Finity Market Report

April 2019

Finity's half yearly view of the Australian market for Steadfast brokers

A hardening market has been seen across most classes, with further hardening to come...

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Class Snapshot

	Rate Change						Capacity
	Recent		Previous		Outlook		
Property	↑	10%	↑	10%	↑	5-10%	Contraction for corporate risks, high loss accounts and high cat exposed risks. Otherwise still plenty of capacity.
Liability	↑	3%	—	0%	—	3%	Abundance of capital, with many insurers, underwriting agencies and Lloyd's capacity.
Financial Lines	↑	20%	↑	20%	↑	20%	Withdrawal of insurers from D&O market. Reducing exposures (eg. side C, Royal Commission and cladding exclusions). Significant premium increases for loss affected accounts.
Business Packages	↑	5%	↑	5%	—	–	New entrants across direct and intermediated increase competition and capacity.
Domestic Motor	↑	4%	—	1%	—	2%	Stable environment, some easing of competitive forces as insurers consolidated their positions.
Home	—	1%	—	0%	—	0%	Despite benign underlying rate change, strong sum insured increases have been achieved. New entrants across direct and intermediated increase competition and capacity.

	Profitability		Watch Points
	Recent	Outlook	
Property	●	●	Adequate sum insured particularly in cat exposed areas. Claims inflation and increase in water damaged claims.
Liability	●	●	Tort environment fairly benign – with some hot spots in Northern Queensland and Victoria. Class actions and psych claims are emerging.
Financial Lines	●	●	Class actions as well as downturn in construction and retail environments have driven substantial losses for listed D&O exposures. There will be more to come. Professional indemnity has historically performed well, with some claim pressure emerging for Financial, Architects, Real Estate, Surveyor, and Legal occupations.
Business Packages	●	●	Alternative distribution channels emerging through direct and insurtech avenues.
Domestic Motor	●	●	Slowdown in new car sales. Evolving smash repairer landscape with further consolidation of repairers and the increased interest of private equity players.
Home	●	●	Affordability of buildings insurance a political concern. ACCC Northern Australia Insurance Inquiry - a number of findings and recommendations relating to broker remuneration, stamp duty, mitigation, disclosure and policy wording and coverage.

Sources APRA Quarterly Statistics, Finity Competitive Monitoring tools

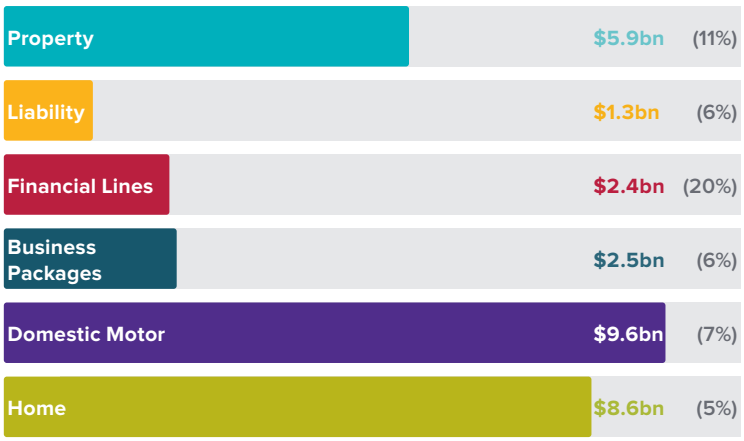
Recent = December 18 HY **Previous** = December 17 HY

Commentary

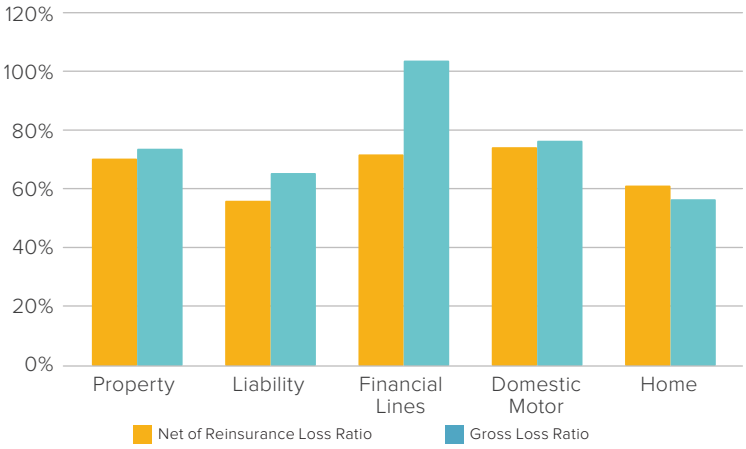
- **Most commercial lines classes are experiencing rate increases, with more expected to follow. Financial Lines, (particularly D&O) has had the strongest increases, with Property next in line.**
- **Rate increase wont be enough to return the Commercial Lines market to profitable levels over the next six months – Property and Financial Lines will need further rate increases.**
- **Outlook for personal lines remains challenging, with limited rate growth expected in the short term.**
- **Incidents notified as a result of the Hayne Royal Commission will lead to substantial claims cost for financial institution portfolios.**
- **Still a healthy amount of capacity in the market, although there are some signs of contraction in loss affected classes i.e. Financial Lines and Property.**
- **The reinsurance market has started to harden which will create additional pressures on profitability over the next year.**

Class Commentary

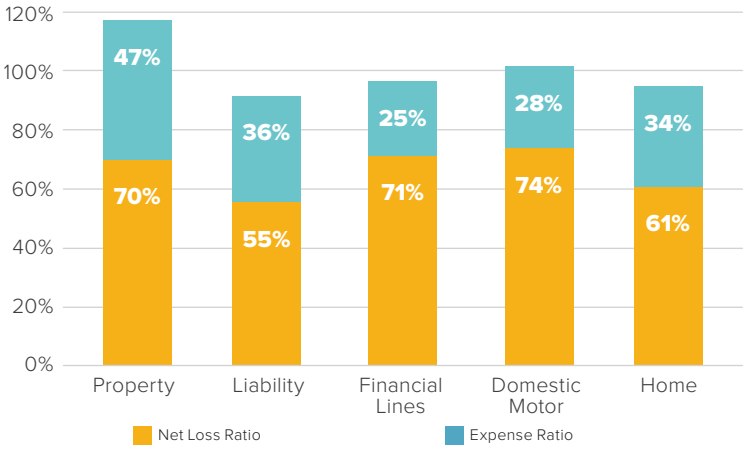
GWP Year to Dec 18



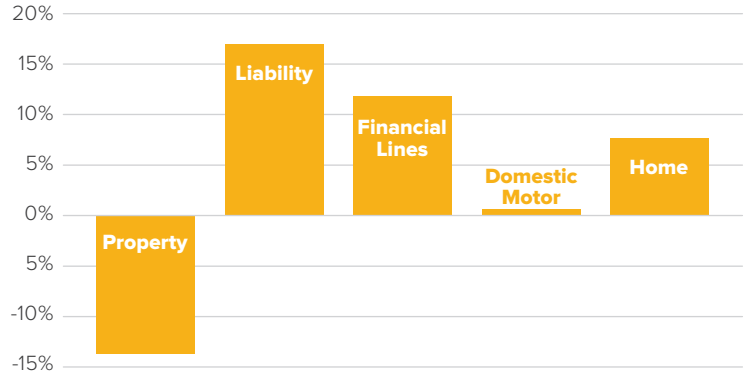
Loss ratio (Year to Dec 18)



Net Combined Operating Ratio (COR) (Year to Dec 18)



Insurance Trading Margin (ITR) (Year to Dec 18)



Source APRA Quarterly Statistics, Dec-18

Note The COR and ITR include an estimate of unallocated expenses that relate to this class (7% of NEP)

Property

After a number of years of a soft market and poor profitability from small and large weather events, the property market is hardening. Insurers are improving the sophistication of the premium models, taking a more granular assessment of natural peril risk.

Natural peril exposed risks as well as loss affected accounts have seen rate increases above 10% and this is likely to continue until insurers return to more profitable levels or capacity is increased.

Liability

Premium rates have been reducing over recent years and the market is currently only seeing small rate increases in most segments.

A benign claims environment has assisted with profitability in this class, but the rate reductions have now started to put insurers profitability outlook under pressure.

The construction sector has been loss making for insurers for a number of years now. Insurers have responded with sub-limits and higher excesses for hired labour, although significant rate increases (above 20%) would not be a surprise for this segment.

Financial Lines

The D&O and Financial Institutions (FI) markets are in crisis with radical remediation underway, particularly for listed D&O cover. Class actions (particularly securities class actions) and the Hayne Royal Commission have and will continue to result in substantial losses for this class. A lot of these losses have been covered by reinsurance protection. This along with a surprisingly low reported expense ratio makes the Net COR and ITR in the exhibits look much better than the underlying view.

Significant premium rate increases have been occurring (between 20% to 400%) and will be expected for the next year for D&O and FI.

Professional Indemnity cover for non-financial professionals has been performing adequately. Loss affected accounts are likely to see rate increases.

Issues around cladding and the Royal Commission into aged care will put pressure on renewals in the relevant segments.

Business Packages

New entrants into the market in both the direct and intermediated space have increased competition and made organic growth a challenge. Over 10% of premium is now estimated to be written directly.

Insurers are reviewing and increasing the sophistication of their pricing which is likely to lead to more variation by risk. Profitability has been under pressure, but recent rate increases should have rectified this.

Domestic Motor

After a number of years of strong claims inflation, insurers appear to be having some success in containing these increases. Together with moderate rate increases, this returned the class to slight profitability over the past year. However, the future rate and volume growth environment appears challenging.

The evolving smash repairer market and improving vehicle technology requires insurers to adapt to the changing landscape.

Home

Favourable weather conditions largely contributed to a strong year for this class. Future premium growth remains challenging, along with competitive forces.

High cost inflation due to building costs over the recent years continues to place pressure on loss ratios.

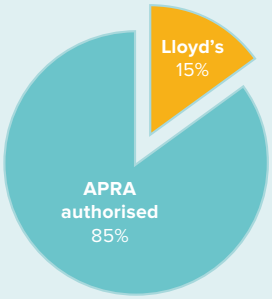
Affordability of Buildings insurance remains a key issue, with a wide range of recommendations coming out of the ACCC Northern Australia Insurance Inquiry.

Environmental Commentary

Market Players – Commercial Lines

Most APRA authorised insurers have carefully reviewed their loss making portfolios and a number are under remediation. Lloyd's Corporation has taken a tougher stance on loss-making syndicates and classes of business, resulting in reductions in approved volumes for some portfolios and some Syndicates going into run-off in extreme cases. Property and Financial Lines are the key portfolios hit by the remediation across both APRA authorised and Lloyd's players.

Brokers are likely to have less placement options than in previous years for corporate and complex risks in these classes. Underwriting agencies and branches of international insurers may provide some options for placement, although price should be expected.



- **Domestic players** have been focusing on de-risking, improved pricing and expense reduction. All had additional compliance costs as a result of the Hayne Royal Commissions. Investor reports highlight the following:
  - **IAG** – In 2018, average premium increases of 6% and remediation in complex Property and Fleet. In 2019, more of the same, and further enhancement of digital distribution for SME.
  - **Suncorp** – In 2018, focused on streamlining activities and remediation in commercial lines. In 2019 will continue to pursue premium rate increases and growth in preferred segments.
  - **QBE** – In 2018, achieved 5% rate increases group wide and de-risked from loss making portfolios and cat and high hazard property. Expect more of the same in 2019.
- **Lloyd's** has grown substantially over the last 10 years in Australia, now making up at least 15% of the Commercial Lines market. We expect this growth to flatten given the recent remediation.
- **Underwriting agencies** have increased as an avenue for distribution over the last 10 years, as insurers have streamlined their offerings. Over $2.5bn of premium is channelled through about 180 underwriting agencies.

Market movements

Brokers and Underwriting Agencies

M&A activity continues.

- Aon considered bid for Willis Towers Watson, then withdrew.
- Marsh buy JLT for $US5.6bn.
- Gallagher buys JLT aerospace broking.

Insurers

A lot of activity in London and Bermuda.

- Axa XL: New strategy after merger to be announced in 2019.
- QBE merges European and Asian operations.
- Arch has entered the lenders mortgage insurance market in Australia.

Hayne Royal Commission

The General Insurance (GI) industry is still working out what the recommendations really mean and this will take some years to emerge and is uncertain given the upcoming election. We do think that there will be an impact for GI despite the focus on the banking industry.

The key recommendations that may impact GI are:

- No hawking of insurance.
- Review of conflicted remuneration by Dec 2022.
- Deferred sales model for add-on insurance.
- Claims handling as a financial service.

We estimate the potential insured losses from claims arising directly from the Royal Commission to be $1.5bn – $2.0bn. This is about one year's worth of Financial Lines premiums.

Regulatory and Legislative Changes

- Expect ASIC and APRA to be tougher.
- Hayne Royal Commission will result in a number of changes.
- Australian Law Reform Commission – Inquiry into Class Action Proceedings and Third-Party Litigation Funders has produced recommendations which if applied should ease some claims pressures for D&O.
- New regulation of executive remuneration for financial institutions.
- Unfair Contracts Terms applied.
- ACCC Northern Australia Insurance Inquiry – detailed review into home and strata insurance in northern Australia, particularly with regards to affordability. A range of recommendations made, including a ban on conflicted remuneration to insurance brokers.

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 was awarded the Insurance Industry's Professional Services Firm of the Year in 2018.

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