributable to the seismic characteristics of the country. The potential costs of an earthquake were recognised and accounted for in the reinsurance programmes purchased by local insurers. However, the recent weather events, the Auckland storm, and Cyclone Gabrielle, introduced the likelihood that frequent and costly catastrophic events might occur anywhere in New Zealand. It is no longer possible to say there are specific 'hot spots' in the country.

Apart from being more catastrophic than expected, the economic environment has contributed to these events being more costly than was predicted. Inflation undoubtedly increases the cost to repair and reconstruct damaged properties, however indecision about the future suitability of land adds delays and higher recovery and reconstruction costs.

In respect of property insurance, it is not an over-statement, to describe the current market conditions as being the most difficult since the Canterbury earthquakes. A significant difference is that the consequences are far more widespread, with the prospect of similar events in the future.

We believe the difficult property insurance market will persist and may deteriorate further over the next two years. Your insurance broker is in the best position to help you determine how to prioritise the risks that should be insured compared to the cost of insurance you can accept.

In the following sections of this commentary, we will discuss the market influences, specific to each policy type, in more detail.

Prevailing Market Conditions

Commercial Property & Profits Policies

Individuals and businesses in New Zealand paid just over $8 billion of premium in 2022. This was to protect personal and commercial property, motor vehicles and liabilities. The amount does not include Life and Health insurance premiums.

Approximately 53% of the $8 billion is paid to protect physical assets like commercial property, houses, and household contents. Consequently, when natural disasters occur and premiums increase, most of us are directly affected.

In our April 2023 commentary we reported that insurance claims associated with the Auckland storm and Cyclone Gabrielle would exceed $1.5 billion. This forecast easily exceeded the weather event claims paid in New Zealand for a full year: $274m in 2020, $324m in 2021 and $355 (estimated) in 2022.

Two months later and with the opportunity to more accurately assess the damage caused by these two events, the Insurance Council of New Zealand has estimated the cost for insurers will be more than $3.5 billion. In fact, it is possible that the two events alone could cost the same as all general insurance claims in 2022.

Repair and reconstruction delays are a significant part of the forecast costs. Tim Grafton, the ICNZ CEO said he "remain(s) realistic about the rate of settlement from now on. Many motor and contents claims are straightforward to settle, re-lining a house can take months, full rebuilds over a year. The most complex claims, typically with land issues, can take longer still. Insurers are in this for the long haul."

These events coincided with the reinsurance negotiations for many insurers. Reinsurance premiums, paid by our local insurers to protect themselves from catastrophic events, have been increasing for several years. Howden, a respected reinsurance broker, recently published their Annual Market Report. In their report, Howden described the difficulties the sector is experiencing as a result of 40 year-high inflation, costly natural disaster events, the war in Ukraine and reducing availability of capital or investment.

The cost of reinsurance, to cover catastrophic events, is one of the largest expenses for an insurance company. Suncorp (trading as Vero Insurance in New Zealand) has reported their annual reinsurance costs (approximately $2.1 billion) will increase by 12% or $250 million for the coming year. In their 4 July 2023 statement, Suncorp said "this reflects the hardening global reinsurance market and the impact of adverse weather events through the La Nina cycle in recent years across Australia and New Zealand".

Other insurers will be experiencing similar outcomes for their reinsurance negotiations.

Apart from the increased cost of insurance for clients, a shortage of capacity (or less stock on the shelf in a trading context) is rapidly becoming a problem for commercial clients. Less than a year ago those shortages were apparent for high hazard businesses and those in the Wellington region; Canterbury to a lesser extent. More recently the capacity shortages are apparent throughout New Zealand.

Reducing the amount of cover an insurer is willing to provide for a particular client is usually a mechanism to reduce the insurer's region-wide exposure. For example, the amount of aggregated Wellington capacity available from an insurer will be considerably less than the aggregate capacity available in a less hazardous region. The difficulty is determining which regions are 'less hazardous' because the location of a severe weather event is becoming less predictable, as well as more frequent and costly.

Capacity shortages can be resolved by using a different insurer or additional insurers through a practice called co-insurance. Co-insurance is not an unusual solution although, until now, it has only been necessary for Wellington risks, high value sites or hazardous occupations.

A shortage of capacity can be likened to there being more demand than supply, bringing about yet another upward pressure on the cost of insurance for commercial buyers.

In respect of commercial insurance, we anticipate insurers will increase their use of technology to identify high risk locations and conservatively underwrite each risk. This means that their location data will become more accurate and their risk selection more cautious. Terms quoted by insurers may include higher flood deductibles or excesses, the insured perils might be reduced, site specific terms might be imposed and premiums will continue to rise.

Businesses and organisations can mitigate some of the consequences of the insurance market conditions by exercising sound loss prevention or reduction measures and working with an experienced broker who will convey those positive elements of the risk profile to senior decision makers at financially secure insurers.

Construction Risk Policies

Inflation also presents a significant challenge for commercial and residential Construction Risk policies. The delayed effects of the Covid pandemic are higher project costs that were initially caused by labour and material shortages as well as shipping delays. This has evolved to become a more deep-seated 'cost of risk' element that now forms part of most negotiations with contractors.

Contractors are becoming more inclined to incorporate costs for possible delays, cost over-runs and unexpected shortages and the greater likelihood of disputes as contracts come to a close.

Insurers have a similar mindset when considering a new Construction Risk policy. They also have higher sums insured to consider which might exceed the amount of cover they are able to provide.

The situation is summed up by Cameron McLisky of Berkshire Hathaway Specialty Insurance, saying "on a project, you're writing something that is going to take four or five, six years to be completed. It's very hard when you're making a future prediction as to not only the cost of something but how the project is going to run. Is it going to run on time, is it going to run according to plan, is it not going to encounter any unexpected hurdles? It's a difficult thing to get right, and it's even harder to get right when you're in a high inflationary environment".

Our view is that premiums for Construction Risk insurance will continue to rise at least in line with the same levels as annual construction inflation, about 9.5% (20.9% in 2022) for residential properties and 11% (up to June 2022) for non-residential constructions according to a report by the Ministry of Business Innovation & Employment.

Personal Property Insurance Policies

The claims from the Auckland storm and Cyclone Gabrielle are already having an influence on the market for home and contents insurance policies. These weather events were the second and third largest insurance events in New Zealand's history. The latest claim statistics are:

Auckland storm	57,205 claims	$1.84 billion
Cyclone Gabrielle	55,607 claims	$1.66 billion

ICNZ statistics published on 15 September 2023

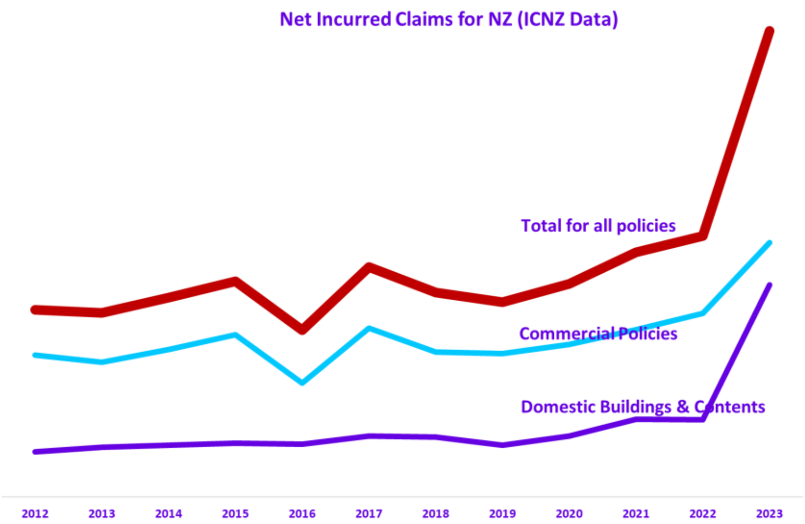
Prior to these events the largest insurance event was the Canterbury earthquake(s) where 168,855 claims worth $22.46 billion were handled by New Zealand insurers.

It was evident that natural disaster events in New Zealand were becoming more costly and occurring more frequently. However to give some perspective to the size of the Auckland storm and Cyclone Gabrielle, on average a large storm or flood event would cost insurers $0.12 billion.

The scale of the Auckland storm and Cyclone Gabrielle and their timing, within weeks of each other, drew the attention of global reinsurers. The consequence has been increased premiums across the country to pay for the higher reinsurance costs. For example, and as described earlier in this commentary, one insurer's reinsurance premium increased by $250 million.

New Zealand is not alone. Australian households face a similar situation because of their exposure to cyclones, floods and bush fires. [Recent research in Australia] revealed house and contents premiums increased between 28% and 50% in flood-prone areas that are insurable. Some Australian households, about 12%, pay the equivalent of one month's gross income for house insurance.

New Zealand insurers were already experiencing an upward trend for claims since 2019, as evident from this graph.



The upward trend has been similar for domestic and commercial claims although the latter contributes larger claim costs because of the higher value of commercial properties.

Another contributing factor has been the higher repair and construction costs attributable to inflation. These result in higher sums insured and higher claim settlements when an insured event occurs.

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Apart from increasing premiums, insurers have also adopted a more conservative approach when considering houses that are coastal, on a known flood plain or on or close to land that is subject to landslips. Categorisation of land by local authorities has added another unfavourable dimension, especially when those decisions are delayed, making it uncertain whether a particular house is uninsurable (some of Category 2 and all of Category 3 land may be unsafe to live on because of unacceptable future landslip or flooding risk).

Insurance brokers are mindful of several issues in this type of environment. The first is monitoring claims to ensure settlements are not delayed and they are based on fair and proper amounts. The second is to encourage clients to review their sums insured regularly; making sure the sum insured remains adequate in the inflationary environment.

Third, brokers are concerned about the affordability of insurance. Contesting or negotiating the premium is one way to achieve affordability however sometimes it becomes necessary to change the cover, reduce the perils that are insured, introduce a higher excess amount or pay premiums on an instalment basis.

These options are all reasonable and a better solution than lowering the sum insured or cancelling the cover.

Liability Insurance Policies

Professional policy classes, such as Professional Indemnity and Directors & Officers Liability, offer better news for insurance buyers. The premiums for these policies have remained relatively flat over the last few months and this trend is likely to continue.

Other more common Liability policies, such as Public Liability and Statutory Liability, for small businesses have been under pressure for several years however the outlook is stable. Any premium increases are likely to be attributable to inflation on legal expenses and business sales volumes.

Insurance brokers will often encourage a sustainable relationship between the insured business and their insurer, similar to the relationship between a bank and their client. The benefit of working with a long-term insurer is often apparent when a substantial claim arises and the relationship shows itself to be more than transactional. A long-term insurer understands the business better and is more likely to respond as if 'we're in this together'.

For larger clients, where more substantial or complex liability insurance products are necessary, there continues to be a short list of insurers in New Zealand (local law plays a significant part in this type of insurance therefore it is often not possible to attract the interest of overseas insurers). Examples are publicly listed companies, those with a national profile or in contentious industry sectors. An ability to demonstrate ongoing financial stability, prudent governance and sound operational management of these large businesses is essential.

Commercial Motor Policies

Typically, motor insurance premiums across New Zealand are influenced by a predictable accident frequency. This results in relatively stable premiums albeit subject to inflation and the availability of skilled repairers.

However, the recent weather events, particularly the Auckland storm in February 2023, will have an impact on motor insurance premiums with 8,322 claims costing insurers $211 million having been reported for private and commercial vehicles.

$211 million for claims might not appear significant but it is more than twenty times the amount that insurers would expect to pay for motor claims over any other three-day period. It is also about twice the amount an insurer would expect to pay for all claims from a large storm. It becomes more significant because insurers operate motor portfolios at close to a break-even position.

Inflation continues to be an influential factor, as does the escalating cost to repair newer vehicles that incorporate windscreen and bumper technology. On the positive side, the skilled labour shortages attributable to the border closures are easing.

Our conclusion is that there will be increasing pressure on commercial motor premiums. The pressure will be aligned to inflation, accident records for individual accounts and the portfolio results for the insurer(s).

Large or industrial fleets have a smaller market available therefore the opportunity to generate competitive interest from new insurers will be difficult unless good fleet risk management practices exist. This might include utilisation of vehicle safety technologies and telematics, or other measures that might represent the fleet as 'better than average' to insurers. In such circumstances, for fleets with a good claims record, there will often be an opportunity to generate competition between insurers.

Marine Insurance

Difficulties with shipping and container scheduling, attributable to Covid border closures, business shutdowns and the war in Ukraine, continue to be felt for marine insurance. As New Zealand is at the end of most shipping routes, we did expect the impact on New Zealand businesses to be felt for a longer period than in most other countries. These obstacles are beginning to ease.

Brokers will regularly remind their import and export client that inflation is affecting the prices for commodities and raw materials. Therefore, a regular review of the maximum shipment sum insured on an Annual Marine Cargo policy is essential.

Definition of Hard-to-Place Broadens

Hard-to-place risks is a phrase used to describe some property risks in the Wellington region, Canterbury to a lesser extent and those risks that incorporated hazardous processes or activities or where the building was constructed of hazardous materials.

In the past six months the range of hard-to-place risks has broadened to include social housing or back-packer properties, holiday parks (particularly when close to the coast or a body of water), chemical or pharmaceutical businesses, plastic product manufacturers, or locations where there is a high accumulation of value. This list will grow as insurers adopt a more cautious approach to the risks they will underwrite.

In some cases the appetite of New Zealand insurers will be exhausted, making it necessary to search overseas insurance markets. This is by no means a premium saving solution because, almost without exception, overseas insurers will have a higher premium expectation than their New Zealand counter-parts. Using overseas insurers is only likely to achieve the amount of cover required by a client.

RMA Financial has developed a relationship with overseas brokers and secure insurers. This provides a reliable avenue to explore the availability of cover when the appetite of New Zealand insurers becomes exhausted.

It is very important to be aware that overseas insurers require comprehensive and on-time underwriting information. Brokers and their clients need to start the renewal process early in order to achieve the best outcome.

A comprehensive submission, for an overseas insurer, should include:

- Information that profiles the client's business, their locations and other relevant information; and
- Recent property valuations if obtained; and
- A risk survey report with site plan(s) and photographs; and
- Other policy and claim information compiled by the broker.

Strategies in a Hard Insurance Market

The term 'hard market' refers to insurance market conditions that feature the reduced availability and scope of cover, but increased premiums and excesses.

Hard market conditions can develop in niche segments of the insurance market or they can affect the whole market. For clients, a hard market might influence their profitability, the pricing of their own products and services, their competitive position, budgets, decision-making around risk retention and their risk management practices. Therefore the effects of a hard market should not be under-estimated for insurance buyers.

To achieve the best result in a hard market the broker's role is to coordinate clear and consistent communication about the insurance market to their client. The broker understands the detrimental effects of a hard market on their client, something is usually not apparent to insurers that deal directly with the public.

The Hard Market in 2023

The catalyst for the current hard property insurance market conditions in New Zealand goes back to the Kaikoura earthquakes in November 2016. The rate of premium increases slowed for a period in 2018 and 2019 but increased again as New Zealand began to experience more frequent and severe weather events. Other larger catastrophes around the world contributed to a global market deterioration but the largest and most recent influence has been the Auckland storm and Cyclone Gabrielle in February 2023.

Strategies in a Hard Market

Prior to the insurance renewal brokers will communicate early to their client about the insurance market conditions. Other opportunities, such as scheduled meetings and spontaneous or informal catch-ups can also be used to keep clients informed about what might be, for them, a rapidly changing market. This level of communication helps clients to be prepared for what might be a difficult renewal.

Brokers will already have a good understanding about impact on their client. Intuitively they will know their needs and priorities as the next renewal approaches. As always, knowledge of their client's business, industry segment and business goals is crucial.

A broker will be able to provide measured, accurate guidance and focus on positive alternatives and potential solutions to address the challenges. In some circumstances it may be difficult to predict what terms or cover can be negotiated until credible and formal insurer terms are received.

Discussions about risk control, operational practices, supply chain management, and other risk related features of a client's business will become more commonplace. Comprehensive information about these issues will often motivate new methods to mitigate risks in the business and 'paint the best picture' to the insurer.

As the expiry date approaches brokers will keep their client informed about any developments so they are able to make an informed decision when the broker's recommendations are made. Communication is one of the most important skills for a broker to possess, even more so when difficult market conditions exist which, for property insurance, look set to continue for several years.