



# **RADAR**

**FY2022**

Our class-by-class insights for insurers

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# Welcome

**Hello** – this is Taylor Fry’s RADAR 2022, our insights on the stand-out events and trends affecting insurers. Increasing natural perils, cyber threats, inflation, affordability and the lingering fallout of COVID-19 are top of the list. We analyse the impacts for industry, government and community, and emphasise the importance of a collective approach in finding solutions.

Drawing on the latest APRA data, combined with deep industry know-how and experience, we unpick each line of business across three years of results to help insurers benchmark their performance, and assess their strategies and goals. Peruse our handy class-by-class snapshot for a quick overview, then dive deeper into each class for the detail.

You’ll also find a summary of investments and solvency for the market more broadly and, new this year, we spotlight two of the hottest topics – climate and cyber – with key considerations for decisionmakers.

We hope you find clarity and meaning on the following pages, as you explore the challenges and opportunities ahead in this ever-changing landscape. 

**Win-Li Toh**  
*Principal*

### DOMESTIC MOTOR

Competition increasing

Trends improved safety technology and autonomous vehicles  
Liability shifting: drivers to manufacturers

### HOUSEHOLDERS

1 in 25 homes uninsurable by 2030 across Australia

Affordability and availability are growing issues

### COMPULSORY THIRD PARTY

Strong competition continues

Trends Reserve releases, lockdowns and regulatory recovery of excess profits in NSW impacted incurred costs

### WORKERS COMPENSATION

Underwriting result **\$489m** FY22 most profitable year on record

Trends Mental health injuries and the gig economy

class-by-class  
**Snapshot**

#### SOLVENCY

**1.69 times** the Prescribed Capital Amount as at June 2022. In line with industry average for past 3 years

#### INVESTMENTS

Interest rates rising have resulted in unrealised losses on fixed interest  
 Opportunity Higher interest rates may increase investment income

### COMMERCIAL MOTOR

Increased road use  
**12%** premium volume growth

Trends EVs and autonomous vehicles, rideshare and car rentals, GPS tracking technology

### COMMERCIAL PROPERTY

Premiums increased by **16%** underlying profitability a concern

Trends Catastrophe reinsurance costs, business interruption reserves

### TRAVEL

Travel is back loss ratios increased due to the Omicron surge

Opportunities Invest in flexibility and dynamic pricing, customer-centric policy design and claims management

### PUBLIC & PRODUCTS LIABILITY

Affordability concerns pose reputational risks for insurers

Obstacles Claims inflation and the litigious environment - Risk mitigation is key

### PROFESSIONAL INDEMNITY & DIRECTORS AND OFFICERS

Combined ratio below **80%** in 5 of the last 6 quarters

Trends Returns likely to ease as competition increases, market softens and higher inflation

### LENDERS MORTGAGE INSURANCE

New home loans Growth in lenders mortgage insurance premiums

Trends Loss ratios likely to trend up if economic conditions deteriorate and reserve releases run out

# Domestic Motor




FY22 was challenging, with domestic motor insurers experiencing natural peril losses from the southeast Queensland and New South Wales floods, and a higher inflationary environment. As lockdowns retreated into the past, profitability reverted to pre-pandemic levels, although moderated by work-from-home arrangements.

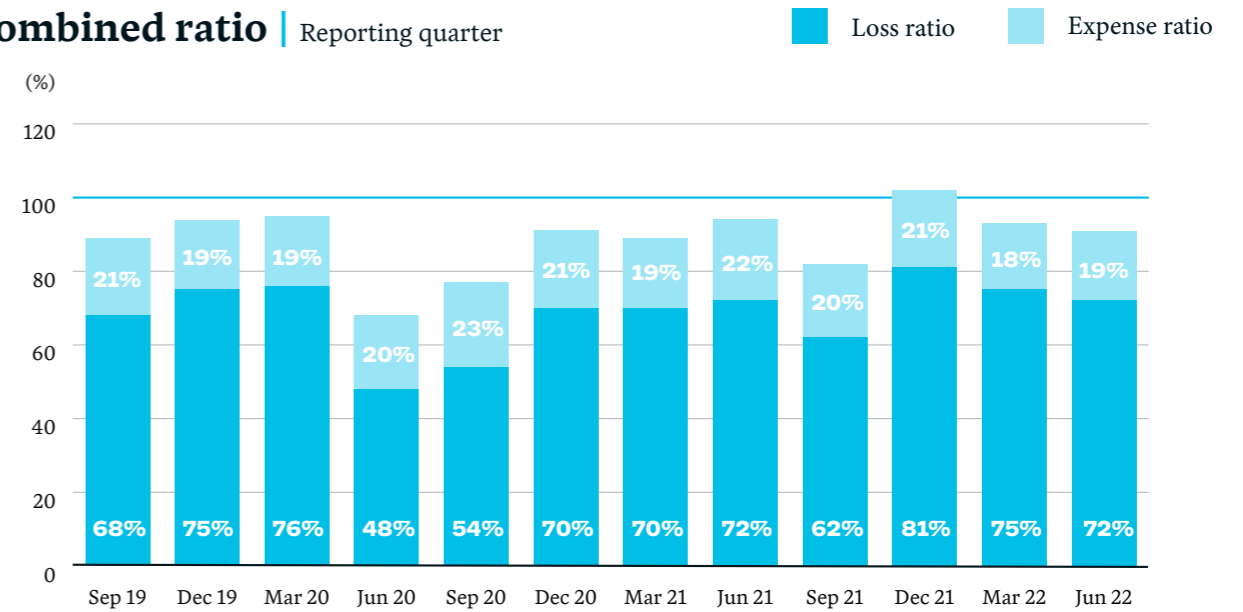
Despite the hurdles, many insurers delivered strong gross written premium growth, as they increased premiums to counter these impacts. A key challenge ahead will be maintaining market share as competition intensifies.

**Premiums grew by 8%** due to a 4% increase in average premiums and a 4% increase in risks written. Competition continues to intensify, with challenger brands such as Hollard, Youi and RAC making inroads, with premium growth of 15%+ pa over the past three years, supported by targeted pricing strategies. This has reinforced the need for established insurers to continue innovating on product and price.

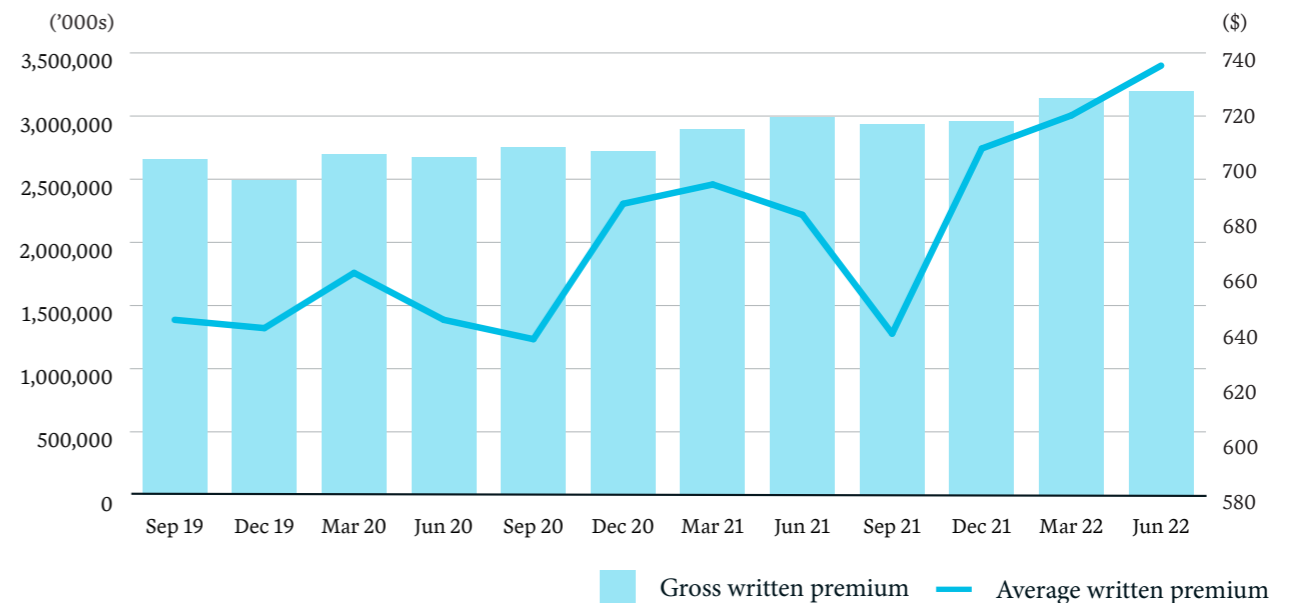
**Loss ratios rose** to pre-pandemic levels, as traffic volumes bounced back and the La Niña season (a wet phase of the natural climate cycle) began to swing into full force. This year's floods prompted catastrophe reinsurers to push through double-digit premium increases, forcing some insurers to reduce reinsurance cover. We expect the next few quarters to also be affected by severe weather events. Working from home however is likely to become entrenched, easing pressure on losses from reduced road use.

**Repair and replacement** cost pressures continue to increase claims inflation, as production shortages persist. Australia recorded 20,665 electric vehicle (EV) sales in 2021, up from 6,900 in 2020. EVs make up 2% of new car sales. While demand for new cars has recently increased, supply-chain constraints continue to increase average claim size, as parts become more expensive and sums insured increase. EVs require specialist skills to repair, and house technology and parts that are expensive to produce and replace. This leaves insurers more exposed to supply-chain issues. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

Improved safety technology and the rise of autonomous vehicles will likely disrupt the industry and cause premium movements between various classes of business, as liability shifts from drivers to manufacturers of the autonomous vehicles. Maintaining competitiveness and ensuring customer value will become increasingly important considerations for insurers. IAG recently launched a new flexible car insurance brand Rollin, aimed at a younger customer base. We expect more traditional

insurers to innovate and design new products to attract different market segments to compete with offerings from new players.

Longer term, existing insurers will need to prepare for the impact of EV manufacturers offering insurance. For example, Tesla now offers insurance in 10 states in the US and uses real time data to better understand risk. This is a potential game changer for the motor insurance industry.

More frequent and costly natural disasters threaten the ongoing commercial viability of householders insurance, particularly in the most disadvantaged flood-prone regions.


Multiple floods and high repair costs combined to make FY22 another loss-making year for insurers, despite premium increases. Following three years of losses, insurers are closely reviewing their natural perils exposure to determine whether insurance continues to be viable in high-risk regions and if it is, the level of premium increase required to restore profitability.

Insurers have an important role to play in helping society better prepare for the impacts of climate change. They're well placed to put a price on risk and advise policymakers on how this risk is expected to respond due to climate change. They can also model the impact of proposed mitigations, and promote forward-focused planning and building standards. The goal here is to make society 'as safe as houses'.

**Combined ratios** remain above 100% for the third year in a row. This is despite a 6% increase in average premiums. Increases in the cost of construction materials and labour, combined with supply-chain issues and demand surge following the recent flood events, will continue to place upwards pressure on insurer costs well into 2023.

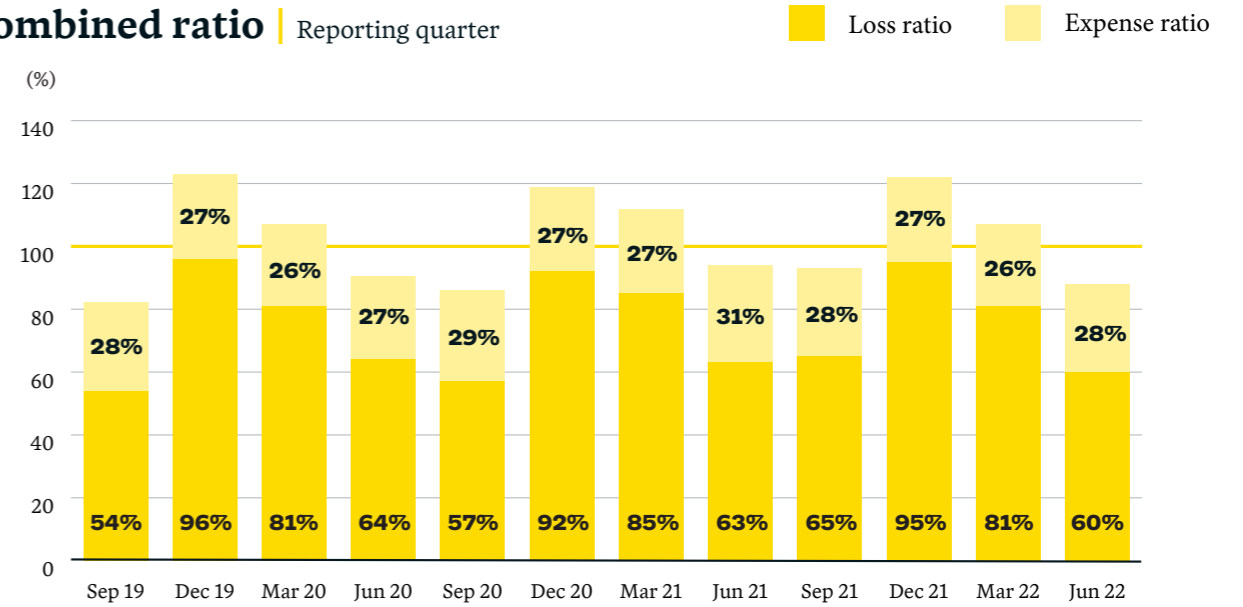
**More frequent and severe natural disasters** continue to impact insurer profits. The southeast Queensland and New South Wales flood event is now the second costliest extreme weather event in Australia's history. Insured losses across all classes of business are currently more than \$5.1 billion and continue to develop. In Qld, the \$741 million Resilient Homes Fund is being used to repair, retrofit, raise or buy back eligible properties impacted by the 2021/22 floods. Investment now is key to mitigating the impact of more frequent and severe natural disasters in future.

**Insurance affordability and availability** is a growing issue. This is leading to underinsurance and is exacerbated by recent inflationary pressures. Estimates produced by the Climate Council show 1 in 25 homes across Australia will be uninsurable by 2030, with some regions impacted far more than others. The launch of the ARPC cyclone reinsurance pool is designed to improve insurance affordability and availability in northern Australia. This is only one part of the solution. Other options being discussed include: reduction of taxes on insurance; investigating mitigation for existing properties; potentially cross-subsidising high and low-risk homes, particularly for vulnerable households; improving building standards and planning; and post-event funding.

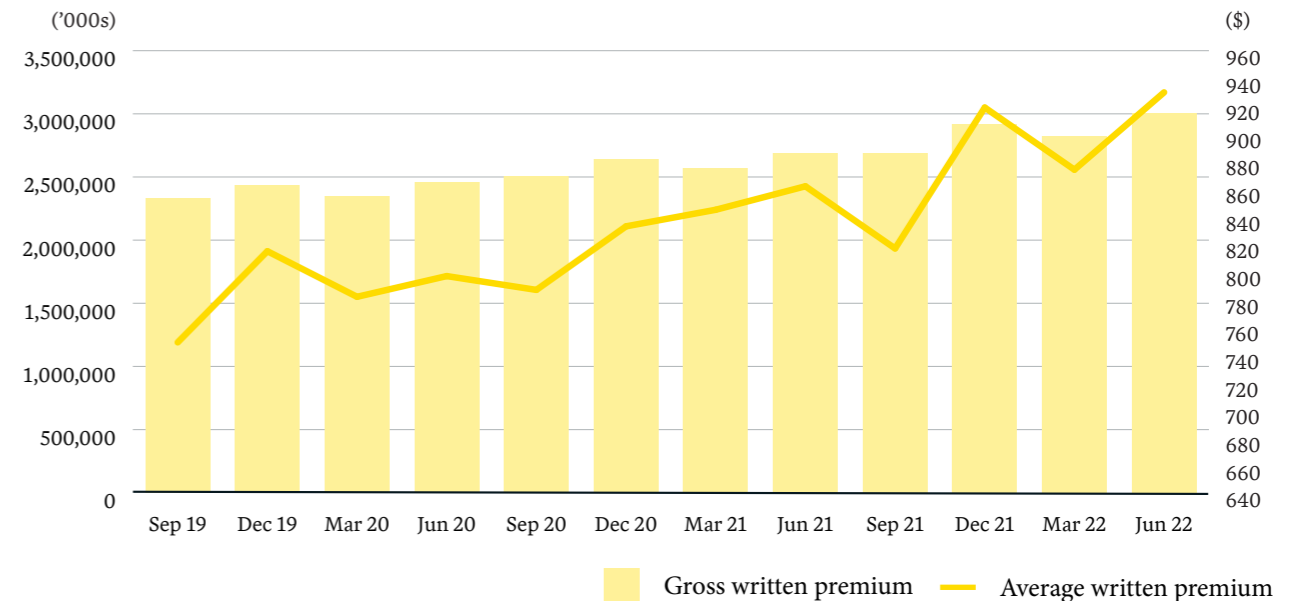
To achieve meaningful change, it is clear deep commitment and ongoing collaboration between all parties will be needed. 

# House+ holders

## Combined ratio | Reporting quarter



## Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

More frequent and severe natural disasters are increasingly fuelling losses and threatening the future availability and affordability of home insurance. Insurers are asking themselves, can I continue to offer household insurance in its current form and, if so, at what price? Specifically, insurers will need to understand and consider:

- What is my exposure to catastrophic losses in each region? How is climate change going to affect this in the medium to longer term? How uncertain are these estimates?

- How will my reinsurance arrangements need to change? In particular, what does my upper limit need to be and how can I use pre-paid reinstatements and multi-year contracts to protect against increasing reinsurance costs once natural disasters occur? Will participation in the ARPC cyclone reinsurance pool help?
- With the skills I have as an insurer, how can I contribute to the discussions with government, community and industry to address the pressing issues of affordability and availability?

Competition remains strong in the privately underwritten CTP schemes, with collected 2022 gross written premium similar to 2021 levels, despite a growing exposure base. Incurred claims costs are generally unremarkable except in South Australia, where they appear to be affected by prior year reserve releases and in New South Wales, where they were impacted by COVID-19 lockdowns and the treatment of transitional excess insurer profits from prior periods. For this reason, care should be taken in interpretation of the APRA data for NSW and at the overall level.

CTP experience in SA was largely unaffected by COVID-19, whereas Queensland experienced some claim reductions and NSW accidents reduced by more than half during the lockdown period,

which lasted more than three months. This improves reported loss ratios, although in NSW excess insurer profits will eventually be recouped through the transitional excess profits and losses (TEPL) framework. Indeed, during the year, the NSW regulator commenced recovery of excess profit related to the 2018 accident year, which may be distorting the APRA reported claims cost statistics.

In NSW, insurers can apply to the regulator to retain up to an additional 3% of profit in each accident period for their investment in approved measures that deliver proven benefit to the scheme. To date, five applications have been given preliminary approval by the regulator. We anticipate greater insurer focus on this 'innovation allowance' in the future.

# Compulsory Third Party


## Competition in NSW has continued

to put downward pressure on premiums, with industry earned premium remaining relatively stable despite a growing market. Recovery by the regulator of past excess insurer profitability has commenced through the TEPL mechanism. Some insurers who had provisioned for TEPL have released these reserves to operating expenses, likely a partial explanation of the recent reduction in industry incurred claims cost.

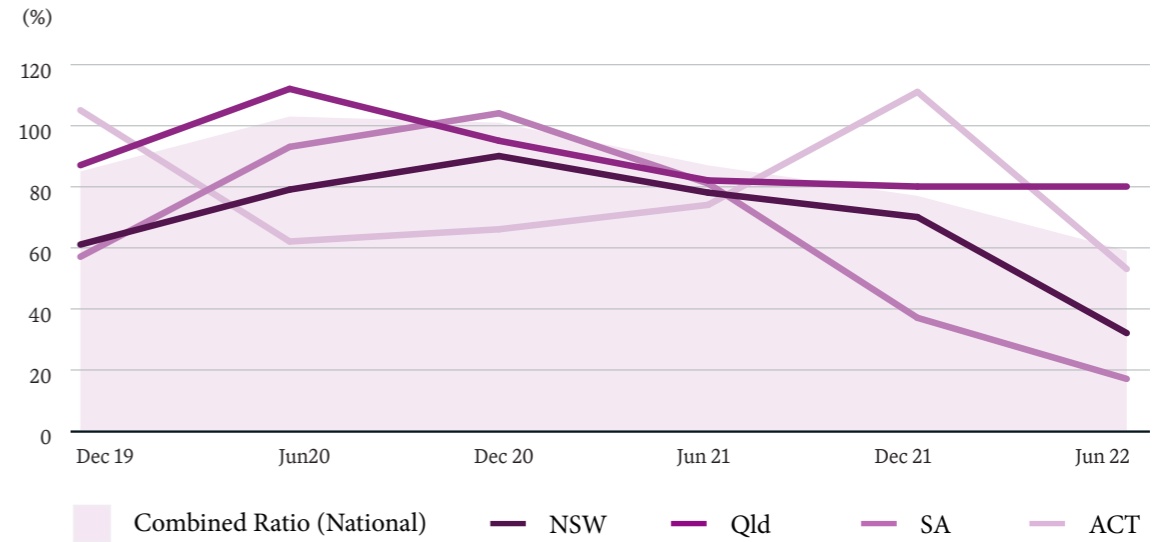
## South Australians have more choice

than ever with Youi entering the CTP market on 1 July 2022. Five private underwriters now compete for the almost \$300 million in annual premium collection. There have been material changes in market share, with a doubling of AAMI gross written premium and a 30% reduction in that of NRMA/SGIC.

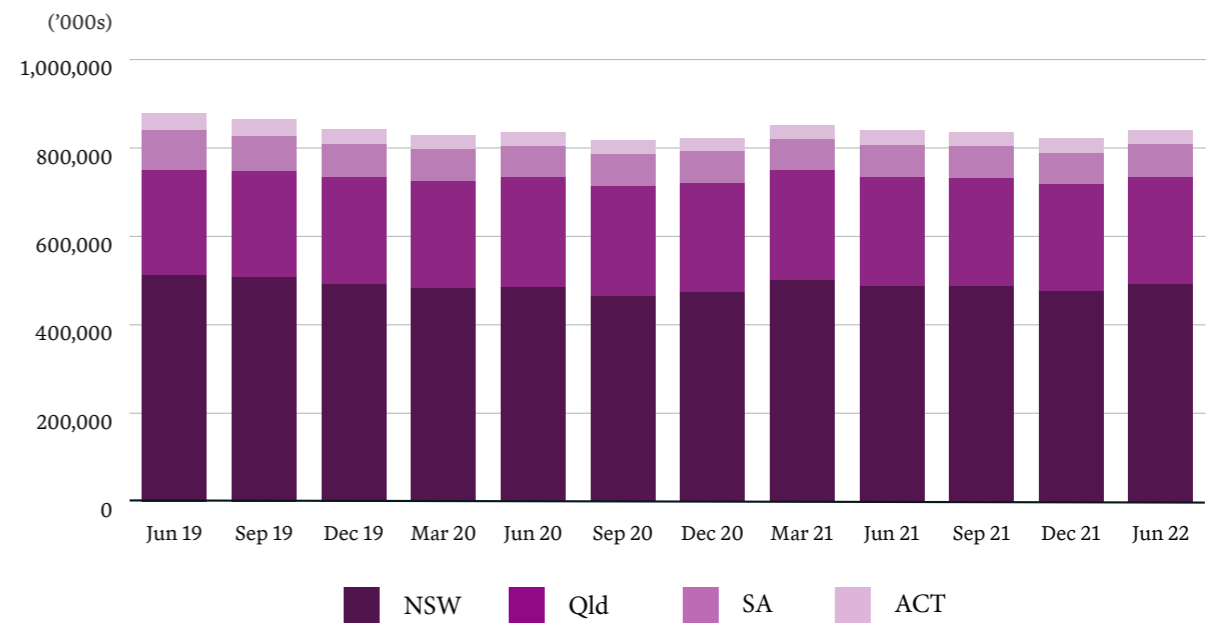
## Insurer profits in Qld were pressured

over the year, as wage inflation increased claims costs. However, reduced traffic volumes in the first half of 2022 – in part due to the eastern Australian floods and in part due to the continuing impact of COVID-19 driven by the BA.4 and BA.5 Omicron subvariants – provided some offset. 

## Gross loss ratios | Reporting half year



## Gross earned premium (\$) | Reporting quarter



## Impacts and trends at a glance

CTP is a long-tailed insurance product, with claim payments made many years after the incident giving rise to the claim. As such, economic conditions have a material impact on claim reserves and premiums. CTP insurers will be keeping a close eye on investment markets and rates of inflation, with cost pressures already emerging. Claim frequency, if unaffected by future lockdowns, should increase next year in those jurisdictions that were impacted in 2022, although premiums will already reflect this.





Business is booming – for now! FY22 was the most profitable year on record for insurers, with an underwriting result of \$489 million, up from \$111 million in FY21.

Record profitability was driven by a 20% increase in gross written premium, reserve releases and a reduction in the expense ratio. The increase in discount rates helped the FY22 result. However, inflationary storm clouds are brewing.

The industry is gearing up for an increase in mental health claims, preparing for proposed reforms to the Western Australian scheme and assessing the ongoing viability of excess of loss cover, given recent losses.

# Workers Compensation

As the largest privately underwritten state, the Western Australian draft Workers Compensation and Injury Management Bill 2021 is receiving a lot of attention. The Bill proposes several changes to entitlements and the operations of the scheme, including:

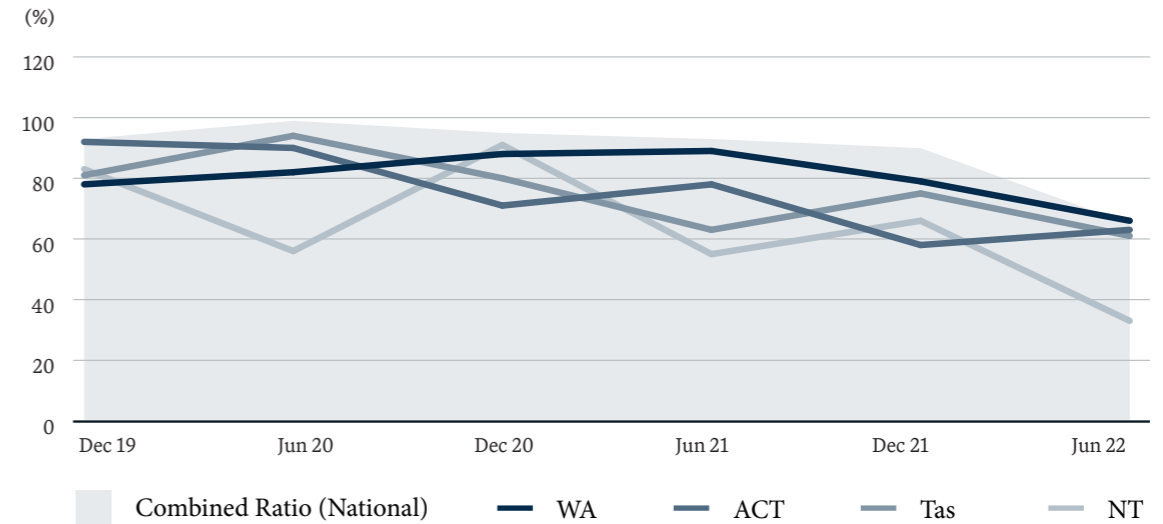
- An increase to the income compensation payment step-down period, from 13 to 26 weeks
- Introducing provisional payments, where liability decisions haven't been made in 28 days
- Restricting the circumstances in which claims can be settled and the timing of those settlements.

While the final changes haven't been agreed, insurers are well advised to consider the potential impact on claims costs, premiums and their operations.

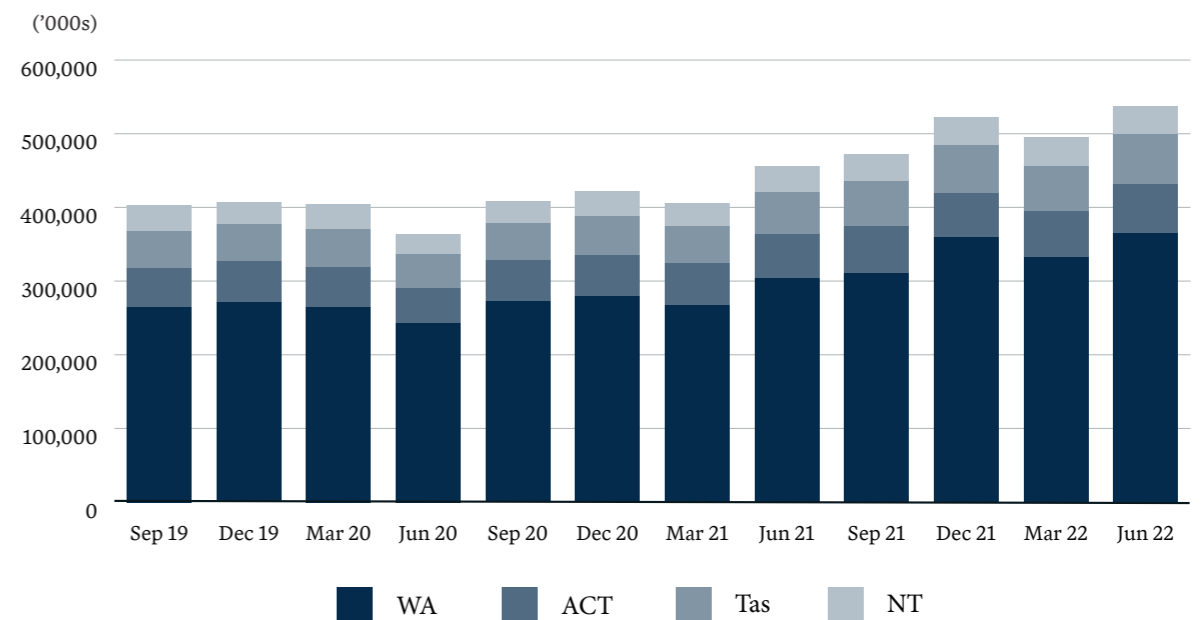
**Mental-health injuries continue to test insurers,** with greater community mental-health awareness and improved diagnosis leading to an increase in mental-health-related claims. As mental injuries come to represent a larger proportion of claims, many insurers are seeing return-to-work rates decline and average claim sizes increase. Unfortunately, there's no easy fix. Improving outcomes will involve refining the management of mental-injury claims, improving communication to injured workers and the early identification of secondary mental injuries.

**Gig economy employees represent a 'blind spot'** for most workers compensation schemes. With more than 100 platforms operating in Australia covering food delivery, domestic services, transport and web services, the deciding factor in whether a gig economy worker is covered by workers compensation is if they are considered an employee or independent contractor. The death of five gig economy delivery drivers in two months towards the end of 2020, combined with a change in government, is perhaps sparking change. Watch this space ...

## Gross loss ratios | Reporting half year



## Gross earned premium (\$) | Reporting quarter



## Impacts and trends at a glance

Substantial changes are afoot. Together, the WA reforms, mental health injuries and requirements related to gig economy workers will impact all aspects of insurers' operations. Insurers need to plan now for how these changes may impact their business to thrive in future. The key questions insurers will need to answer include:

- How are the WA reforms going to impact claims, and therefore the premiums I need to charge, by industry?
- How do my processes need to change to accommodate the proposed WA reforms?
- Is my claims management model fit for purpose, given the rise in mental-injury claims?

# Commercial Motor



Overall, commercial motor remained profitable in FY22. This was despite increases in claims costs from supply-chain issues, which were exacerbated by global geopolitical events.

Average claims costs have been driven up by road activity post-pandemic, along with production and distribution challenges for replacement parts and labour inflation. Commercial motor insurers partially offset this by increasing premiums. Despite the difficulties, and in the absence of a highly competitive landscape, insurers were able to deliver strong premium growth and maintain yet another profitable year.

In the short term, we expect claims inflation to continue to be a challenge, with market pressures ongoing for commercial motor insurers.

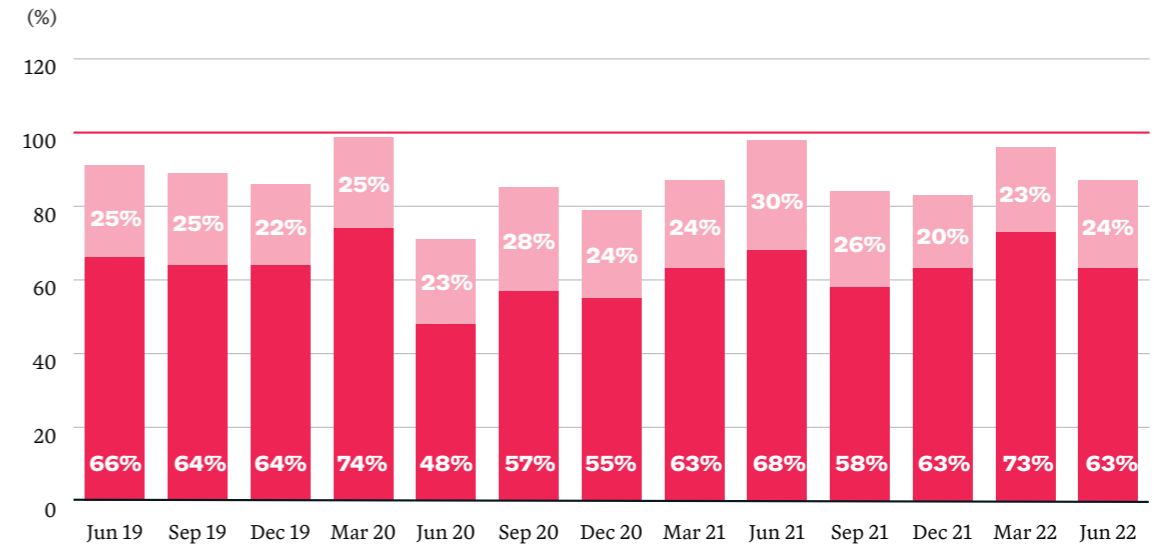
**The 12% premium volume growth** was driven by an 8% increase in average premiums and a 4% increase in the number of risks written. The increase in average premiums reflects the rising cost pressures and an attempt to counter a decline in profitability, while the increase in the number of risks shows the return of business activity.

**Loss ratios further increased** and are now similar to pre-pandemic levels. This was driven by the end of government-mandated lockdowns, the rejuvenation of business activity and supply shortages of replacement parts. The expense ratio has remained relatively stable, reflecting insurers' commitment to improving efficiencies, such as through the use of approved repairers.

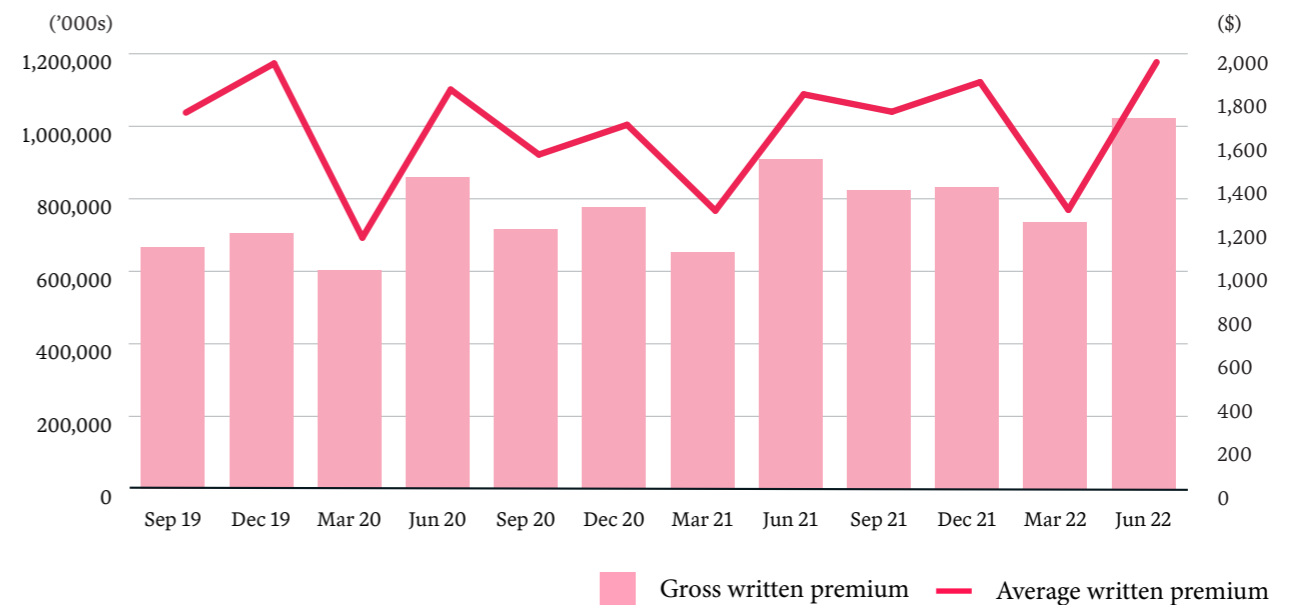
**Cost pressures are expected to continue** with labour market shortages and the increased use of technology in vehicles, as well as production shortages impacting the cost of repairs and wait times for customers. 

Combined ratio | Reporting quarter

Loss ratio Expense ratio



Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

An increase in business activity and road use has resulted in profitability returning to pre-pandemic levels. With added pressure from claims inflation and labour market shortages, insurers will need to find innovative ways to maintain profitability. This includes staying on top of trends altering the commercial motor insurance landscape, including:

- The growing use of electric vehicles now and the transition to autonomous vehicles in the future
- Reduced car ownership due to ridesharing and car rentals
- Use of telematics to monitor vehicle movements, with recent advancements in GPS tracking technology.

While underwriting results improved over the past 12 to 18 months concerns remain regarding the ongoing insurance profitability for this class, particularly given rising natural peril activity and higher reinsurance costs.

Net combined ratios have remained below 100% for each of the past six quarters, despite significant natural perils, including the southeast Queensland/New South Wales flood event in February 2022 (total industry losses of \$5.1 billion and rising) and South Australia/Victoria severe storm event in October 2021 (total industry losses of \$0.8 billion).

While this is encouraging for insurers, the reported net loss ratios benefited from a release of COVID-19 business interruption reserves in


FY21 Q4, and significant reinsurance recoveries from natural peril events in FY22 Q1 and Q2. Importantly, commercial property has delivered negative insurance margins for much longer, with an average combined ratio of more than 100% over the past seven years.

Insurers responded to ongoing high natural peril claims costs and ongoing uncertainty with COVID-19 business interruption claims by raising rates. Premiums increased by an average of 16% over FY22 and were particularly high in areas impacted by natural perils.

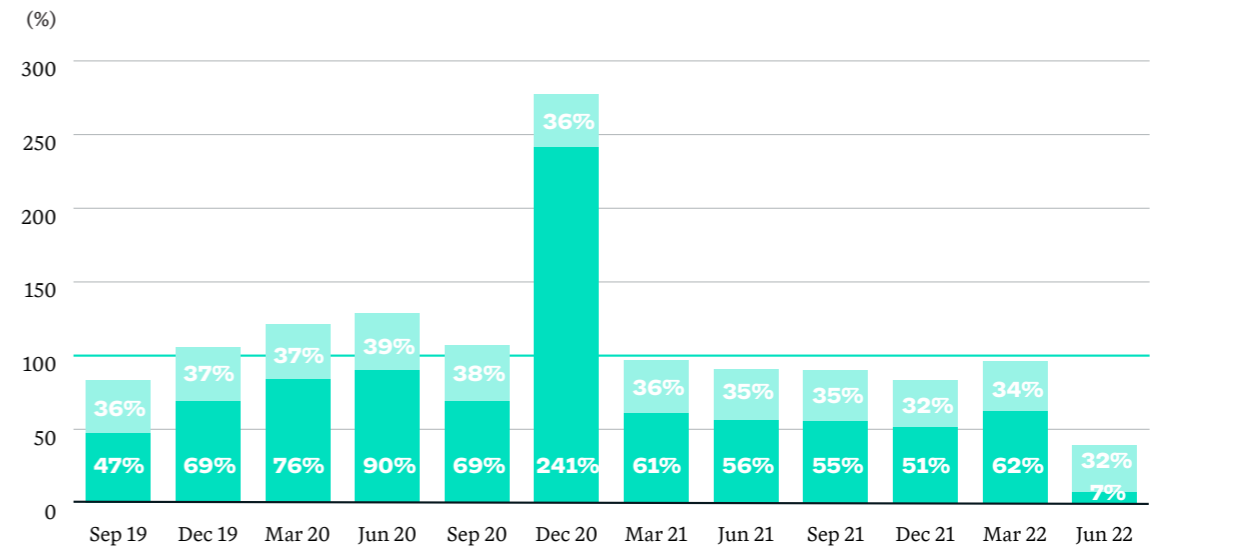
# Commercial Property

**The ultimate cost of COVID-19** business interruption claims remain uncertain. A second insurance industry test case was launched during 2021 to determine the meaning of certain policy wordings. While the second test case went largely in favour of insurers and was upheld on appeal to the Full Court in February 2022, applications for special leave to appeal to the High Court have been filed and remain unresolved.

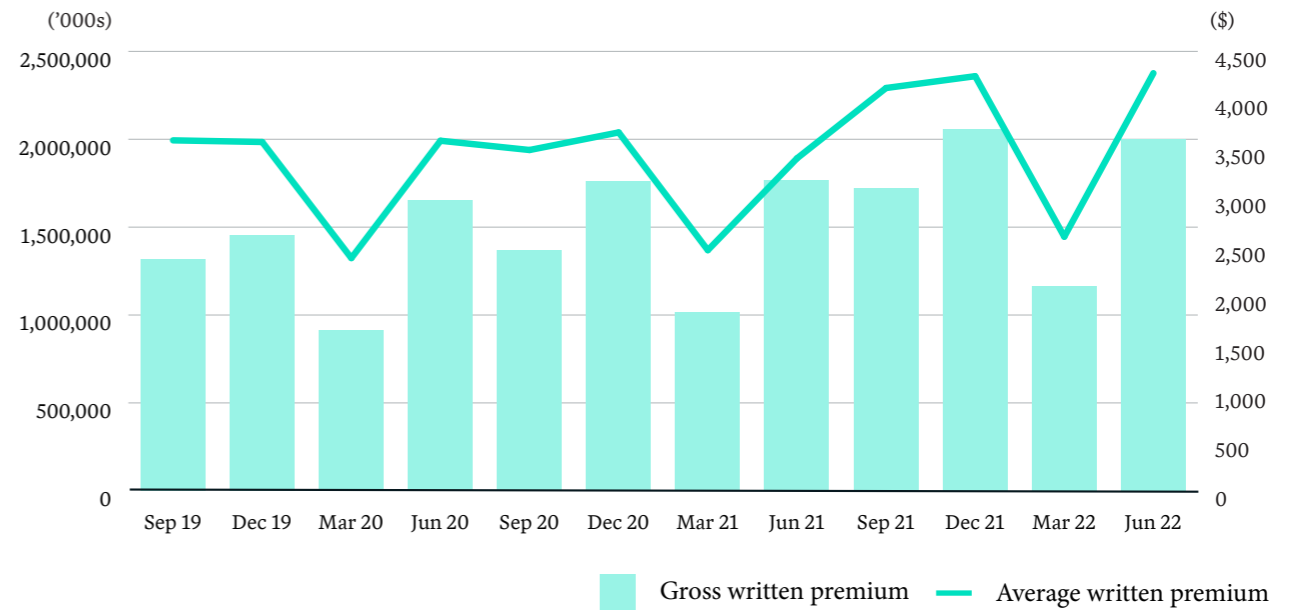
**Cost and availability of cover** is likely to be a growing concern in areas impacted by natural perils, as insurers seek to better understand and manage catastrophe risks. Insurers are also likely to face increasing catastrophe reinsurance costs, which will in turn put upward pressure on the premiums charged to customers.

**The upward pressure on rates** for properties in medium-to-high-risk cyclone areas may be partly mitigated by the launch of the Australian Reinsurance Pool Corporation (ARPC) cyclone reinsurance pool in July 2022. The pool includes cover for SME building insurance policies and strata insurance. Participation in the pool will be mandatory for large general insurers with eligible policies by December 2023, with estimated premium savings of 17% (SME) and 15% (strata) for properties in northern Australia. 

**Combined ratio** | Reporting quarter



**Total premium volume (\$)** | Reporting quarter



## Impacts and trends at a glance

Looking ahead, insurers should review their catastrophe reinsurance strategies, considering rising reinsurance costs. As part of this review, insurers will need to consider the timing of participation in the ARPC cyclone reinsurance pool and the consequent impact this will have on customer pricing for SME and strata insurance. Finally, insurers should revisit the adequacy of their COVID-19 business interruption reserves, with the potential for further reserve releases if the second test case appeal is resolved in insurers' favour.



# Travel

With Australian borders reopening in September 2021, travel showed the first signs of recovery since COVID-19 arrived in the country. Not unexpectedly, loss ratios increased from the September quarter, reflecting the resumption of leisure travel and the emergence of Omicron towards the end of 2021. Notably, all-time-high expense levels showed in the December quarter, as insurers rushed to shore up their resources.

Although capacity is returning, with an increasing appetite among travel insurers to provide some level of pandemic cover, the industry is experiencing a range of teething problems. Chief among them is a shortage of claims managers, caused by staff leaving the market altogether when travel ground to a halt during lockdowns. This mass exodus is being felt in claims processing delays, creating a potential logjam for the industry. Further, the months-long claims management training is adding to delays in claim payments, as well as increasing mental and physical pressure for existing claims managers, as they shoulder the extra workload.

As travel ramps up, potential also exists for an increase in complaints, with media reports of executives being summoned to handle bags, unions unhappy, numerous flight cancellations, bags lost, and people missing flights due to long airport queues – with no hope of recompense because insurance doesn't cover tardiness.

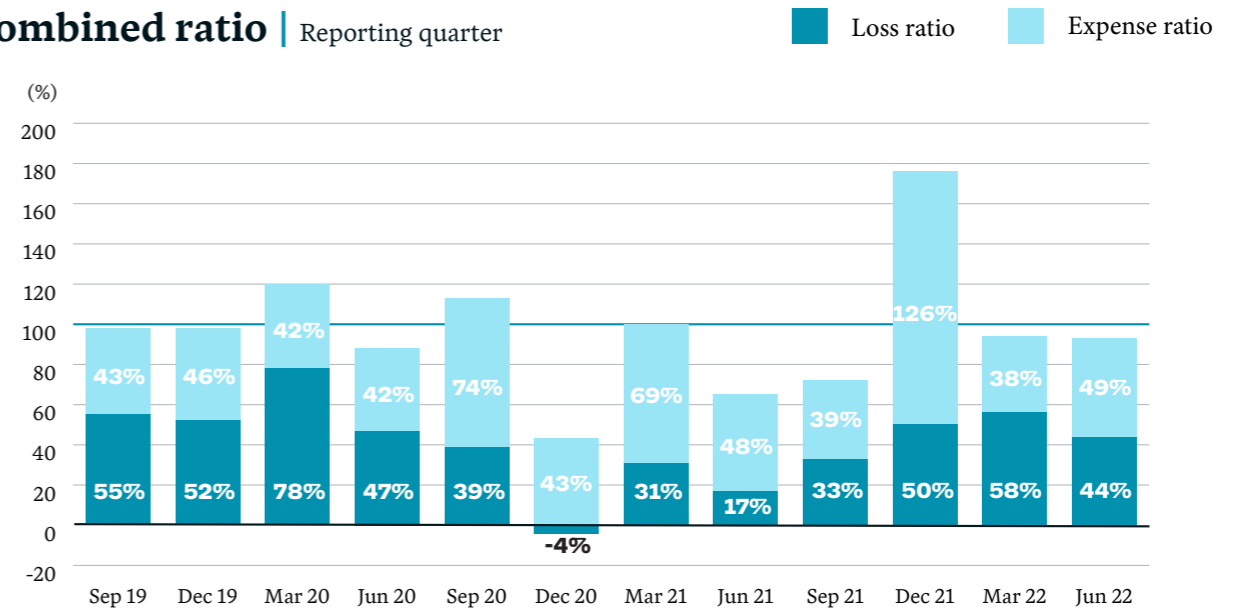
Despite these challenges, travel insurance seems mostly to have returned to sustainable profitability. As pandemic becomes endemic, along with border reopenings, the industry expects COVID-19 impacts on journey disruptions (and therefore claims costs) to lessen over 2022.

**Travel insurance has provided much-needed cover for COVID-19** during the Omicron surge. While the market had not anticipated Omicron, responsive rate increases and sub-limits on the cover have been generally sufficient to meet associated claim costs without sustained losses. As communities increasingly expect genuine protection from their policies, the success of the industry in weathering Omicron is a good example to guide future responses to unforeseen events without excessive exclusions.

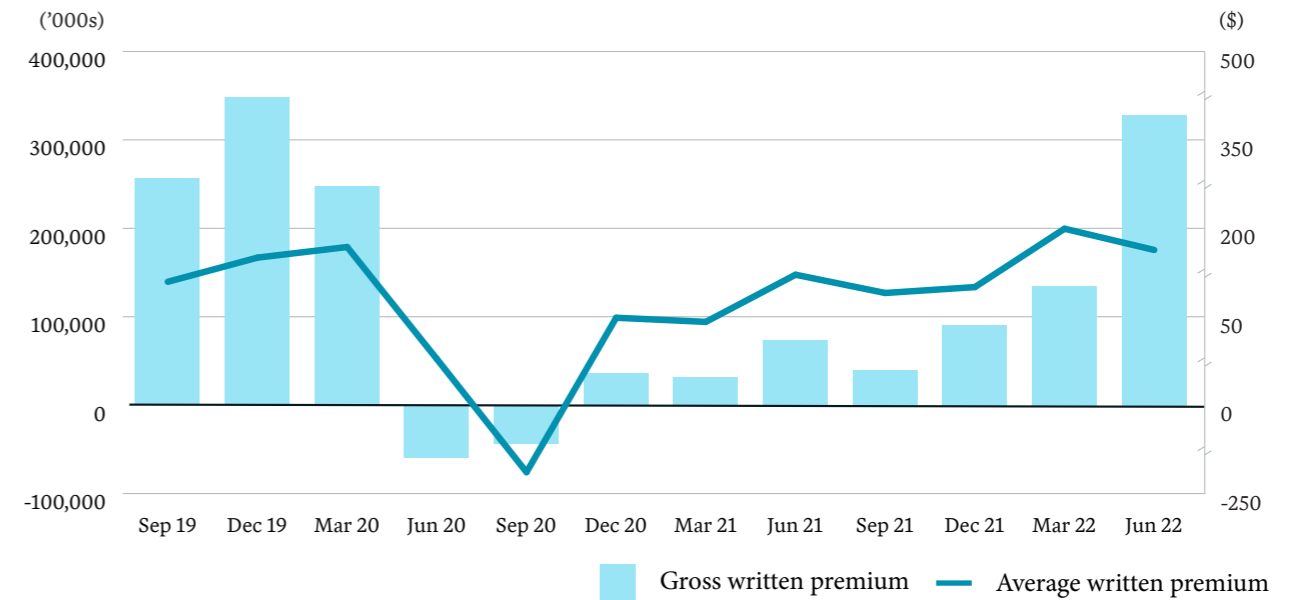
**Expanding capacity.** COVID-19 represents an unprecedented stress test for the travel insurance industry, with a general withdrawal of capacity throughout. The reopening of borders, as well as increased awareness and demand for travel insurance, has created opportunities to gain market share for those travel insurers who successfully weathered pandemic challenges.

**Several countries have mandated travellers hold a reasonable amount of travel insurance**, including COVID-19 cover. This represents an excellent opportunity for the industry to grow further – particularly via partnerships/distribution arrangements with travel agents and airlines. 

Combined ratio | Reporting quarter



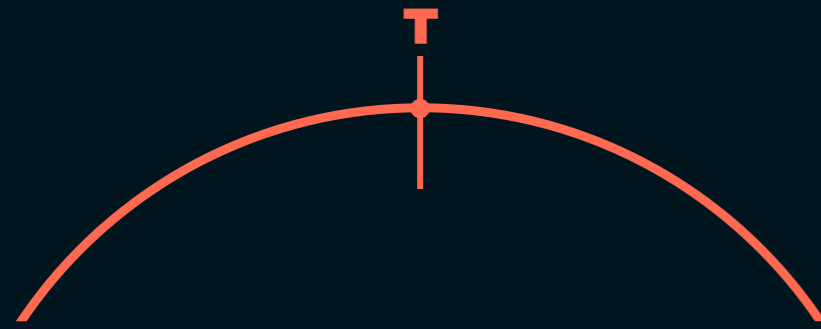
Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

While COVID-19 has been disruptive, it has also introduced new opportunities for travel insurers that survived. These insurers can take advantage of current lower capacity, and continue to invest in improving flexibility and creating more dynamic pricing. A focus on more customer-centric policy design and claims management will help address community concerns about transparency and travel uncertainty.





Overall profitability for public and products liability insurers in FY22 has emerged better than FY21, which experienced high loss ratios. The combined ratio for FY22 averaged 90%, following reserve releases for older accident years in FY22 Q3.

The market continues to harden, contributing to affordability concerns for small-to-medium-size businesses, while providing relief to insurers from increasing claims costs due to higher regulatory activity and litigation.


In the short term, we expect claims inflation, increased regulatory activity and litigation costs to continue to be a challenge for insurers. As with long-tailed products, there's a substantial lag between the premium increases and observed claims costs. Further, the general affordability concerns pose reputational risks towards insurers and the industry.

# Public & Products Liability

**Over the year, the 9% written premium growth** was driven by a 13% increase in average premiums, offset slightly by a 3% decrease in the number of risks written. Significant increases to average premiums were observed for the construction sector and public liability policies with larger excesses (greater than \$1,000). We expect markets to continue to harden as insurers respond to the increasingly litigious environment. Other forms of social inflation (such as sporting concussions and e-cigarettes) continue to present risks to insurers.

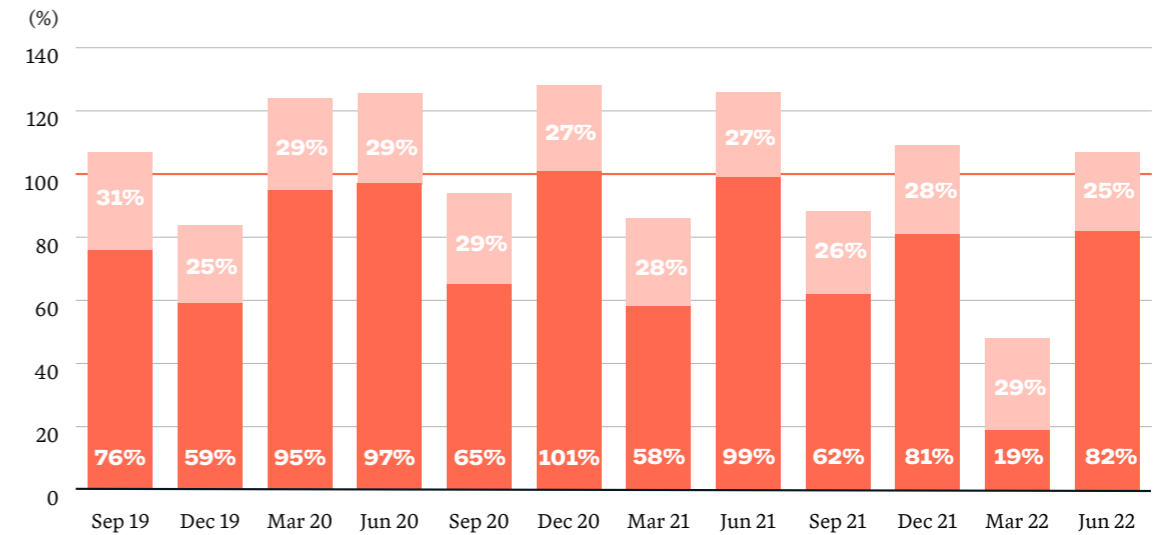
**Issues of affordability and availability** have become more severe in the past few years for certain sectors of the economy. For example, public liability cover for tourism, leisure and other business sectors focused on recreational activities have experienced large premium increases and restrictions on terms, leading to some businesses

being unable to continue operating in the same way. If affordability concerns are not addressed, then this may result in a level of distrust towards insurers and pose reputational risks for the industry. In recognition of the need to address these concerns, the Insurance Council of Australia formed a Business Advisory Council in September 2021 to bring together business and insurance sectors, with the aim of working through practical solutions to insurance availability and affordability issues.

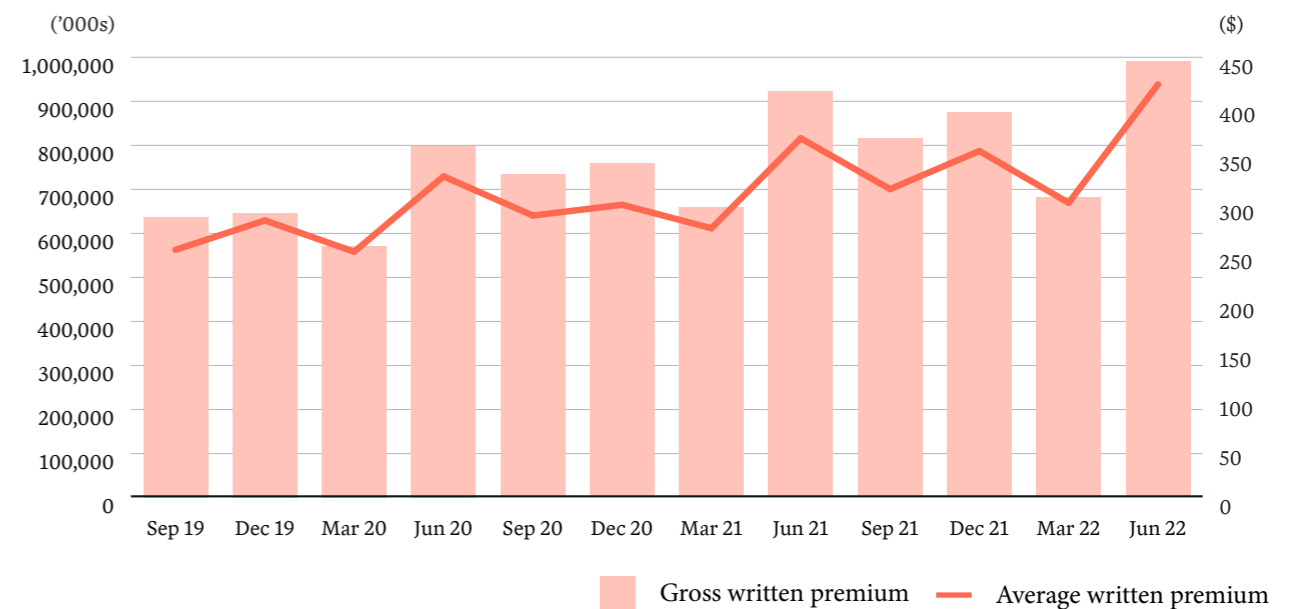
**Insurer reserves continue to be under pressure** from claims inflation, and rising costs of litigation and settlements. This is being driven by the increased regulatory activity for manufacturers, suppliers and retailers brought on by the pandemic. Recent increases in risk-free yields and discounting are expected to reduce existing reserves. 

**Combined ratio** | Reporting quarter

Loss ratio Expense ratio



**Total premium volume (\$)** | Reporting quarter



## Impacts and trends at a glance

With increasing claims costs over the past few years, profitability has been declining (excluding reserve releases from prior years). As a result of rate increases and reserve releases FY22 was profitable, although this may only offer temporary relief, as current claims expenses have continued to track upwards - suggesting claims costs are rising faster than rates. The continued hardening of rates has however led to affordability concerns for small-to-medium-size businesses. It's vital insurers and their brokers engage with their clients to ensure risks

are mitigated, making premiums affordable while continuing to offer genuine protection. The Business Advisory Council may also assist in brokering solutions where other efforts have failed.

Insurers will also need to pay particular attention to the litigious environment and other forms of social inflation. Questions to consider include: what impacts will these have on rates? What constrictions on limits and changes to terms and conditions are needed to ensure clarity in coverage and avert unexpected consequences?

# Professional Indemnity & Directors and Officers

Insurers enjoyed strong underwriting performances over the past 18 months, with combined ratios below 80% in five of the past six quarters. The favourable loss ratios were driven by strong premium growth as well as releases on prior year reserves. Profitability may ease going forward if the market softens, and recent upticks in inflation may prompt insurers to strengthen reserves.

Concerns remain with certain occupations and industry groupings. Class-action activity may rise if regulatory changes made by the previous government are wound back.

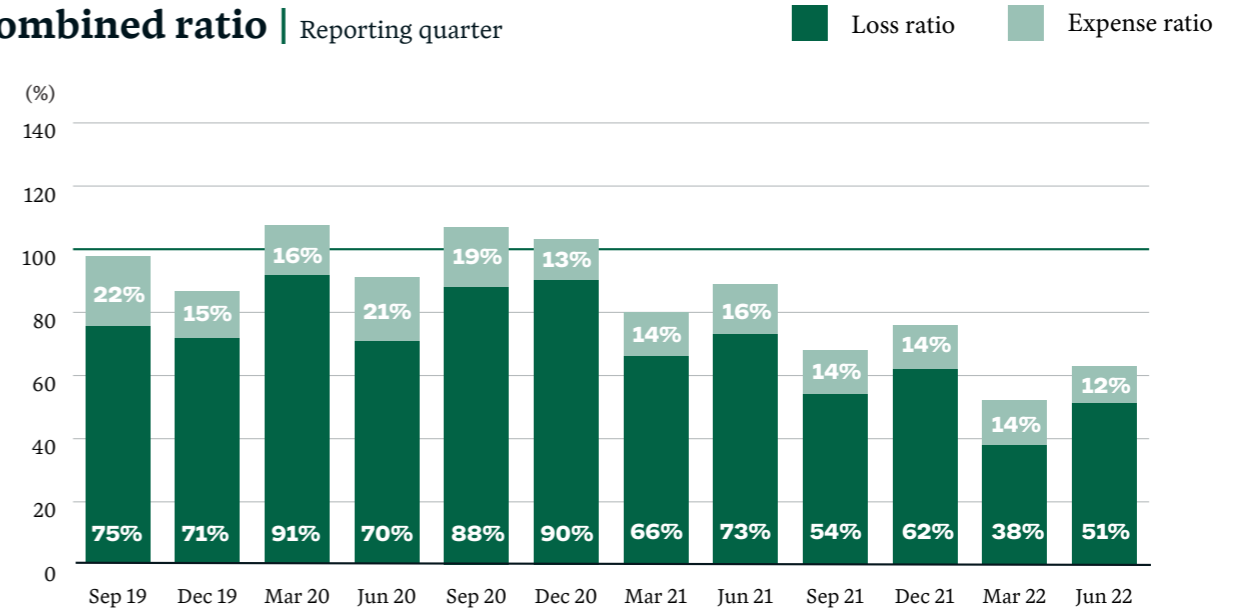
Given favourable returns, we're likely to see an increased appetite for insurers to write PI & DO, which may in turn see an easing of the harder market conditions prevailing since 2017. However, we expect insurers to remain selective in which parts of the market they participate, given concerns with particular sectors. Some sectors experiencing difficulties with cost and availability of cover are responding by exploring alternative mechanisms, such as Discretionary Mutual Funds.

**Growth in premiums are outstripping** growth in claims, leading to improved underwriting profits. Given the long-tail nature of the business, insurers are also likely to benefit from rises in interest rates, although this may be partly offset by rises in inflation.

**There was a drop in class action** activity in the 2021 calendar year, partly due to regulatory changes made by the previous coalition government, including Managed Investment Scheme Reforms, which required litigation funders to hold an Australian Financial Services License. However, some of these changes could be reversed under Labor, leading to a renewal of class action activity. There has also been an uptick in technology and climate-related class actions, which is likely to continue.

**Cost and availability of cover** remain an issue for certain occupations, with professionals in financial occupations and the building industry experiencing rising professional indemnity insurance costs and restrictions on cover availability. Insurers are seeking to better understand and manage risks within these sectors through improved data and underwriting processes. Cyber cover, too, is still in the spotlight, as insurers update their policy wordings to explicitly exclude silent cyber coverages from non-cyber products, including PI & DO, but the approach isn't consistent across the entire industry. <sup>®</sup>

## Combined ratio | Reporting quarter



## Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

While PI & DO has performed strongly, insurers should expect returns to ease going forward as competition increases, the market softens and potential reserve strengthening is required in response to higher inflation. The new government has also flagged that litigation funding reforms introduced by the previous government may be wound back, which could result in a renewal of class-action activity that impacts the profitability of DO covers.

In cyber, as technology is more embedded in our lives and cyber attacks become more sophisticated, industry challenges in defining what constitutes a cyber incident may mean silent cyber remains an ongoing issue.

# Lenders Mortgage Insurance

Insurers in this class have enjoyed strong underwriting performances over the past 12 to 18 months, boosted by strong economic fundamentals and rising property prices. Increases in interest rates may contribute to increased claims, but the market is likely to continue performing strongly, if unemployment stays low.

A volume increase in new home loans during 2021 flowed through to high levels of written premium for lenders mortgage insurers. This strong underwriting performance was also boosted by low levels of claims and some reserve releases, which contributed to rising profit margins across the sector in FY22.

Many insurers had strengthened insurance liabilities during FY21 in response to COVID-19 concerns. In particular, insurers were worried about possible rises in loan delinquencies and claims, as previous government stimulus and bank pandemic assistance programs expired. However, the improved economic outlook during FY22 led to a release of these reserves.

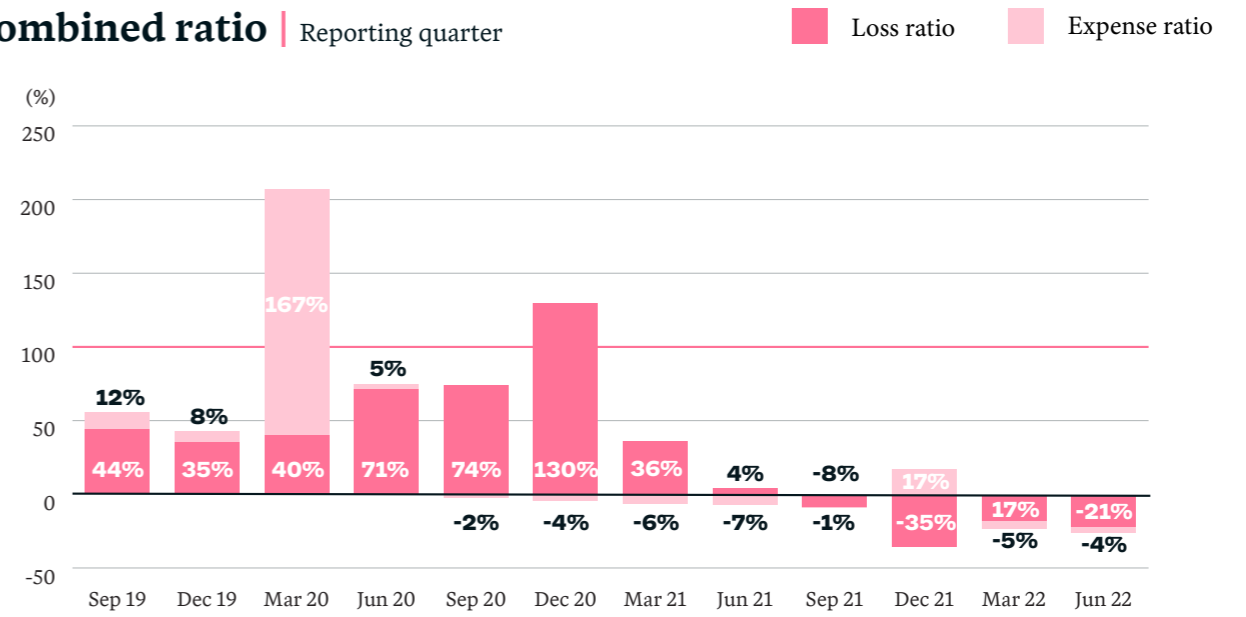
Competition wise, an already concentrated LMI market has been further rationalised over the year, with the sale of Westpac LMI to Arch in August 2021.

**The surge in new home loans** underpinned growth in lenders mortgage insurance premiums, although with slight weakening in the last two quarters of FY22. The strong top-line growth was a welcome development for insurers, following relatively weak premiums in the preceding three years.

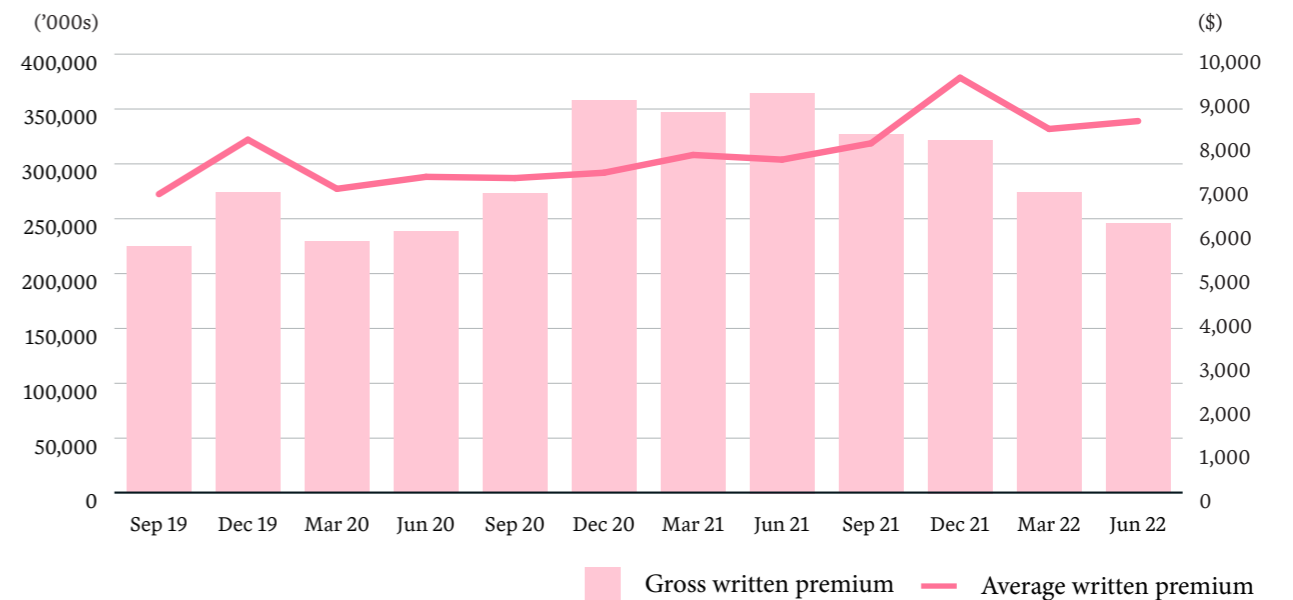
**An improved economic outlook** led to low claims and allowed release of the reserves that had been built up in response to COVID-19. This resulted in negative reported loss ratios for each of the past four quarters. However, this is clearly not sustainable and we're likely to see loss ratios trend up as reserve releases run out.

**Insurers' capital bases benefited** from the strong underwriting performance, which has in turn led to many LMI insurers reviewing their capital levels and reinsurance strategies. This strong performance has also enabled these insurers to resume dividend payments. <sup>®</sup>

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



## Impacts and trends at a glance

Loss ratios are likely to trend up as reserve releases run out. Adding further pressure, increases in interest rates – and potential weakness in the property market – may heighten the risk of mortgage defaults and increased claims. On the flipside, insurers may benefit from improved investment returns in the higher interest rate environment.

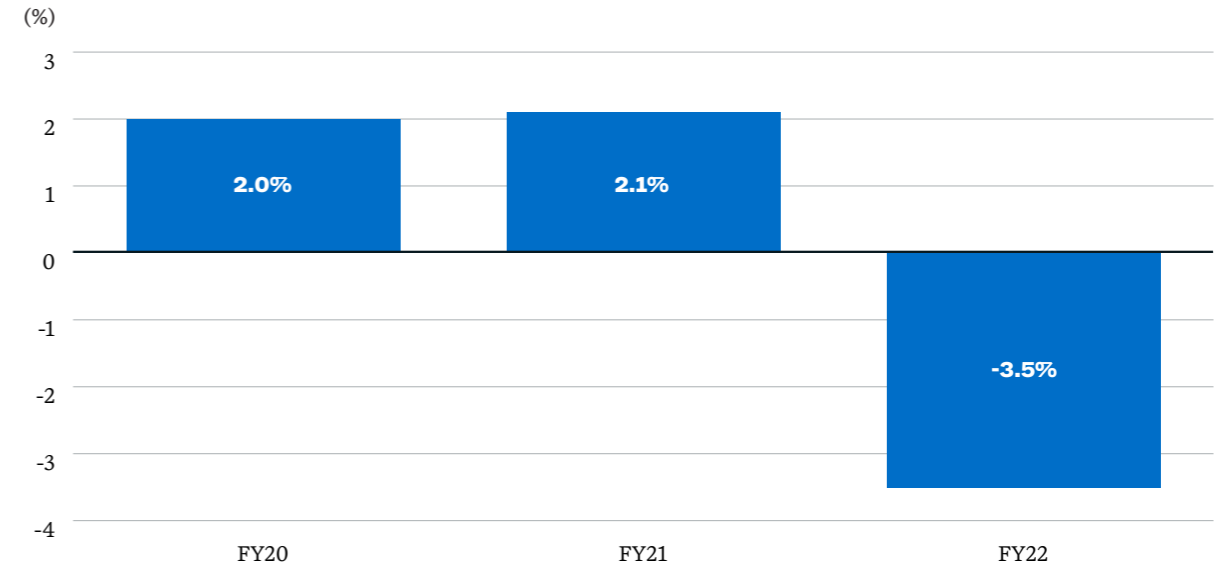


# Investments

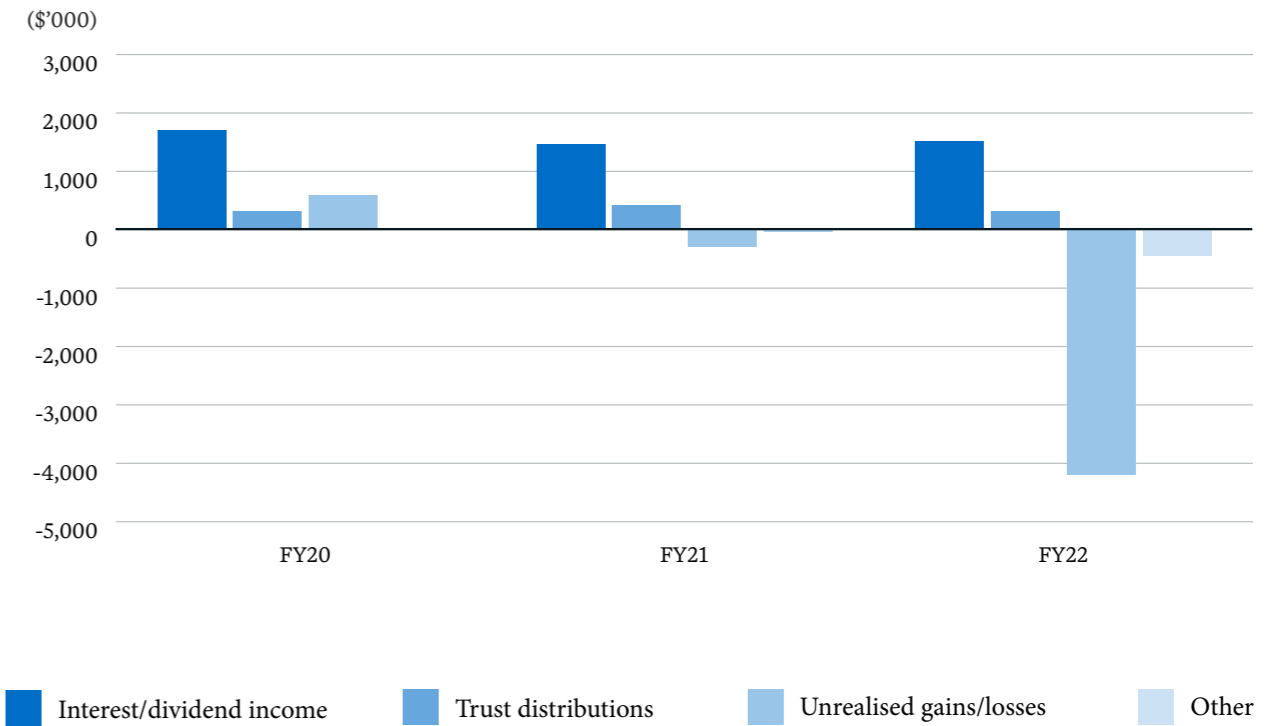
Insurers sustained an average annual investment loss of 3.5% during FY22. This was almost entirely due to unrealised losses on insurer bond portfolios attributable to rising interest rates, as the RBA increased the cash rate in response to increasing inflation. While investment assets were lower, due to the impact of the higher interest rates, the value of insurer liabilities was mostly unchanged – as the beneficial impact of higher discount rates was largely offset by higher inflation assumptions. As a result, the net impact of higher interest rates was a one-off adverse impact on insurer profitability and a contraction in insurer capital bases.

Looking forward, the rise in interest rates may create additional opportunities for insurers to increase investment income. This addresses a long-standing concern for insurers operating in a low interest rate environment, where low investment returns put pressure on insurers to achieve higher underwriting profits – with the profitability of longer tailed classes of business particularly affected. In some instances, insurers may want to rebalance their investment portfolios to take advantage of the higher yields available. However, matching of assets and liabilities continues to be important, and insurers need to be aware of the asset risk capital implications of any change in investment strategy. <sup>®</sup>

## Investment returns | Reporting year



## Investment income breakdown (\$) | Reporting year

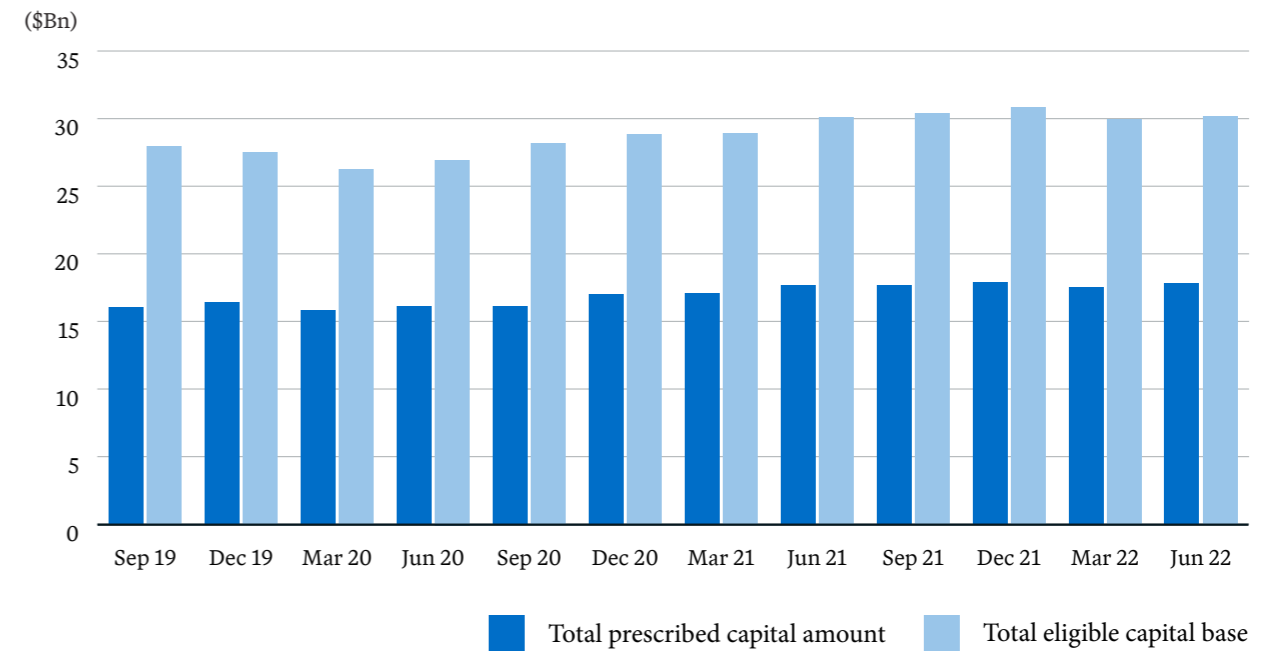


# Solvency Strengths

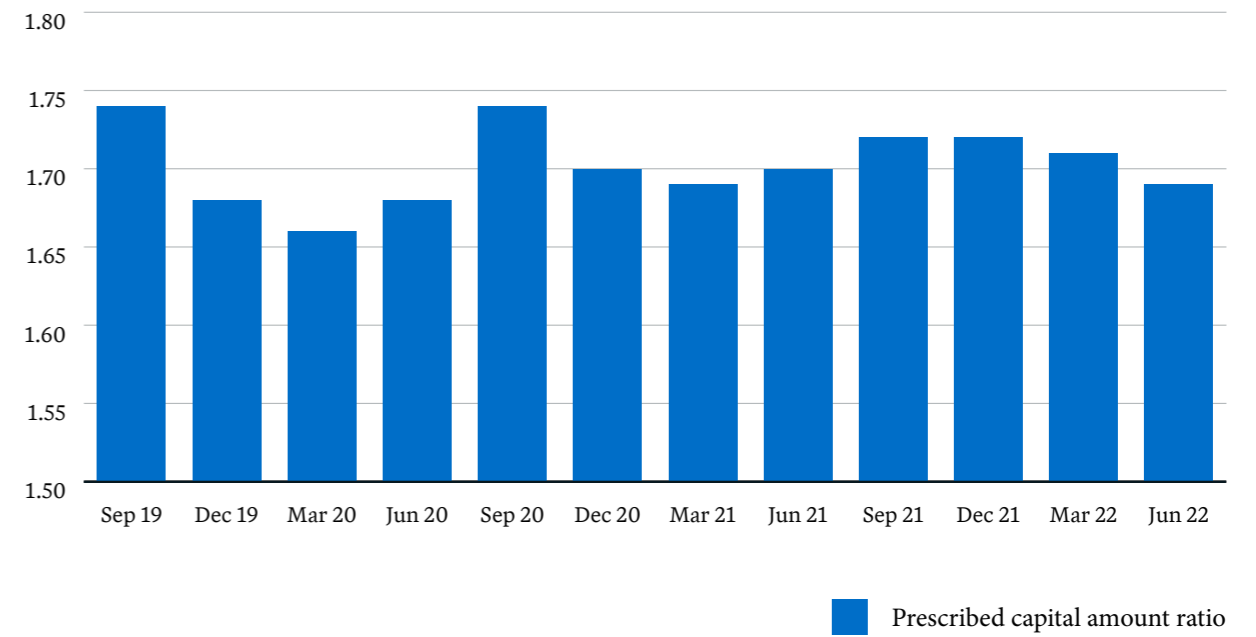
The solvency ratio decreased slightly in the second half of FY22, following growth in the preceding year. The decrease in solvency was primarily attributable to a contraction in capital base. This was caused by the impact of the higher interest rates on investment assets, and upward pressure on insurance liabilities due to higher inflation assumptions.

Despite the dip in solvency in the past two quarters, industry solvency remains relatively high at 1.69 times the Prescribed Capital Amount (PCA) as at June 2022. This is broadly in line with average industry solvency over the past three years. <sup>®</sup>

## Capital base vs prescribed capital amount | Reporting quarter



## Prescribed capital amount coverage ratio | Reporting quarter



# Spotlight on Climate



Australia had several unprecedented extreme weather events in the past year. These have affected insurers, government and policyholders across the nation, offering challenge and opportunity in navigating the way forward ...

## *More extreme weather*

Climate change is already increasing the risk of extreme weather events, though impacts vary by region and by type of peril. In February 2022, the Intergovernmental Panel on Climate Change (IPCC) released its alarming Sixth Assessment Report, a “dire warning” that climate change is a “grave and mounting threat to our wellbeing and a healthy planet”. In emphasising the urgent need to adapt to a warming Earth, the IPCC explains that a certain amount of climate change is ‘baked in’, so even if we immediately reduce emissions significantly (which isn’t happening), significant climate impacts will still take place.

## *Rising claim costs and reduced insurance access and affordability*

Climate change has, and will continue to, increase the frequency and severity of catastrophic losses in future, placing pressure on premium rates, and on insurance access and affordability in some market segments.

## *New pool to address home insurance costs in vulnerable regions*

Concerns regarding affordability and availability of householder and commercial property insurance cover in the cyclone-prone north of Australia have been growing in recent years. These concerns are likely to be elevated by the impact of climate change on extreme weather events. In response, the Australian Government established a reinsurance pool for cyclones and related flood damage, which began operations on 1 July 2022. The pool is aimed at reducing the cost of home insurance for households in cyclone-prone parts of the country.

## *Weather events in eastern Australia*

New South Wales, in particular, has suffered through the 2021 floods, then the even worse and more extensive 2022 flood events. As the climate warms, heavy rainfall events are expected to become more intense, causing increased potential for flooding. Solutions that reduce loss of lives, livelihoods and property in a flood-prone future are complex and involve multiple parties. These include local, state and Commonwealth governments, as well as insurers, banks, builders, developers and communities. Insurance is a vital part of the solution. For example, insurance pricing, terms and conditions can provide incentives for the construction of more safely situated and resilient buildings.

**APRA has advised climate risks are material, foreseeable and actionable now. Insurers who haven't already done so need to consider how climate risks will affect their business and customers.**

But the impacts of climate reach far beyond extreme weather events ...

## *There is growing global momentum toward standardised disclosure of climate-related risks*

The Task Force on Climate-related Financial Disclosures (TCFD) issued voluntary guidelines that 2,600 companies around the world endorsed in 2021. The US, United Kingdom, New Zealand, Japan, Hong Kong and the EU are all moving ahead with measures to mandate reporting for listed companies on climate-related risks. The recently created International Sustainability Standards Board has also released draft International Financial Reporting Standards on Climate-related Disclosures, which builds on the recommendations of the TCFD. The message for insurers is that investors and regulators will expect increasing maturity and quality of disclosures.

## *Net-zero commitments*

Globally, more than 20 leading insurers representing 11%+ of world premium volume have committed to transition their insurance and reinsurance underwriting portfolios to net-zero emissions by 2050. Globally, 39 major insurance companies have adopted policies to no longer insure new coal projects and, in many cases, to phase out their cover for existing coal operations. Net-zero commitments are likely to drive underwriting standards for the market in future.

## *Looking ahead*

We can expect a more disaster-prone future, in which all companies will be under increasing pressure not only to adapt to climate change but also reduce emissions. Additionally ...

- Changing regulator, investor and consumer expectations of all companies to support the transition to a net-zero global economy is likely to continue. From an insurer perspective, this will continue to drive changes in reporting, disclosure and underwriting best practice.
- New technologies and new business practices to support net zero will present further challenges for insurers. These risks are unlikely to be manageable based on past experience alone. Insurers are likely to play a critical role enabling such projects, however ensuring robust underwriting and reasonable risk transfer will be important. 

**Climate risk management, adaptation and mitigation will be increasingly critical for insurers, customers, and regulators into the future – and is likely to require new capabilities and a broader range of partnerships.**

# Spotlight on cyber

**With technology increasingly embedded in our work and home lives, and the ease with which cybercrime tools and services can be accessed, cyber risks have extraordinary potential to damage any organisation. Yet cyber insurance remains in its infancy in Australia, with take-up of approximately 35-70% for larger businesses and only 20% for SMEs.**

## ***Why cyber risk is a major threat***

One of the main reasons cyber risk poses such a threat is that for many companies, cyber resilience is low, particularly for SMEs. This reflects the relative immaturity of the market, but progress is being made, with cyber top of mind for boards.

As their awareness and understanding grows, insurers are beginning to require commonsense measures

from potential insureds, ensuring they're accountable for basic protections. Companies that don't invest in protecting their data, systems and networks or training their staff on cyber security are at a greater risk of being victims of cybercrimes.

## ***Think of it as basic safety – would you leave your house unlocked?***

It's much like the protections expected in the more mature householders class. An insurer may hold a homeowner at fault if they failed to take precautions such as locking the front door – and that sounds perfectly reasonable to most of us. The 'basic' measures in cyber are really no different, but it will take time for the industry to reach a similar level of maturity – especially for smaller companies – of understanding, broad acceptance and consistency.

## ***Strengthening underwriting practices***

The rapid increase in cybercrimes over the past two years has resulted in increasing claims for cyber insurers. This has led to rising premiums and

There may also be issues in attributing the responsible party for a cyber event – especially if many players scattered around the world are involved.

reduced levels of cover being offered, although there are signs of emerging flexibility for the better risks. In response, some larger insurers have increased their broker assistance to customers and started to invest more time understanding and underwriting these risks.

As a result, in the past year underwriting practices have strengthened. Marsh, for instance, has introduced a cyber self-assessment offering, along with market comparison tools. This helps potential policyholders assess their maturity against international best-practice frameworks.

## ***Nuts and bolts of eligibility***

To gain cover in this way, organisations must undertake some straightforward safety measures. Two-factor authentication, for example, is often necessary. Recently, exclusions for not complying with mandated zero-day patching – where a vulnerability is disclosed on the same day the fix is released – have been introduced in some covers.

In other words, and to use the householders analogy, insurers are suggesting insureds close the door and add a couple of locks in these immature stages of cyber insurance, rather than bring in the national guard.

The increased focus on understanding cyber risks is a win-win – companies improve their cyber health and insurers experience fewer claims.

## ***Accumulation risks and acts of war***

With no geographical boundaries limiting where a cyber claim can arise, accumulation risk presents a key challenge for insurers. One area of contention is exclusions for war coverage. This is a standard exclusion for traditional insurance products where acts of war relate to physical property damage.

But in cyber, the distinctions are not so clear cut and there are examples of cyberattacks that have been sponsored by sovereign states. For example, the


Russian military were found by the United Kingdom's National Cyber Security Centre (NCSC) to have almost certainly been responsible for the NotPetya malware attack in 2017. Several indicators seen by the NCSC demonstrated a high level of planning, research and technical capability.

## ***Taking action to meet the challenges***

Lloyd's recently announced it will require all standalone cyberattack policies to contain clauses excluding losses arising from state-backed cyberattacks from March 2023. This could create a situation where some cyber losses will not be covered, risking devastating financial loss and reputational damage.

Importantly, no government reinsurance pool in cyber exists – as it does in commercial property, through the ARPC (Australian Reinsurance Pool Corporation) – to mop up excluded losses due to terrorism catastrophe or acts of war. There may also be issues in attributing the responsible party for a cyber event – especially if many players scattered around the world are involved – which could flow on to delays in the initial handling of claims. This uncertainty highlights one of the additional deterrents to the uptake of cyber insurance, on top of price and cover availability.

Another key impediment for insurers – lack of available data – will be partly addressed through the recent collection of cyber insurance industry data by APRA, expected to be released during 2023.

It's clear the challenges are substantial and cyber insurance is in its infancy, but there is no doubt in time it will be integral in providing security in our daily lives. 

**With no geographical boundaries limiting where a cyber claim can arise, accumulation risk presents a key challenge for insurers.**



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