Insurance Market Update

Overview

The New Zealand insurance market continued to firm over the last quarter of 2018, with premium increases common across all classes. In the case of the property segment, increases are accompanied by restrictions in capacity for locations in higher risk earthquake zones. We are yet to see any relief for property owners in the more active seismic zones. Rising costs from New Zealand earthquakes and losses in the US have put further pressure on reinsurance pricing, which has flowed into the New Zealand insurance market.

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Property - New Zealand market

Natural Disaster

New Zealand markets suffered significant losses from both the Canterbury ($23 billion) and Kaikoura ($3 billion) earthquake events. Following the Kaikoura earthquake in November 2016, most insurers in New Zealand placed an embargo on accepting new property risks or increases to sums insured for risks in the Wellington and Marlborough regions. These embargos remain in place with some insurers, more than two years after the event. Others, while not applying a strict embargo, will not offer additional capacity for Wellington area risks. This capacity squeeze has further tightened in recent times with some insurers significantly reducing their natural disaster exposure to the Wellington and other seismically active regions. This is resulting in premium increases for most and increases in excess levels for some.

In other parts of New Zealand, the impact is varied and is dependent on location, construction, age and the New Building Standard (NBS) rating of the property. The Auckland and Waikato regions, which are both classed as low seismic zones, can expect nil to minimal increases.

Insurers continue to require comprehensive information when assessing risks. This generally includes such items as building valuations, engineering and geotechnical reports (depending on location), risk management reports, council data, NBS rating, underlying land structure and status reports on any building improvement or strengthening notices issued by a local authority.

Obtaining natural disaster cover for earthquake prone buildings and buildings noted as at risk by councils, remains difficult and expensive.

Food sector

In addition to the seismic issues raised above, insurers are also looking closely at certain types of risks where there have been recent significant global losses. One specific area which is impacting New Zealand companies is the insurance of EPS (expanded polystyrene sandwich) type paneling, largely used in the primary and food processing sector. Local insurers' appetite for these types of risks has decreased significantly following a series of losses in Australia during 2018, including one single fire where total insured losses exceeded AU$400 million. This particular incident involved a meat processor which suffered a significant fire following a hot work incident involving a third party contractor. As a direct result of this loss IAG (NZI), previously the largest insurer of EPS in New Zealand, has actively sought to reduce their exposure to EPS risks and impose significant premium increases across Australia and New Zealand. It's clear there is now a shortfall in the New Zealand insurance market capacity for these types of risks and options need to be obtained from overseas markets; some of whom are already wary of EPS risks. Chinese insurers are an emerging option for some, depending on risk ownership.

Emerging risks

Insurers are cautious when underwriting properties with other higher risk building materials, such as aluminium composite paneling, used on the exterior of buildings. Some of these panel products have a core of highly flammable polyethylene (refer to the Grenfell fire in the UK) which attracts 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.

Regulatory

The Fire and Emergency New Zealand Act brought significant change to the NZ Fire Service. The legislation repealed the two Acts that previously governed fire services in New Zealand and introduced a single New Zealand fire service called Fire and Emergency New Zealand or FENZ. The cost of the changes is being passed on to individuals and companies who buy insurance, and the impact is significant. As part of the transition to the new regime, the Government increased the Fire Service Levy rate by 40% from 1 July 2017. Further changes scheduled to be introduced from 1 July 2020 have now been placed on hold and the government has instead announced another review on future funding options for FENZ, including removing it from property insurance. We continue to monitor the situation and will provide further updates.

Property - Global markets

Overseas insurers/reinsurers continue to be impacted by major catastrophe events and the diagrams and charts below provide a graphic snapshot. Insurance today operates in a global market and the impact of these global events on the New Zealand insurance market should not be underestimated.

USD 225 billion
Economic cost of natural disasters in 2018

USD 90 billion
Insured cost of natural disasters in 2018 – 4th costliest year on record

USD 215 billion
Economic cost of weather disasters in 2018

USD 89 billion
Insured cost of weather disasters in 2018 – 4th costliest year on record

155 MPH
Landfall **wind speed** of Hurricane Michael in Florida; Fourth strongest U.S. Mainland landfall on record

USD 653 billion
2017 & 2018: Costliest back-to-back years for **weather disasters** on record

42 billion-dollar natural disasters
in 2018

USD 15 billion
Combined insured losses from Japan typhoon, flood, and earthquake events

USD 237 billion
2017 & 2018: Costliest back-to-back years for **public and private insurers** on record

USD 595 billion
Amount of available **global reinsurance capital**, making the industry well-equipped to handle consecutive high-cost natural catastrophe years

Fourth warmest year
on record dating to 1880 for combined **land** and **ocean temperatures**

394
Individual events

64%
of 2018 **global insured losses** incurred in the United States

35.93 (912.6 mm):
Maximum rainfall total from Hurricane Florence in North Carolina

USD2.1 billion
Insured cost from Windstorm Friederike; **Fifth-costliest European windstorm** of the 21st Century

1.82 million
Acres burned from wildfires in California; Highest on record in the state

Source: Aon, Weather, Climate & Catastrophe Insight, 2018 Annual Report

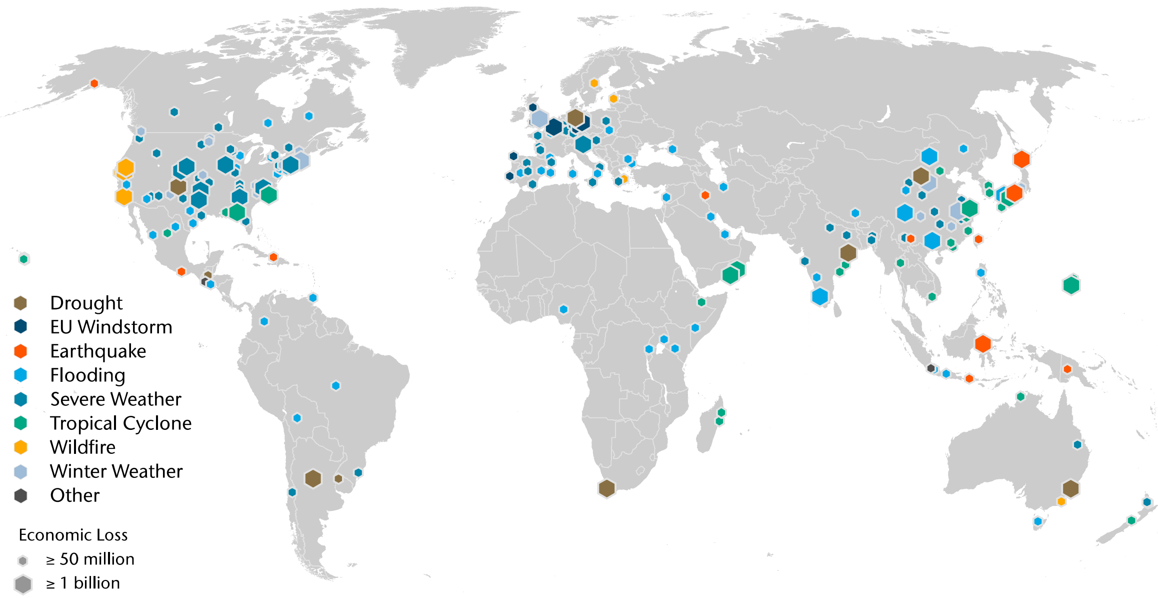
Economic losses from natural disasters in 2018 were significantly diminished from the major losses incurred in 2017. However, the USD225 billion total marked the third consecutive year of catastrophe losses surpassing the USD200 billion threshold and was the 10th time since 2000.

2018 Natural Disaster Events and Loss Trends

Top 10 Global Economic Loss Events

Date(s)	Event	Location	Deaths	Economic Loss (USD)	Insured Loss (USD)
October 10-12	Hurricane Michael	United States	32	17.0 billion	10.0 billion
September 13-18	Hurricane Florence	United States	53	15.0 billion	5.3 billion
November	Camp Fire	United States	88	15.0 billion	12.0 billion
September 4-5	Typhoon Jebi	Japan	17	13.0 billion	8.5 billion
July 2-8	Flooding	Japan	246	10.0 billion	2.7 billion
Spring & Summer	Drought	Central & Northern Europe	N/A	9.0 billion	0.3 billion
September 10-18	Typhoon Mangkhut	Oceania, East Asia	161	6.0 billion	1.3 billion
July – September	Flooding	China	89	5.8 billion	0.4 billion
November	Woolsey Fire	United States	3	5.8 billion	4.5 billion
August 16-19	Tropical Storm Rumbia	China	53	5.4 billion	0.3 billion
			All Other Events	123 billion	45 billion
			Totals	**225 billion**[1]	**90 billion**[1,2]

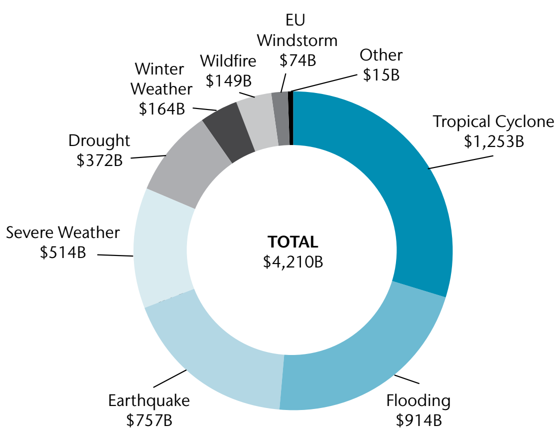
Significant 2018 Economic Loss Events



Additional major events during the year included the deadliest and most destructive wildfire ever recorded in California. This is the second year in a row that California set a new record for wildfires. October's Camp Fire destroyed 18,804 structures alone, including most of the city of Paradise. Total economic costs were estimated to approach USD15 billion. In Japan, torrential rains during the month of July led to catastrophic flooding across much of the country with total damage nearing USD10 billion. Another multi-billion-dollar flood occurred in India's state of Kerala during the seasonal summer monsoon months.

There were 42 individual billion-dollar natural disaster events in 2018, which was above the average of 31 events dating to 2000 and higher than the 36 events that occurred in 2017. Asia Pacific led with 17 events, which was the most in the region since 2013 (19). The United States was second with 16 individual events; slightly less than the 20 in 2017. EMEA had 8 events and the Americas had 1.

Aggregate Economic Loss by Peril since 2000



Source: Aon

AON

Liability

The Liability insurance market remains relatively stable. 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 is showing signs of "hardening", especially for some professions such as design/construction and lawyers, due to increased claims activity and a reduction of capacity, especially amongst Lloyd's syndicates following a thematic review of poorer performing classes and syndicates. Lloyd's has experienced increased claims (frequency and severity) over the last two years. Locally, insurers are becoming more selective in terms of individual accounts and classes they wish to continue to underwrite and on what premium/policy terms and conditions. The focus for most is retention of their quality accounts and the gap (perceived or real) between renewal and new business rates has disappeared. Ongoing regulatory scrutiny and investigations, from the likes of the FMA and Commerce Commission, continues to place some industries such as fund managers, financial advisers and real estate agents on insurers' watch lists. New legislation for Anti-Money Laundering has come into effect for lawyers, accountants and real estate agents. Insurers are adopting different approaches to providing affirmative cover under either professional indemnity and/or statutory liability policies.

Directors and Officers Liability

As a result of the Mainzeal Judgment, the spotlight is once again on corporate governance and Directors & Officers Liability insurance. The recent judgment in the High Court found that four Mainzeal directors had breached their statutory and fiduciary duties under s135 (Reckless Trading) of the Companies Act 1993. Mainzeal's failure cost subcontractors over $45 million and, overall, creditors lost about $115 million. Mainzeal went into liquidation in 2013, having purchased a Directors & Officers Liability insurance policy with a $20 million limit of liability. Out of the total compensation of $36 million, three directors (Dame Jenny Shipley, Peter Gomm and Clive Tilby) were ordered to pay $6 million each and Richard Yan (founder of Mainzeal's parent, Richina Pacific) ordered to pay $18 million. In the event the other directors cannot pay, then Yan is liable for the entire $36 million. The judgment was delivered on 26 February this year and it raises questions about the adequacy of policy limits, including defence costs. The judgment is being appealed and the market awaits the next decision with great interest.

Insurers of dual market listed companies continue to restrict their exposure through the application of low limits while the premiums continue to increase due to securities class actions. Local insurers have limited appetite for providing company entity cover however London markets remain an option. For NZX listed companies, insurers / reinsurers continue to scrutinise placements as they wish to review their underwriting to ensure that the New Zealand Directors and Officers Liability insurance market does not have the same exposure and outcomes.

Statutory Liability

Statutory Liability insurers continue to experience higher defence costs and reparation orders under the Health and Safety at Work Act 2015. The starting point for reparation orders is now between $80,000 and $250,000 (dependent on the injury) and defence costs in a serious Health and Safety at Work claim have doubled from what they were four years ago. Consequently, Statutory Liability insurers are requiring premium increases and depending on the industry and/or claims history a higher Excess to apply for breaches of the Health & Safety at Work Act.

Cyber

Cyber insurance is an evolving market with active interest and involvement from majority of New Zealand insurers. There continues to be significant media attention around privacy breaches, data protection and all businesses being targets from sophisticated, organised criminal gangs to independent opportunists. Cyber risk continues to appear in the top 3 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 EU has now enacted the new 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 would bring New Zealand more in line with other countries who have adopted more onerous legislation.

Premium rates for cyber are relatively flat, however insurers are looking for increases or hinting that increases are on the way.

Motor Vehicle

Motor insurance premiums, along with policy excesses, increased during 2018 but early indications suggest that they are now stabilising as insurers' motor portfolios slowly return to profit once again.

However, the motor insurance market continues to face escalating claims costs due to an increasing number of vehicles on the road and a resultant increase in claims frequency and severity. The average repair cost for newer vehicles is much higher than older vehicles due to the materials used in their manufacture and, in particular, the increasing use of expensive in-vehicle technology. This includes such things as sensors, cameras and automatic braking radar. These items are largely located on the periphery of vehicles, exposing them to damage in an accident. Electronics currently account for 25 percent of a vehicle's value and this is estimated to soon reach 40 percent. Additionally, labour costs from motor repairers are increasing due to the added skill and time needed to accommodate the complexities of this in-vehicle technology, the new types of materials being used and to reinstate electronic control and safety systems.

In respect of heavy motor, insurers are becoming more cautious and requiring premiums commensurate with claims experience and exposure, although options are available to mitigate these increases. Fleet risk management, including driver training and the installation of driver monitoring devices, are key tools to offset increases and improve claims outturn. For very large fleets, managed fund options should be explored.

Aviation

The aviation market hardened further during the fourth quarter of 2018 with attritional losses continuing to erode insurer profitability. For renewals, underwriters are focused on their exposures and capacity participation, leading to technical rates being offered that are influenced by management as they seek to return to an underwriting profit.

Capacity levels have contracted notably in recent months due to the large number of markets in the aviation class reducing with withdrawals, either completely or for selected lines (i.e. out of GA or aircraft manufacturing), and insurer consolidation through acquisitions and mergers. This has led to reductions in line size participation and a reduced appetite for considering new business.

In London, Lloyds markets are exerting significant pressure on individual syndicates to improve their results or cease trading. This has led to underwriters looking to reduce their exposure with little or no negotiation flexibility to gain or retain business. A similar theme is occurring across Australian and Singapore markets, however, we have had greater success with negotiating acceptable terms while balancing their shareholder demands.

Any factor such as hazardous uses, low time pilots or incurred claims is enough to cause significant rate and conditions adjustments. Quality information made available to the market early is a must and we expect this hard market trend to continue for at least another 12 months.

Contract Works

Contract Works insurers are experiencing similar pressures to those faced by the property insurance market. Insurers are seeking increased rates while also reducing capacity for certain risks such as wet civil works and, regionally, where there is an exposure to natural disasters and in particular earthquake. Wellington is particularly challenging at present given the value of construction projects in the pipeline. We are also seeing a retraction in additional covers being offered and restrictions to some coverage lines. The market is also reviewing excess levels and this often results in increased excesses being applied.

Yet another factor to consider is the insurance of the finished project upon completion and this can be challenging. If the asset is located in Wellington or another seismically exposed region, it is recommended that insurance capacity for the completed project is reserved at the commencement of construction in order to ensure placement is possible. With this in mind, some markets are using property insurance criteria when underwriting construction risks and will be influenced by whether they wish to insure the finished building. If it does not fit their property risk appetite, then they may be reluctant to provide terms for the construction risk or will consider it but with higher than usual premiums and more restrictive terms.

We recommend you engage your broker early in the project planning stage to ensure any potential insurance issues are addressed.

Marine

The effect of a string of losses and poor financial performance at Lloyd's is having a wide-reaching impact on marine insurance globally, with a number of syndicates withdrawing capacity or simply restricting their offering with revised business plans that do not allow for substantial growth. Locally there remains a number of marine insurers, however the competitive tension previously enjoyed went flat in 2018 and for the first quarter of 2019 we are seeing increases in rates on certain lines, some cover restrictions and a reduction in lead capacity.

Cargo

Overall the cargo market in New Zealand fared well last year with the introduction of a number of co-insurers on renewals to relieve capacity-driven pricing increases and coverage has been relatively unchanged. Regular claims continue to erode profitability and some primary produce exports suffered inherent vice losses due to a wet growing season. In addition, stock through-put policies have been a focus with static locations that have EPS panels in their construction requiring good risk survey detail to avoid significant increases in rates while in storage. In general terms, we expect some incremental increases being sought by cargo insurers for the balance of 2019.

Commercial Hull

Several local and Australian insurers continue to offer hull cover for commercial vessels with some incremental increases in rates during 2018. This year seems to be more of the same however we expect to see at least two of the New Zealand markets being open to considering new business for 2019. Options for Loss of Use, Increased Value/Disbursements and Agreed Value requires strong risk information, generally including a valuation.

P&I

The P&I market is in good shape despite premium erosion and high value losses as the P&I Clubs have buoyant reserves even though rate increases have not matched the increase in tonnage on the water. Small incremental changes are sought, with many Clubs looking to fixed premium options without calls. There is still the potential for a further reduction in the number of insurers providing cover, arising out of merger activity. One recent positive change was the Carina P&I market now being managed by the MECO Group and they have indicated their desire to work with Aon for small ship P&I offerings in the Pacific.

Marine Liability (Ship Repairers and Marina Operators)

Several options remain in the New Zealand market when seeking cover for marine liabilities. Terms are generally competitive therefore focus should be on coverage and insurer claims attitude. Underwriters are looking to better understand the risk exposures of those seeking cover and to ensure that relevant and up-to-date terms and conditions are in place.

Pleasure Craft

The London yacht market has imploded somewhat with a recent renewal example facing an increase of 70 percent. This relates more to the superyacht market and builders risk market where high-profile losses have impacted a number of Lloyd's and London market leaders. Closer to home, we have had pleasure craft insurers going through a period of adjustment with their underwriting that has seen some increases while others have remained competitive on trailer craft and marina-based boats. The challenge has come with some vessels on moorings not being offered renewal as well as with higher value and/or exotic construction (carbon and titanium) and/or hi-tech race boats where previously available markets have dried up and sourcing cover, let along reasonable terms, has become a challenge. It is vital to get in early with good underwriting information for unusual or higher value vessels.

Trade Credit

The trend of domestic insolvencies, particularly in the Construction sector, continues in 2019 with the recent administration of Arrow International. Deteriorating loss ratios is resulting in additional underwriting requirements by insurers to maintain buyer cover (e.g. need to seek financial transparency on construction companies). Where financial transparency is not available, insurers are withdrawing/ reducing their exposure.

For exporters, there is a heightened awareness of trade disruptions from Brexit, China/ US trade tension and instability in emerging markets (Venezuela, Turkey, Argentina). There is still strong capacity in the market for export risk, where insurers have strong appetite for covering primary products (seafood, wool, meat, diary, timber) and most opportunities can be quoted. For low graded export countries, cover can be considered with the assistance of Top Up cover (reinsurance) through the New Zealand Export Credit Office.

Retail and Construction based clients have been incurring premium increases and restrictive cover for the last 12 months. Marginal premium increases are expected to follow through to other sectors during 2019.

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
- Foodborne illnesses
- Catastrophic animal diseases
- Liability risk for wildfires
- Autonomous vehicles and plant
- Non-damage business interruption
- Natural catastrophe coverage gaps
- Climate change
- Carrier corporate responsibility initiatives

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