Insurance Market Update

Overview

The New Zealand insurance market continued to firm during 2019 and into early 2020, with premium increases common across most classes. In the case of property, increases were accompanied by restrictions in capacity for locations in higher risk earthquake zones, with Wellington most severely impacted. As we approach the end of the second quarter 2020, premium increases are slowing, and in particular ND rates. The liability market has also experienced challenging times with directors and officers insurance particularly affected by rising costs associated with a more litigious class action environment.

The COVID-19 pandemic is presenting significant challenges for the economy and while insurance policies generally contain infectious disease or pandemic exclusions, there are some types of policies that provide coverage. Globally indications of losses from COVID-19 are in excess of US$101billion. In New Zealand insurers largely excluded cover for infectious diseases so impact locally is forecast to be relatively minor.

There is also an expectation that many businesses may look to reduce their insurance spend as part of their overall expenditure reduction efforts in coming months. This could place pressure on insurers results. We will be monitoring this situation closely and will update our market forecasts as required.

Market Update Sections

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Property - New Zealand market

Natural Disaster

The past two years has seen New Zealand insurers move to technical ratings for properties in high earthquake risk regions, particularly Wellington. This has resulted in significant premium increases and in some cases, while cover may be available, the cost is prohibitive with insureds electing to carry a percentage of risk themselves.

Early signs for 2020 are that most insurers are approaching their technical premium rates for natural disaster and in some cases, premium changes may be restricted to valuation increases only. However there remains a number of accounts that are yet to reach their full technical rate and these can expect higher than average premium corrections. Natural disaster capacity in the Wellington region remains extremely tight however we are now seeing insurers providing capacity for existing clients where values have increased. Those seeking to source alternative pricing or capacity may struggle to generate interest.

To achieve better outcomes for both cover and price, it is important that insurers are provided with comprehensive risk information, up to date valuations, engineering reports, geotechnical reports and other information including land composition and building strengthening work and improvements are all very useful.

Food sector

In addition to the seismic issues detailed above, insurers continue to look closely at risks where there have been significant global losses. This includes EPS (expanded polystyrene sandwich) type paneling, largely used in the primary and food processing sector. Local insurers' appetite for these types of risks decreased significantly following a series of losses in Europe, the USA and Australia during 2018 and 2019. Total losses to insurers for these events exceed USD500m. There continues to be a shortfall in the New Zealand insurance market for these types of risks and companies with significant assets to insure need to obtain options from overseas markets; many of whom are already wary of EPS risks. Chinese insurers are an emerging option for some, depending on the ownership structure of the company.

Emerging risks

Insurers are cautious when considering properties with higher risk building materials, such as aluminium composite paneling, used to clad certain commercial buildings. Insureds need to be able to prove the panels are fire resistant when seeking cover to avoid punitive insurer terms and conditions.

Insurers are also focusing on climate change and its impact on risk profiles. We are seeing insurers looking very closely at regions and areas susceptible to flood or sea inundation and imposing underwriting discipline when considering risks in these categories.

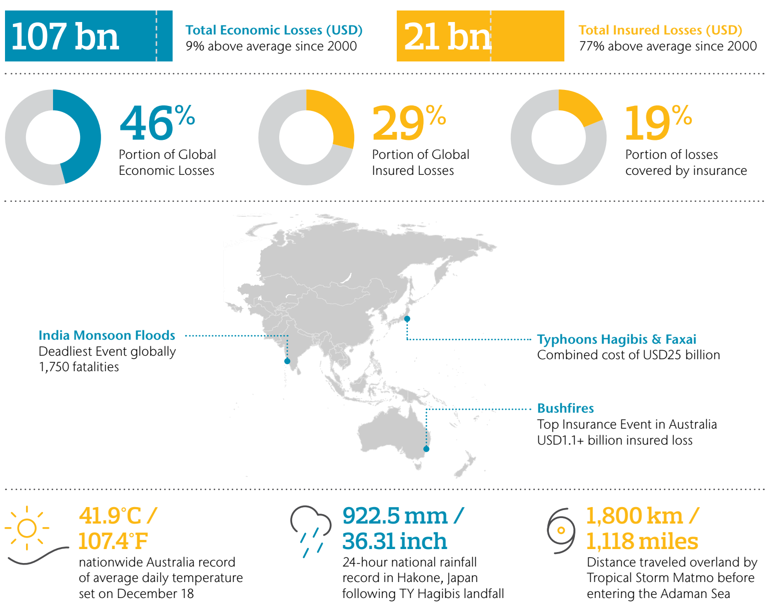
Impact of Coronavirus (COVID-19)

The impact on property and business interruption (BI) insurance from the COVID-19 outbreak is relatively light with the majority of policies excluding losses where no physical loss occurred or via the application of blanket infectious disease exclusions.

Regulatory

Options for the future funding of Fire and Emergency New Zealand continue to be explored. Submissions on possible funding mechanisms including removing the levy from property (or fire) insurance have closed. Officials are reviewing submissions and we await further details. No changes are expected to be in force until July 2022.

Top 5 Most Signficant Events in APAC (Asia & Oceania)



Source: Weather, Climate & Catastrophe Insight 2019 Annual Report | Aon plc 2020

Property - Global markets

The global property insurance market continues to be strongly influenced by losses arising from natural disaster events. Significant losses over the past decade have eroded underwriting profits and when coupled with low investment returns, there is now a strong focus on disciplined underwriting. High quality risk data is required in order to obtain terms. Presentations to underwriters in London, Singapore and other overseas markets are affected by the COVID-19 outbreak with many now being conducted remotely via web conferencing rather than in person. We continue to monitor this position and will keep affected clients updated as the situation evolves.

Natural Disaster Losses

Direct economic losses and damage from natural disasters in 2019 were estimated at USD232 billion. This was reduced from elevated levels in 2016, 2017 and 2018. In terms of economic losses resulting solely from weather disasters, the global total was USD299 billion. 2019 was the 8th costliest year in terms of weather-related natural disasters after adjusting for inflation.

2019: Major humanitarian impacts; manageable financial costs

Economic losses
USD232 billion
3% below average (21st Century)

Insured losses
USD71 billion
6% above average (21st Century)

Two costliest insurance events occurred in Japan

409
total natural disaster events

51%
of **global insured losses** were recorded in the United States

69%
global protection gap

41
billion-dollar economic loss events

12
billion-dollar insured loss events

10+ million hectares
Area burned by wildfires in Russia

18.6+ million hectares
Area burned by wildfires in Australia

1,750
fatalities from the Indian monsoon floods – the deadliest disaster of 2019

2 million people
displaced in Africa following Cyclones Idai & Kenneth

185 mph
(295 kph)
Hurricane Dorian landfall in The Bahamas; tied with the 1935 Labor Day Hurricane as the strongest landfalling storm on record in the Atlantic Ocean

+0.95°C (1.71°F)
Above the 20th Century Average
Second warmest year on record for land & ocean temperatures since 1851

New all-time temperature record set
46.0°C (114.8°F) in France
42.6°C (108.7°F) in Germany

15.71 inches
(399 millimeters)
Wettest January to May U.S. rainfall average on record since 1895

Source: Weather, Climate & Catastrophe Insight 2019 Annual Report | Aon plc 2020

The last decade has featured record-breaking instances of each individual peril including earthquakes, tsunamis, tropical cyclones, severe convective storms, inland flooding, wildfires, drought and extreme heat and cold.

Many countries globally, including New Zealand, registered an event that resulted in their costliest economic natural disasters on record. The economic costs were almost certainly enhanced by a combination of more intense weather events, increased vulnerable exposure and population in the path of the event, and elevated direct business interruption impacts due to a greater supply chain dependency within the globalised economy.

Record economic losses also equated to record payouts by the re/insurance industry. In APAC, the top 10 insured loss events (USD120 billion) accounted for 61 percent of the region’s entire decade total.

Liability

The liability insurance market remains relatively stable, notwithstanding a reduction in capacity in certain poorer performing classes. The increasing spectre of litigation funded class actions is a cause of concern to insurers, especially those underwriting directors and officers liability for listed companies. Insurers and reinsurers continue to exhibit a strict technical approach towards rating and retention levels. The general liability insurance market remains competitive, with several insurers actively seeking to grow their portfolios.

Professional Indemnity

The professional indemnity insurance market continues to show signs of hardening, especially for some professions such as design, construction and lawyers. This is due to increased claims activity and a reduction of capacity, especially amongst Lloyd's syndicates following the thematic review of poorer performing classes and syndicates. The withdrawal of several markets and reduction in approved capacity for several more has led to a reduction in international professional indemnity capacity of more than $200M over the last three years.

In addition, aspects of cover are being reviewed and new exclusions applied in some policies such as defective building product / aluminium composite panels (ACP) exclusions in the design/construction sector. Increased self-insured retentions are also being imposed for larger risks.

The local market continues to focus primarily on account retention and we have seen a shift in focus from some insurers from corporate to small and medium-sized enterprises (SME) accounts with bundled liability packages offering lower policy limits. Ongoing regulatory scrutiny and investigations from the likes of the Financial Markets Authority (FMA), Commerce Commission and Real Estate Authority (REA), continues to place some industries such as fund managers, financial advisers and real estate agents on insurers' watch lists.

Statutory Liability

Statutory Liability insurance market has continued to harden due to the continuation of higher defence costs and reparation orders under the Health and Safety at Work Act 2015. The starting point for reparation orders is between $80,000 and $250,000 (dependent on the injury) and for severe life-changing injuries Courts are now including the 20% of victims' wages which is not covered by ACC as part of the Reparation Order. Consequently, insurers are requiring premium increases and depending on the industry and/or claims history a higher Excess is being applied for breaches of the Health & Safety at Work Act.

Directors and Officers Liability

The Directors and Officers Liability insurance ("D&O") marketplace has transitioned from an actively competitive environment with an abundance of capacity to a cautious environment with reduced capacity, reduced risk appetite and increased premiums.

For publicly listed companies, Aon has recently seen year-on-year premium increases of ~30% to ~100% whilst non-listed companies are experiencing less of a premium increase as noted in Aon's Global Directors & Officers Liability Review (attached in Appendix A.).

The upwards pressure on premiums is fuelled by a number of drivers:

- Aggressive pricing strategies – over a number of years – from providers of Directors and Officers Liability insurance;
- Ongoing regulatory scrutiny and investigations, from the likes of the Financial Markets Authority and the Commerce Commission; and
- Significant increases in securities class action claims activity initiated by litigation funders.

The New Zealand Directors & Officers Liability insurance market has been severally impacted by the evolving nature of the class action environment in New Zealand as evidenced by the:

- judgment against the Directors of Mainzeal, and the subsequent appeal;
- landmark decision to allow the Southern Response class action proceedings to be brought on an "opt out" basis;
- announcement that class actions were being commenced against CBL (company and directors) and Intueri (directors); and
- announcement in respect of a New Zealand class action, regarding building cladding panelling, being initiated by IMF Bentham and Russell McVeagh.

As a result of Australian claims activity and the change in legal environment within New Zealand:

- A number of insurers have withdrawn completely from the D&O market both locally and in London. Most significantly, Allianz Global Corporate & Specialty withdrew from the Australasian liability market in September 2019;
- Locally, insurers are becoming more selective in terms of individual accounts they wish to continue to underwrite and on what premium/policy terms and conditions. In some cases it is a "take it or leave it attitude" with insurers willing to walk away from accounts;
- Insurers continue to reduce the level of capacity that they are willing to provide and it has become common place that maximum Limits of $15m to $20m are provided;

- Affirmative Cyber Endorsements are now being introduced on some D&O wordings to clarify the coverage provided and to enable insurers to manage their aggregated Limits if D&O and Cyber insurance are both purchased; and
- Lloyd's continues to scrutinise poor performing syndicates as they focus on a return to profitability.

Pre-COVID-19, D&O insurers were focusing on the Environment, Sustainability and Governance ("ESG") as the new emerging risk with publicly listed entities being encouraged to disclose to the market:

- their governance arrangements around how they will manage climate-related risks and opportunities, regardless of the materiality of that information; and
- the actual and potential impacts of climate-related risks and opportunities on their business.

This has now been surpassed by global pandemic, COVID-19. It is an anxious time for all businesses and their directors, officers & management coping with the COVID-19 pandemic. Outside New Zealand and well before the global COVID-19 pandemic, there has been a range of "event-driven" D&O claims arising from the likes of cyber incidents, bush fires and the #metoo movement. Climate-change related D&O claims have also started to appear. In the United States, already a number of COVID-19 class actions have been filed against the cruise line industry and pharmaceutical companies.

The risk exposure of companies with subsidiaries in overseas jurisdictions, are being reassessed due to D&O insurers heightened concern regarding the potential for Employment Practices Liability class actions. This is as a result of the #metoo movement and the Fair Labor Act in the United States.

To date, there has not yet been this type of "event driven" claim made against directors, officers or managers in New Zealand. However, given the current backdrop noted above, D&O insurers are now anticipating D&O claims arising from the COVID-19 pandemic with regard to the management (or perceived mismanagement) of a company through the unprecedented uncertainty and/or the financial failure of the company.

Whilst the Australian Government has for a period of six months from 26 May 2020 relaxed the liability threshold for assessing the materiality of information to be disclosed to the market from a "reasonable person" test to one of "knowledge, recklessness or negligence" (civil proceedings). New Zealand's Financial Markets Authority has not followed suit as it believes that New Zealand's current legislative settings and the manner in which they are applied, remain appropriate for the COVID-19 environment.

Q2 saw the continued trend of significant premium increases together with increased Excesses and reduced capacity. In addition, a number of insurers have announced that they are not considering any new directors & officers liability policies or offering higher Limit options, thus allowing holding insurers to price their capacity accordingly. We do note that a couple of insurers are "still open for business" and they are seeing this as an opportunity to cherry pick accounts.

Detailed below are the overall pre-COVID-19 trends being experienced in the Australian and New Zealand directors and officers liability insurance market for listed and non-listed companies.

	Australia and New Zealand - Listed Companies				Australia and New Zealand - Non Listed Companies			
Overall Trends	Retentions	Capacity	Insurer Attitudes	Coverage	Retentions	Capacity	Insurer Attitudes	Coverage
Energy	Increasing	Tightening	Prudent	Stable	Increasing	Tightening	Prudent	Stable
Construction	Increasing	Tightening	Prudent	Stable	Increasing	Ample	Prudent	Stable
Power	Increasing	Tightening	Prudent	Stable	Increasing	Tightening	Prudent	Stable
Financial Institutions	Increasing	Tightening	Prudent	Stable	Increasing	Ample	Prudent	Stable
Marine	Increasing	Tightening	Prudent	Stable	Flat	Ample	Flexible	Stable
Aviation & Aerospace	Increasing	Tightening	Prudent	Stable	Flat	Ample	Flexible	Stable
Food, Agribusiness & Beverage	Increasing	Tightening	Prudent	Stable	Flat	Ample	Flexible	Stable
Pharma & Life Science	Increasing	Tightening	Prudent	Stable	Increasing	Tightening	Prudent	Stable
Communication, Technology & Media	Increasing	Tightening	Prudent	Stable	Flat	Ample	Flexible	Stable
Healthcare	Increasing	Tightening	Prudent	Stable	Increasing	Tightening	Prudent	Stable
Retail / Wholesale Trade	Increasing	Tightening	Prudent	Stable	Flat	Ample	Flexible	Stable

Source: Directors and Officers Report | Aon plc 2019

Cyber

Cyber insurance is a continually evolving market with active interest and involvement from most New Zealand insurers. There continues to be significant media attention around privacy breaches, ransomware attacks, the importance of data protection and the reality that all businesses are potential targets for sophisticated, organised criminal gangs as well as independent opportunists. Cyber risk remains in the top three items of any risk survey. Many countries have, or will be introducing, more onerous laws to protect the privacy of their citizens as well as increasing transparency requirements in respect to how organisations manage serious data breaches. The most recent being the California Consumer Privacy Act. The EU enacted the General Data Protection Regulation (GDPR), while Australia has amended its Privacy Act. Both have extra-territorial jurisdiction for those businesses whose data processing activities are related to the offering of goods and services in those territories or where the personal information is collected in those territories.

New Zealand's Privacy Act controls how agencies collect, use, disclose, store and give access to personal information. The Privacy Bill report recommendations will bring New Zealand more in line with other countries who have adopted more onerous legislation. This is expected to be enacted during the current parliamentary term.

Premium rates for cyber are relatively flat as competition and capacity remains strong however, more dominant cyber insurers are looking closely at previous rating and looking to make rate changes where they deem necessary.

Trade Credit

The impact of COVID-19 on credit insurers has been significant with many insurers expecting a sharp increase in payment defaults, repayment plans and insolvency claims in the coming months due to many businesses faced with unprecedented supply chain disruption and reduced demand. Consequently, most insurers will be reducing exposure in industries directly impacted by COVID-19 – e.g. Airlines, Transport, Travel ,Retail, Fuel, Construction, Education, Mining etc. . This will affect domestic and export trade.

For exporters, there are additional challenges from trade disruption and getting goods to market. Some insurers have temporarily suspended cover in affected countries due to border restrictions and port closures. Where cover has been reduced or removed, we are seeking top up cover (reinsurance) through the New Zealand Export Credit Office.

Premium rate increases are being applied across all policies, estimated at 10-15%. The increased risk and reduced capacity has meant insurers have little appetite for new business. Some new cover has been considered in essential service sectors, primarily food and beverages, pharmaceuticals, technology, logistics/ transport, agriculture.

Construction

The construction insurance market continues to tighten. Many overseas insurers have closed or reduced their contract works teams, accordingly their appetite for business is also reduced. Locally, insurers have maintained their presence, including Allianz who shut down all other New Zealand general insurance operations. All insurers require comprehensive information in order to understand key risks, for instance earthquake resilience or flood protection.

Current market conditions mean there are restrictions in cover, particularly regarding defects, and sublimits and other extensions are under scrutiny. Excesses are also increasing, particularly for larger projects where minimum deductibles will apply.

Recent large losses mean there will be a greater focus on hot work procedures and permits. Hot work policy conditions will be applied and these need to be understood and followed in order to preserve cover.

In the construction liability insurance segment, public liability rates are rising, and minimum excesses are being applied. The bigger focus is on products and in particular, where these are procured from as well as the quality assurance process. Defective product cover is becoming extremely restrictive, and there will likely be further application of non-conforming product exclusions.

Professional indemnity is one of the hardest hit classes of insurance following the Lloyd's thematic review with construction project professional indemnity significantly affected. Many insurers have completely withdrawn from underwriting these risks, with some syndicates closing up permanently. Locally, our markets for Professional Indemnity are being more selective of the risks they underwrite for project specific Professional Indemnity; however, we continue to be able to place cover.

Motor Vehicle

Motor insurance premiums, along with policy excesses stabilised during 2019 and in some cases profitable fleets were rewarded with modest reductions in premium. However, motor insurers remain cautious particularly as the volume of vehicles on the roads continues to increase as does the sophistication of technology contained within vehicles has the potential to force up claims costs.

Heavy motor fleets continue to face challenges with a restricted appetite from insurers. Fleet risk management, including driver training and driver monitoring devices remain key tools to offset premiums increases and reduce claims. Managed funds continue to be an option for larger fleets.

Aviation

Insurers had hoped that 2019 would return the aviation insurance market to profit, but even with increased premiums achieved on all classes of business, it was once again a loss-making year. Traditionally losses that occur with airline placements are mitigated by other aviation sectors such as general aviation and products liability, but in 2019 these sectors also incurred significant losses.

Looking ahead, commentators are forecasting the hardening market to continue. Human error, rising repair costs and an increase in ground incidents are just some of the main factors influencing loss activity. 2019 is being reported as being one of the safest years historically for commercial aviation but, whilst the number of fatalities has decreased, the number of accidents and value of losses has increased.

Industry results are putting pressure on insurers to look for changes to their terms and rates. Insurance capacity for aviation continues to reduce as markets withdraw or reduce their maximum capacity. Finding alternatives will be paramount, and the increasing pricing may entice new entrants.

Aon are working on developing new markets and have recently added a new UAV insurer to the mix and expect to add another MGA who has significant capacity in the general aviation sector.

Market Withdrawals

2017/18

- Aegis
- Allied World Europe
- Arch
- Ark
- Argo
- Ascot
- Canopius
- Channel
- Generali*
- Hardy
- HDFC Ergo
- Markel
- Navigators

2019/20

- AmTrust
- Aspen
- Brit
- Hiscox
- Ortac
- WR Berkley
- Swissre
- Amlin
- Asia Capital Re

4th
Safest year ever

11
Fatal accidents

24
Total losses

23
Airlines ceased operations

Emerging Risks

Aon continues to monitor emerging risks and potential impacts in the insurance sector. Areas currently being assessed include:

- Drones, robotics and artificial intelligence
- Sharing economy
- Big data losses
- Cyber terrorism
- Non-damage business interruption
- Climate change
- Foodborne illnesses
- Catastrophic infectious diseases
- Liability risk for wildfires
- Autonomous vehicles and plant
- Natural catastrophe coverage gaps
- Carrier corporate responsibility initiatives

Marine

The global marine insurance market continued to harden in 2019 as a result of poor portfolio performance in several marine classes at Lloyd's. This resulted in an overall reduction in capacity (13 insurer withdrawals over the past 24 months) across all products along with a combination of rate increases, stricter underwriting criteria and restricted cover. Aon continues to have access to markets across all product lines to provide support should the local market be unable to do so.

Locally, marine insurers have felt the global impacts which has meant some classes of business have been subject to market pressures whereas others remain competitive. 2020 is likely to follow the path set in 2019 and insurers will put more emphasis on understanding clients' risk management strategies evidenced via the quality of submissions. At the start of 2020, Allianz announced the closure of their marine and transit division in New Zealand.

Cargo

In New Zealand, the cargo market remained relatively competitive in 2019 with most marine insurers showing interest in portfolio growth in this class. There has been a continued appetite to co-insure risks with support being received from several insurers. Globally, the cargo market is under more pressure with 2020 rate increases estimated at 15-20% which may impact local markets during the year. Challenges continue to persist for static risk cover, especially with EPS risks being severely restricted in the property market. In 2020, we anticipate incremental general rate increases and an increased focus on underwriter submissions.

Commercial Hull

Commercial hull is one of the poorest performing classes of business both at Lloyd's and indeed globally. In 2019, there was a large reduction in available capacity which is being felt by local insurers via their reinsurance arrangements. Local insurers are cautious in their approach to new business but continue to be supportive on renewals. A focus on vessel risk management is key to ensuring a successful renewal as both working losses and large claims erode insurers profitability. We will monitor this closely as 2020 progresses.

P&I

The P&I market remained steady and stable across all clubs in 2019 and should continue to do so in 2020. All clubs announced their general increases leading into the new year of up to 5% to ensure their reserves do not require additional calls. All clubs remain wary of risks involving US nationals following continued high value claims. Aon's London P&I team are market leaders and are a proven resource to provide solutions when approached.

Marine Liability (Ship Repairers and Marina Operators)

In 2019, insurers remained open to writing marine liabilities with a greater focus on risk information and clients implementing robust terms and conditions. Given the right underwriting information, insurers locally and across the Pacific are willing to write new business and remain very supportive on renewing business. These classes of business may experience small market increases in 2020 but we do not anticipate much change.

Pleasure Craft

Along with commercial hull, pleasure craft continued to be one of the worst performing classes of business in 2019 amongst Lloyds syndicates. Catastrophic losses globally have severely impacted underwriter portfolio performance with many insurers withdrawing from the class. Locally, our core insurers continue to write business but subject to stricter underwriting criteria and a key focus on vessel condition and surveys being made available for new business. This will become the new norm for clients seeking alternative quotes in the market.

Aon have invested in a new global lead for yacht business in London to focus on this class of business. This should have a positive impact on our global underwriting relationships and provide options in the future for exotic risks (superyachts, racing yachts and the like).

Contact us

Aon has teams dedicated to each of these sectors that are available to discuss and consult with you, where your organisation has a specific interest in any of these areas.

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