AON Q1 2021 | Insurance Market Update

Overview

2020 proved to be one of the most challenging years in modern history with COVID-19 the most prolific global pandemic since Influenza in 1918, impacting most businesses to some extent and causing turmoil in the global insurance marketplace. In 2021 New Zealand, like the rest of the world continues to deal with the economic and social impacts of the pandemic. The substantive impact on the global economy has led to considerable human and fiscal impacts that will be felt for years to come.

In 2020, global economic loss and insured loss derived from natural disasters increased from 2019 (although it was not a record-setting year). The most widespread and newsworthy events were recorded in the United States of America. Weather-related disasters accounted for nearly all insured natural disaster losses (99%). This was due to a relatively low number of significant earthquake events, and the fact that where the events did occur, they were located predominantly in regions with lower insurance take-up.

The severely hardening market of the past 24-36 months on the back of years of core underwriting losses driving insurers to remediate their books with actions such as the Lloyd's Decile 10 review, now appears to be stabilising, but there are some areas that continue to prove challenging. Rates will remain at elevated levels; however, there are early signs that the pricing trajectory may be moderating in some areas. Policy terms are the focus, so that insurers avoid unexpected losses.

With respect to property, areas that continue to be especially challenging include natural disaster cover in locations in higher risk earthquake regions, in particular, Wellington, and industries which utilise high risk materials such as expanded polystyrene sandwich (EPS). Liability market challenges include directors' and officers' liability insurance driven by reduced capacity, reduced risk appetite and insurers' perceived exposure to 'event driven' claims exposures such as cyber incidents and New Zealand having an evolving class action environment. Cyber incidents continue to dominate global and local media headlines, including earlier in the year the Microsoft Exchange hack. Increasing Cyber claims frequency and severity has resulted in Cyber insurance market conditions firming with notable acceleration during Q1 2021. The Motor Vehicle insurance market shows signs of competitiveness for profitable fleets; factors include lower insurer claims costs in 2020 due to fewer motor vehicle accidents with less vehicles on the road due to COVID 19 lockdowns and restrictions.

Key themes from Aon's Global Market Overview Q1 2021 are:

The market remains challenging; however, there are early signs that the pricing trajectory may be moderating as:

- Insurer growth goals have taken the place of a prolonged period of portfolio remediation,
- COVID-19 losses to date have not materialised as expected; and
- New capacity continues to flow into the market.

As economies rebound in 2021 with the rollout of COVID-19 vaccines, traditional risk and exposure variables are likely to normalise, while the following key longer-term issues gain relevance in insurer appetite and rating models:

- Environmental, Social and Governance issues (e.g. Inclusion, & Diversity, Climate Change);
- Supply chain resilience and the increased focus on local sourcing of strategically important manufacturing and goods;
- The increase in frequency and severity of weather-related events; and
- Special Purpose Acquisition Companies.

COVID-19s impact on the global insurance industry

In New Zealand, insurers largely exclude cover for infectious diseases; therefore, the impact locally is forecast to be relatively minor. However, globally, insured losses are significant, particularly across event cancellation and business interruption insurance.

The COVID-19 catastrophe is a live event with losses still accumulating. The current best estimate is that losses will be in the range of USD40-60 billion. However, some carriers are more cautious and believe that when all losses are fully formed the insured industry loss could be closer to USD100 billion. Because some of the losses are subject to litigation that may take many years to settle, (re)insurers are naturally careful about providing specific commentary and it is probable that the final loss will not be known for five or more years.

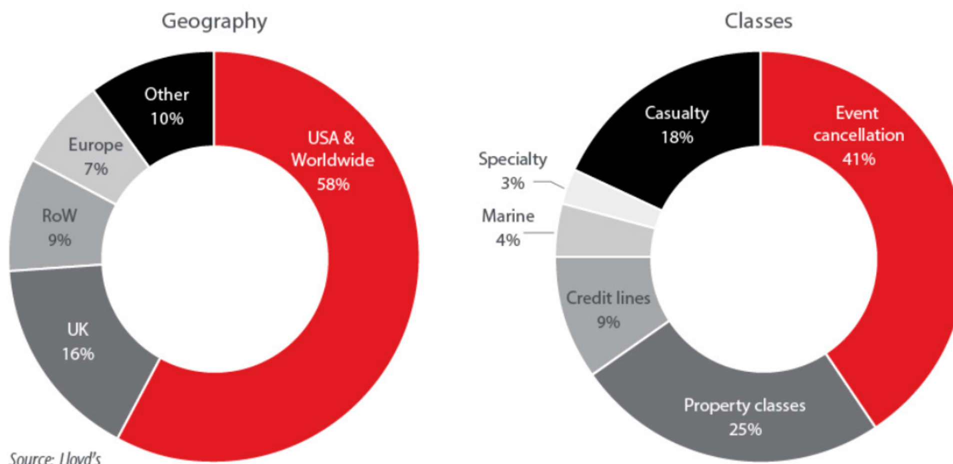
To date, estimates have been dominated by first party claims, but insurers are predicting that losses in third party claims are likely to increase in 2021. For example, COVID-19 increases pressure on the directors' and officers' market, with more COVID-19 claims expected.

Litigation in respect of interpretation of business interruption policies continues, e.g., in the United Kingdom on 15 January 2021, the UK Supreme Court handed down a judgment largely siding with the Financial Conduct Authority (FCA) and the policyholders the FAC represented. Some other courts, e.g., South Africa and Ireland ruled in favour of policyholders, but in Australia, a Federal Court supported a broad interpretation of a pandemic exclusion. In the USA, litigation continues to support insurers, although recently several cases have been allowed to proceed to discovery.

Whilst the number of deaths resulting from the pandemic continue to climb, most life insurers report that the mortality risk is "manageable" and "well below stress levels".

Capital remains robust for many (re)insurers, many of whom have raised equity and/or debt and many insurance groups reported profits in 2020. The COVID-19 pandemic did not prompt widescale downgrades of major (re) insurer groups rated by AM Best and Standard and Poor's.

Distribution of COVID-19 losses



Note - Property classes includes business interruption.

Climate change challenges are growing

Climate change challenges and risks are growing. In December 2020 the New Zealand government declared a climate change emergency in line with many other countries.

Insurer sustainability strategies

In designing their own sustainability strategies, insurers are starting to adopt divestment policies or impose underwriting restrictions on organisations perceived as not working towards reducing their carbon footprint quickly enough, or to actively discourage activities that might impact the climate. In March 2021, the decision of Axa SA, France's biggest insurer to drop a German coal energy giant as a client is viewed as a first, and a precedent-setting decision for the insurance industry. This follows Axa becoming the first insurer to impose coal-related underwriting restrictions in 2017. Global giants Allianz SE, (Germany's biggest insurer) and Zurich Insurance Group also have announced plans to reduce support for companies that derive energy from coal or generate coal beyond specified percentages, which are not, following a transition period, complying with the Paris Agreement.

Weather related losses

The past six years have been the hottest since records began, with 2020 being both the hottest in Europe and the joint hottest year ever recorded. In addition, there were record-breaking hurricane and wildfire seasons in North America and Australia respectively, while California saw its first "gigafire" (a fire that exceeds 1 million acres in size). At the same time, severe thunderstorms and storms in Europe and North America, often combined with hail or tornadoes, are becoming more frequent.

In 2020, according to Insurance Council of New Zealand data, local insurers paid $239 million in weather-related claims, dominated by flooding. Flood losses are no longer seen as catastrophe risk; but becoming foreseeable risks. Insurers are now seeking specific information relating to flood risks and are starting to impose limits and higher deductibles where underwriting determines a higher risk.

Corporate resilience for climate change and sustainability

Businesses and directors and officers should be considering climate change risks and the tools to manage these risks. Aon is committed to helping our clients implement environmental, social and governance best practice internally to promote corporate resiliency and sustainability, and to prepare for the ongoing challenge we face in relation to emerging risks. Aon New Zealand's recently released 'Corporate Resilience for Climate Change' solution brochure is available here.

Market Update Sections

To navigate to a particular market update section, please click below.

Property – New Zealand

Construction

Property – Global markets

Trade Credit

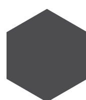
Liability

Marine

Cyber

Aviation

Motor Vehicle

 Emerging Risks

Property – New Zealand market

Market stabilising

There are signs that the insurance market is gradually stabilising for clean risks with no high hazard exposure and with single digit increases expected. New capacity in London is being created with more capital entering the market (to date approximately $28 billion) and insurers are looking to maintain or increase participation as rates appear to be profitable (subject to final results from the many COVID-19 legal challenges).

Capacity still challenged

Capacity remains challenging in a number of areas including Wellington region natural disaster cover. Insurers continue to look closely at risks where in recent years there have been significant global losses. This includes expanded polystyrene sandwich (EPS) type panelling, largely used in the primary and food processing sector and higher risk building materials such as aluminium composite panel (ACP) used to clad certain commercial buildings. There continues to be a shortfall in New Zealand insurance markets for these types of risks with companies with significant assets to insure needing to obtain options from overseas markets.

Natural Disaster (earthquake) cover

Capacity remains extremely limited in the Wellington region. Following three to four years of insurers moving to technical ratings in high earthquake risk regions, resulting in significant premium increases, the signs are that most insurers have approached their technical premium. Some continue to reduce line sizes to manage portfolio volatility.

COVID–19

The impact on local New Zealand property and business interruption insurance is relatively light, with the majority of policies excluding losses where no physical loss occurred or via the application of blanket infectious disease exclusions.

Coverage derogations are a growing concern

Insurers are imposing across-the-board clarifications and exclusions, particularly related to silent cyber, infectious disease and contingent business interruption. Newly proposed language is at the heart of many negotiations with differing insurer legal opinions driving a lack of alignment amongst insurers, leading to differing terms and conditions on policies.

The underwriting environment remains difficult

Information requests continue to get ever-more detailed. Often insurers are unable to formalise quotes until all requests for detailed information and compliance with risk control recommendations are satisfied. This can lead to last minute deviations from expected terms.

Emerging risks

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

Regulatory – Fire and Emergency funding review – FENZ levy

The Department of Internal Affairs (DIA) Fire and Emergency funding review is now focusing on ways to improve the existing insurance–based levy system and a new scope of the fund review was released on 30 April 2021. DIA is working with targeted stakeholders through this phase of the review to ensure that the Fire and Emergency levy adheres to the principles in the FENZ Act (that the levy is stable, universal, equitable, predictable and flexible) and can be effectively implemented. DIA will make recommendations about what improvements, if any, can be made later in 2021 and Government will then decide what changes will be made to the FENZ Act. Following this, public consultation will take place on how much levy different parties should be charged.

Tips for clients

Re-review insurance coverages and structures

Risks, exposures and risk management strategies have changed. Coverages, limits and deductibles should be carefully considered to ensure they remain appropriate.

Explore alternative solutions

Traditional and non-traditional options are expanding, and it is increasingly important to explore alternatives such as captives and facilities, risk financing, and changes to program structure to achieve the best outcomes.

Achieve better outcomes

To achieve better outcomes for both cover and price,

ensure 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.

Start early

The renewal process is taking longer. There is greater underwriting scrutiny, and more questions are being asked. Give yourself enough time to respond.

2020: Top Significant Natural Disaster Events in APAC (Asia & Oceania)

2020 was an active year for natural disasters which left costly and deadly impacts across APAC. The total direct economic cost of APAC natural disasters was USD101 billion; however only 12% (USD12 billion) of the economic cost was covered by insurance due to the fact the APAC region has a high proportion of uninsured disaster costs.

Australia was impacted by a series of notable severe thunderstorm events, dominated by hail damage. Between 19-20 January 2020, Sydney, Brisbane, Canberra and Melbourne were all struck by hailstorms with an insurance cost topping USD1.4 billion from 131,000 claims.

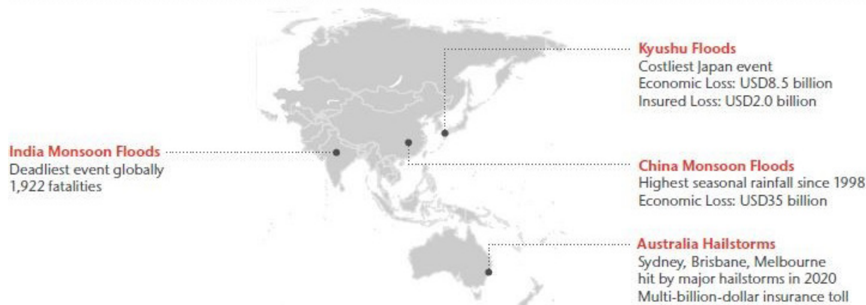
Local New Zealand insurers paid $239 million in natural disaster claims during 2020 (Insurance Council of New Zealand data), all of which were weather-related, including: the Napier flooding; the Marlborough-Nelson hailstorm; and Upper North Island flooding (and in addition the Lake Ohau fire $35 million). In 2019, local insurers paid $202 million dominated by the Timaru hail storm.

From a climate perspective, APAC noted several unusual warm temperature records.

The following APAC summary insight is sourced from [Aon's Weather, Climate & Catastrophe Insight 2020 Annual Report](#).

May 15-21	Cyclone Amphan	India, Bangladesh	133	15 billion	525 million
July 3-15	Flooding	Japan	82	8.5 billion	2.0 billion
June-September	Flooding	India	1,922	7.5 billion	805 million
September 5-8	Typhoon Haishen	Japan, China, Korean Peninsula	4	4.0 billion	1.6 billion
		All Other Events	~3,100	31 billion	5.0 billion
		Totals	~5,500	101 billion[1]	12 billion[1,2]

[1] Subject to change as loss estimates are further developed
[2] Includes losses sustained by private insurers and government-sponsored programs



Property – Global markets

The global property insurance market continues to be strongly influenced by losses arising from natural disaster events. During 2020, natural disaster catastrophe losses were above average and in addition many markets faced claims from the concurrent COVID-19 event. The last decade has featured record-breaking instances of each individual peril including earth¬quakes, tsunamis, tropical cyclones, severe convective storms, inland flooding, wildfires, drought and extreme heat and cold. The impact of climate change is making pricing natural catastrophe risk more difficult, with forward-looking modelling now running alongside historical data by (re)insurers.

Over the past 10 years many countries, including New Zealand, experienced 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.

There is a strong focus on disciplined underwriting and high-quality risk data is required in order to obtain terms. In addition to the London market, alternative market options are emerging for some, notably in Singapore, Bermuda and China.

London Market

Transformation to a virtual market

The London market transformed into a virtual market during March 2020, shifting from a predominately face-to-face market to a more technology-enabled trading marketplace. Video conferencing platforms meant communication between clients, brokers and underwriters has, for most, been enhanced. Trading days on average have become longer/stretched out because of market conditions, and the new ease of communication has increased interactions. Trading practice changes occurred against a backdrop of the hardest property and casualty market in 20 years for many sectors. Placements needed more carriers, longer negotiation, and a greater variety of structure options for clients to weigh up, many of whom were facing very challenging financial conditions in their own industries.

Our current thoughts on London market trading

The consensus is that the London market trading environment will evolve as a result of COVID-19 driven by broker and client preferences - retaining the best of the COVID-19 enforced experience, where it improved client service. With a backdrop of a hard market, and greater pressure to manage total cost of risk (TCOR) and risk managers concerns they missed an opportunity to differentiate their company by not holding face-to face meetings, we expect a bounce-back in client visits to London and Europe during 2022.

Market trends

For New Zealand placements that faced significant re-rating during 2017–2020, there are signs that rating levels may have peaked. This trend is being aided by sufficient, competitively–priced capacity available to deliver on average flat or low single-digit increases at renewal. The number of Aon London placements for New Zealand increased by 7% – indicating some pricing differential remains between local and international carriers. Our expectation is that current trends for property rates will continue, subject to natural catastrophe level influences, but with possibly slowing momentum from mid-year.

2021 sector outlook

Discussions with carriers and the close analysis of their business plans indicate total per risk capacity at the start of 2021 to be stable or slightly increased. We anticipate the trend of over-supply in the primary layer and under-supply on excess layers to even out as the year progresses. Exclusions for pandemics and cyber write-backs will remain a focus, with London remaining less flexible than European carriers, who are also tightening up terms.

Carriers are now very focused on profitability; and change may be slower than in past cycles. The trend for larger and new climate change-related natural catastrophe events and a low-interest-rate environment means carriers will likely be cautious when seeking growth than in past market cycles. We have observed examples of increased lines being offered on favourite accounts to achieve small signing increases at 1 January 2021, but in a way that doesn't add material competition.

Alternatively, the high levels of profitability for the

best London and European carriers in the sector (Aon's international property claims data shows many have claims loss ratios below 50%) may awaken new levels of carrier competition from the mid-year point. If this does happen, and in past cycles we know it can happen quickly, it will impact the most profitable countries and industries first, before a broader market change.

2020: Global Natural Disaster Catastrophes

2020 saw an above average number of natural catastrophes with significant humanitarian and financial impacts. Although it was not a record-setter in terms of financial losses deriving from natural disasters, both economic loss and insured loss increased from last year.

Weather-related disasters accounted for nearly all insured natural disaster losses (99%). This was due to a relatively low number of significant earthquake events, and the fact that where the events did occur, they were located predominantly in regions with lower insurance take-up.

Global	2020	2019
Economic Loss	USD268 billion. 10% above 21st century average	USD 232 billion. 3% below 21st century average
Insured Loss	USD97 billion. 40% above 21st century average	USD 71 billion. 6% above 21st century average

There were several notable records set on a regional, period or event-level scale, the most widespread were in the United States with a record setting Atlantic Hurricane Season and wildfires in the Western USA, prompting a new modern era record for acres burned and the third-highest annual peril pay-outs for insurers on record.

While re/insurers faced a challenging year in the USA, it was a different story in the rest of the world where aggregate pay- outs were diminished. However, the fiscal analysis is only a small part of the broader story. Prolific rainfall in parts of south Asia left some of the worst monsoon season flooding in years (notably China, Japan, India and South Korea). Multiple hailstorms struck major metropolitan areas in Australia; drought conditions ravaged parts of South America; and Europe endured its costliest winter windstorm in nearly a decade. These events occurred within the broader realm of COVID 19 and resulted in major challenges from a relief and recovery standpoint.

Perhaps the biggest takeaway from 2020 was the recognition of how concurrent events can have major global implications, and highlighted the need for additional investment around risk mitigation strategies to navigate new forms of volatility, and the growing influence from climate change on daily life.

The following executive summary insight is sourced from Aon's Weather, Climate & Catastrophe Insight 2020 Annual Report.

2020: Global natural disaster catastrophe loss data

Economic Loss

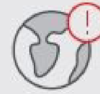
USD268 billion

10% above 21st Century average

Insured Loss

USD97 billion

40% above 21st Century Average



416

notable natural disaster events

76%

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

64%

global protection gap

billion-dollar economic loss events (second highest on record)

28

billion-dollar insured loss events (highest on record)

1,922

fatalities during the India monsoon season; deadliest disaster of 2020

$35B

Cost of China's monsoon season in the worst Yangtze River Basin floods since 1998

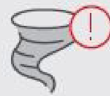
M5.3

Magnitude of the destructive earthquake in Croatia on March 22

195 mph

(315 kph)

Wind speed of Typhoon Goni at landfall in the Philippines; strongest landfalling storm ever recorded globally



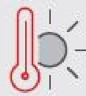
140 mph

(220 kph)

Estimated wind gusts during the August 10 Midwest derecho in Cedar Rapids, Iowa

30%

Portion of South America's Pantanal Region that burned due to wildfires in 2020



38.0°C / 100.4°F

Hottest temperature ever recorded above the Arctic Circle; June 20 at Verkhoyansk, Russia

+0.98°C (+1.76°F)

Above the 20th Century Average Per NOAA: World's second-warmest year on record for land and ocean temperatures dating to 1880

Liability

The liability insurance market remains relatively stable, notwithstanding a reduction in capacity in certain poorer performing classes. The ongoing spectre of litigation funded class actions is a cause of concern to insurers, especially those under¬writing directors and officer's liability for listed companies. Insurers and reinsurers continue to exhibit a strict technical approach towards rating, minimum premiums and retention levels. The general liability insurance market remains competitive, with most insurers content to offer reasonable limits to most industry sectors. Several local insurers offered "softer" renewals than they would have ordinarily done during 2020 in appreciation of business uncertainty caused by COVID-19, especially to SMEs. Some are seeking targeted redress in 2021.

Directors' and Officers' Liability

Terminology

Side A Directors' and Officers' Liability insurance provides indemnity to directors and officers for claims bought against them where they are not indemnified by their Company (natural person protection);

Side B Company Reimbursement provides indemnity to the Company where the Company grants indemnification to its directors and officers in respect of claims brought against them (balance sheet protection);

Side C Securities Entity provides indemnity to the Company in respect of securities claims brought against the Company by security holders (balance sheet protection).

A substantial premium re-alignment particularly over the 2020 renewal cycle was driven by reduced capacity, reduced risk appetite and insurers' perceived claims exposure enhanced by the COVID-19 pandemic. Whilst there appears to be some stabilisation of the market, we are still anticipating premium and retention increases to continue.

Limits

In respect of publicly listed companies, insurers are reducing their capacity in order to control their loss exposure. Due to significant premium increases, some insureds are reviewing the total limit purchased.

However, it is generally only Side C cover where insureds are considering reducing or removing the cover entirely in order to lessen the size of the premium increase. In respect of private companies, insureds are not considering cutting limits as the premium saving does not currently outweigh the benefits.

Pricing and capacity

We anticipate ongoing upward premium pressure for the rest of 2021, with some easing in the rate of change relative to 2020. Insurers are generally reducing their capacity to $10m to $20m, particularly for listed companies. Insurers are being selective as to where they are willing to provide capacity. We are now seeing 'green shoots' of new excess capacity emanating from the London insurance market; however, these markets are tending to take advantage of the upward premium trend, rather than create pricing competition. For private companies, insurer preparedness to outlay capacity has also become more considered and the perceived quality of the risk and industry sector plays a significant part in their decision making.

Retention

Insurers minimum retentions are increasing. For public companies Side B cover minimum excesses are typically $100,000 and Side C $1 million. For private companies, Side B deductibles are also subject to upward pressure.

Coverage

Notwithstanding the harder market conditions, directors' and officers' coverage continues to remain generally stable for large financially robust organisations; however, insurers are reviewing enhancements in cover provided in the soft market to tighten back coverage. During the course of 2020, insurers maintained a strict underwriting approach with securities offering exclusions and increasing the premium applicable for Extended Reporting Period Extensions. Some insurers are also taking a more considered approach to backdating the continuity on new business. For less robust organisations, or those in more challenging sectors, insolvency exclusions may be applied. With effect from 1 January 2021, Lloyd's markets were required to be clear on the extent of cover provided in their policies emanating from a cyber incident, for directors' and officers' insurance a cyber endorsement will be applied providing affirmative cover for a cyber act or cyber incident.

Claims

Globally, claims continue to increase, with insurers continuing to point the finger at securities class action activity as a key driver for premium and capacity re-alignment, as well as a perceived increase in risk from 'event driven' claims exposure such as: cyber incidents; COVID-19; the #MeToo Movement; Modern Slavery/Fair Labour legislation; Task Force on Climate-related Financial Disclosures (TCFD). The New Zealand Government has introduced legislation to make climate-related disclosures mandatory, through an amendment to the Financial Markets Conduct Act (2013), affecting around 200 large FMC-reporting entities. If approved by Parliament, the legislation will require entities to start making climate-related disclosures for financial years commencing in 2022, with disclosures being made in 2023 at the earliest. New Zealand has an evolving class action environment with active litigation funders which is a concern for directors and officers of both listed and private companies.

2021 sector outlook

We anticipate on going upward premium pressure for the rest of 2021, with some easing in the rate of change relative to 2020. We also anticipate greater capacity stability as insurers reach their portfolio strategies with regard to both their preferred positions on directors and officers' programmes and premium requirements. For most insurers, changes in appetite are likely to be risk specific or globally directed as a result of further unanticipated deterioration of their claims portfolios.

Tips for Clients

In order to improve your renewal outcome, we recommend being proactive and providing additional information regarding the company's corporate governance, in addition to the completed proposal form.

The key issues directors should be considering are whether coverage has separate defence costs, as well as whether there are exclusions for insolvency related claims, cover for capital raisings or claims by majority shareholders.

Professional Indemnity

The professional indemnity insurance market continues to show signs of hardening for some professions and sectors such as design and construction due to ongoing claims frequency and severity. Several Lloyd's syndicates are still grappling with the implications of the Lloyd's thematic review which identified Design/Construct and International Professional Indemnity as the two poorest performing classes. This has led to increased premium rates and a significant reduction in capacity and new business appetite. In addition, aspects of cover continue to be reviewed and exclusions applied in some policies such as defective building product/aluminium composite panels (ACP) exclusions in the construction sector. Increased self-insured retentions are also being imposed for larger risks.

Cyber Endorsements

With effect from 1 January 2021, a significant development has been the drafting and application of Cyber Endorsements (often referred to as 'silent cyber') by Lloyd's of London on Professional Indemnity policies. The driver for this initiative is the ongoing regulatory scrutiny into cyber risks provided in the non-standalone cyber markets and their requirement that insurers suitably identify, assess and manage their cyber liabilities. Accordingly, affirmative language has been introduced as to what cyber/data protection coverage is afforded under the Professional Indemnity policy and what should be catered for elsewhere, most commonly under a standalone Cyber Risk policy. The local market is yet to address this issue, so we await developments.

Local market trends

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. Rates remain relatively flat for smaller professional services firms such as lawyers and accountants buying more modest limits under $5 million.

Regulatory scrutiny and change

Ongoing regulatory scrutiny and investigations from organisations such as 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. Regulatory change has affected the way financial advisers are licenced and can provide advice. There are a limited number of insurers who underwrite this class and they are currently reviewing their portfolios. All have flagged that premium increases are highly likely.

Statutory Liability

The Statutory Liability insurance market continues 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 (depending on the injury) and for severe life-changing injuries the 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 and Safety at Work Act.

Cyber

The world of Cyber insurance continues to be impacted by numerous ransomware and hacking events globally, both insured and uninsured including the Microsoft Exchange attack first observed in January 2021, which affected millions of Microsoft clients around the globe, and the Solarwinds attack detected in December 2020.

Ransomware became a global challenge in 2020, with COVID-19 related attacks driving losses/incidents. The frequency and severity of ransomware events, including the rapid escalation of ransom demands, has resulted in increased business interruption impacts of such attacks being felt. Ransomware activity has dramatically outpaced data breaches/privacy event activity for H2 2020, increasingly a ransomware event will involve data exfiltration. From Aon's recently released Global 2021 Cyber Security Risk Report 'Balancing risk and opportunity through better decisions', a finding is that only 31% of organisations report having adequate business resilience measures in place to deal with ransomware threats. Business Interruption losses are gaining significant attention, with losses manifesting rapidly. As a result, the market conditions for Cyber insurance are firming with a notable acceleration in Q1 2021. Many insurers are suggesting rate/premium increases will continue to rise significantly throughout the remainder of 2021.

Coverage mostly remains consistent. Increasingly, especially given USA and EU scrutiny on Sanctions and Ransomware payments, coverage concerning ransomware is changing with some markets adopting sub-limits, co-insurance arrangements or additional restrictive conditions.

Insurers are carefully considering retention/excess levels, seeking to increase to minimum levels for certain industry verticals.

Capacity has commenced a slow but steady retraction globally and locally, with some Lloyd's markets exiting the space entirely or reducing their maximum line sizes, with all insurers now focused on profitability.

Limit increases were common in 2020 and Aon anticipates this will continue throughout 2021, due to a combination of factors including increased risk awareness, increased claims and incidents, silent-cyber discussions, and a growing understanding of Business Interruption costs/expenses, as well as the cost of incident management.

Regulatory – Privacy Act 2020

New Zealand's new Privacy Act 2020 which took effect from 1 December 2020 strengthens privacy protections. It promotes early intervention and risk management by agencies (the name used for any organisation or person that handles personal information) and enhances the role of the Privacy Commissioner. Key changes include the requirement to report privacy breaches and the clarification that when a New Zealand agency engages an overseas service provider, it will have to comply with New Zealand privacy laws.

Tip for Clients

The key to accessing competitive pricing and coverage terms will be the ability to present a quality underwriting submission that is comprehensive, structured and showcases the organisation's cybersecurity maturity level.

Motor Vehicle

Motor vehicle insurance premiums, along with policy excesses are generally stable, with modest reductions in premium for some profitable fleets. Factors include lower insurer claim costs in 2020, due to fewer motor vehicle accidents with fewer vehicles on the road over

the lockdown periods and restrictions. However, motor insurers remain cautious particularly as the overall volume of vehicles on the roads continues to increase, as does the sophistication of technology contained within vehicles forcing up claim 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.

Construction

The construction insurance market continues to tighten from where it finished at the end of 2020. This means we are seeing policy coverage restrictions continue, coupled with premium and excess increases. This may lead to a requirement for insureds to retain more risk. In addition, some insurers have retreated from providing lines of insurance in New Zealand and/or to the construction market segment, reducing competition between the remaining insurers for construction based risks.

Contract Works

The current market conditions mean there are restrictions in cover, particularly regarding cover for defects and sub limits and other extensions are under scrutiny. Excesses are also increasing, particularly for larger projects where minimums will apply. Insurer expectations around hot work procedures and permits remain and, in many cases, conditions are added to the policy to enforce them. Some insurers have introduced a Communicable Disease Exclusion and Cyber and Data restrictions. As the exclusions are applied by reinsurers, this often makes the application of the exclusion and their format non-negotiable.

Construction Liability

There is pressure on public liability rates and minimum excesses are being applied. The focus is on products, and in particular, where they 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

Professional Indemnity insurance is one of the hardest hit classes of insurance following the Lloyd's Thematic review, with construction project professional indemnity insurance significantly affected. Many insurers have completely withdrawn from underwriting these risks, with some syndicates closing up permanently. Locally, we have seen a push for negligence-¬based policy coverage (rather than wider civil liability coverage) and, in general, insurers are being more selective of the risks they underwrite. Non-conforming materials exclusions are present. Project-specific professional indemnity insurance is getting harder to procure (especially for alliances) and significantly more expensive to obtain, with real restrictions on the extent of limits available.

Directors and Officers Liability

The insurers approach to Directors' and Officers' liability insurance for construction companies remains very cautious, driven by insolvencies. There is a reluctance to either increase a policy limit beyond what is currently purchased or offer terms on new business. Full financial accounts and statements are required, as part of the underwriting submission.

Each of the above classes of insurance has its own pitch points and careful navigation (including adequate time) is required in order to achieve the best outcome.

Trade Credit

The impact of COVID-19 on credit insurers' 2020 financial results (the three big carriers), show that globally gross written premium was down 3% as a result of reduced gross domestic profit (GDP) conditions; and operating profits were affected owing to premium cessions to state reinsurance schemes (e.g. in New Zealand the New Zealand Export Credit Office) and increases in reserves. Loss ratios deteriorated but turned out better than predicted because of low insolvency levels.

Business insolvency levels, which were artificially much lower in 2020, are expected to show a significant year-on-year increase in 2021 and into 2022, depending on when the government and

economic support measures are phased out.

Premium rate increases have subsided, and insurer appetite has returned with credit limit acceptance rates to pre-crisis levels. New business preferences have been in sectors such as Food and Beverage, Agri-food, Pharmaceuticals, Chemicals, Software & IT Services.

We continue to see New Zealand exporters focused on credit risk, largely due to the threat of non-payment risk from overseas markets impacted by COVID-19 as well as additional challenges from trade disruption.

Marine

The global marine insurance market continues to harden in 2021 as a result of poor portfolio performance in several marine classes. There was an overall reduction in capacity across many products along with a combination of rates increases, stricter underwriting criteria and restricted cover. A significant change to market conditions across all Marine product classes has seen the exclusion of cyber and pandemic risks. Practically every maritime insurer has applied these restrictions as market standard. Locally, marine insurers have felt the global impacts, which has meant some classes of business have been subject to market pressures while others remain competitive.

Aon continues to access global markets across all product lines to provide support should the local market be unable to do so.

Cargo

Contrary to the global marine market, marine cargo insurance is 'weathering the storm', with local insurers competing on well performing accounts where clients can demonstrate a strong approach to risk management.

Interest from clients around Stock Throughput (STP) placements is increasing, with a desire to move stock or inventory from a traditional material damage/ property placement to a marine policy. This brings with it challenges around market capacity and appetite, with many marine insurers struggling with accumulation exposure at various central cool stores and warehouses around the country.

From a shipping perspective, we have seen an increasing number of container ship losses over the past 12-24 months, triggering concerns over international trade. Shipping companies maximised their vessel capacity to keep up with demand brought on by COVID-19, ultimately to the detriment of cargo owners. Adding to the mounting pressure to move cargo, we continue to see major delays in shipping caused by heavy weather where container ships are being either slowed down or, in the case of the Ever Given on the Suez Canal, being run aground.

Commercial Hull

Commercial hull continues to be one of the poorest performing classes of business both globally and locally. Local insurers are cautious in their approach to new business, especially for larger fleets, and whilst supportive for renewals, we are seeing a continued push for 5-10% rate increases. A focus on vessel risk management is key to ensuring a successful renewal as both working losses and large claims erode insurers profitability.

Pleasure Craft

Along with commercial hull, pleasure craft has continued to be one of the worst performing classes of business. Catastrophic losses globally have severely impacted underwriter portfolio performance with many insurers withdrawing from the class. Locally, this has been represented in the exit of Club Marine in late 2020 after 30 years in the market, with other insurers taking the opportunity to increase rates, particularly on new business, while limiting capacity to high quality vessels. There are also stricter underwriting criteria, with a key focus on vessel condition and surveys being made available. This will become the new norm for clients seeking alternative quotes in the market.

Protection and Indemnity

2021 was always going to be a challenging year with every Club seeking increases. The stark increase in pool claims, volatile investment market, years of premium erosion, and the watchful eye of Standard and Poor's left little option but to address premium levels. This has resulted in general increases falling within a range of 5-10% for Clubs such as North, Standard and UK. For those that did not formally call a general increase, such as Skuld and Britannia, it was openly discussed that they were seeking a similar level of increase.

Marine Liability (Ship Repairers and Marina Operators)

Insurers remain 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 are willing to write new business and remain supportive on renewing business. These classes of business may experience small market increases in 2021, but we do not anticipate much change.

Aviation

2020 was a challenging year for buyers in the general aviation market. By the fourth quarter of 2020 it was clear that: the upwards rating movement across aviation insurance was set to continue; underwriting performance was under much greater scrutiny to remain disciplined; and there was greater focus on improving results via pricing, capacity and mitigating exposures through tighter underwriting controls on cover. This approach is likely to continue throughout 2021.

Claims, premium/rate increases and policy benefit limitations

Underwriters remain vocal about the challenging market environment and have advised there may be further rate increases. There were several high-profile aircraft incidents in 2020 affecting hull all risk (including weather-related damage to aircraft on the ground) and hull war risk incidents which further strengthened underwriters' resolve to increase rates and premium.

Aviation hull war class rates also started to increase due to several incidents in 2020 including: the Ukraine International Airlines Flight 752 loss in Iran (estimated loss USD53 million); and the destruction of four x Dash 8 aircraft in Kenya (estimated loss USD15 million).

The trend from the first half of 2020 continued through Q2 with airline and aerospace rates increasing by 20 to 25%, with general aviation up between 25 to 30% on average. The increases were exacerbated by following markets on coinsurance placements, where differentials of up to 50% above lead terms were applied. This compared to previous years, when they followed the lead insurer's terms.

Insurers are becoming more selective on when to offer policy benefits, for example betterment cover. Where offered, it is at increased cost with a significantly reduced limit. It is expected this approach will continue through 2021, fuelled by ongoing claims and increases in loss estimates, the most significant of which is the Boeing MAX claim estimate, up from USD1 billion to USD2.1 billion. Other significant claims in 2020 included an Air India Express Boeing 737-800 which overshot a runway amid heavy rain in southern India and an Ethiopian Airlines Boeing 777 freighter which caught fire while being loaded with cargo at Shanghai Airport in China. Such events mean losses continue to outpace premiums.

COVID-19

The effect of the COVID-19 pandemic on the aviation sector will take some time to be fully realised; but the overall impact on the premium pool is anticipated to be significant with estimates of in excess of USD450 million of the airline premium pool, as a result of the continuation of losses, and operators looking to their insurers to return premium due to reduced flight operations and aircraft layups. Underwriters are looking to implement minimum premiums on renewals without adjustable rates in order to avoid future premium shortfalls.

Capacity

Available capacity levels were also reduced in 2020, partly through insurers financial ratings being downgraded, but also through consolidation of markets. The estimated loss of capacity is at least USD35 million (hulls) and USD345 million (liabilities) and more markets withdrawing from aviation insurance.

This has buoyed those insurers remaining in the aviation sector to continue rate, capacity and coverage reviews, including a push towards technical underwriting rating models for pricing and coverage guidance and risk appetite so that insurers remain profitable and eliminate attractional losses.

Reprioritising risk and resilience post-COVID-19

Aon's global survey Reprioritizing Risk and Resilience For a Post-COVID-19 Future was released in February 2021. This survey found that the COVID-19 pandemic has demonstrated the need for businesses to reprioritise risk and to innovate and explore new risk management strategies. The COVID-19 pandemic exposed a number of vulnerabilities in organisations' business models and risk approaches. In our global survey, 82% of respondents said that that prior to COVID-19, a pandemic or other major health crisis was not a top 10 risk on their organisation's risk register and 31% of respondents did not have a pandemic plan.

In 2019, Aon Research data showed that risk readiness had declined rapidly, reaching an all-time low in 12 years. The top risks at that point included: an economic slowdown; business interruption; rapidly changing market forces; and failure to innovate; while a pandemic or health crisis was at the very bottom of the list. Companies, governments, industries, and communities entered 2020 already concerned about the impact of a changing regulatory environment, geopolitical forces, cyberattacks, large-scale disruption, and more. Then, the unthinkable happened – and nearly all of those risks converted at once. When it occurred, launching a global health and economic crisis, organisations' risk infrastructure was tested.

Moving forward, risk and business leaders must reprioritise risk, broadening their perspective and evaluating major shocks, not just anticipated losses. Navigating new forms of volatility, building a resilient workforce and rethinking access to capital will all pay a role in a companies' ability to navigate future events. To move forward, organisations must ensure that their workforce is able to adapt, communicate and collaborate when a crisis strikes. The increased dependency on digital platforms has made organisations vulnerable to adverse cyber events, information loss and reputational impacts on a new scale, and will require a refresh of cyber and risk management.

Topical Risks

- Business Interruption - including supply chain disruption and non-damage;
- Changes in legislation and regulation (e.g. Changes to the Privacy Act 1 December 2020, The Financial Services Legislation Amendment Act 2019);
- Climate change - increasing volatility of weather;
- Cyber incidents - (e.g. cyber-crime, IT failure/outage, data breaches, fines and penalties);
- Market developments - (e.g. volatility, intensified competition, new entrants, M&A, market stagnation, market fluctuation);
- Natural catastrophes - (e.g. earthquake, storm, flood, wildfire);
- New technologies - (e.g. impact of artificial intelligence, autonomous vehicles, drones, 3D printing, Internet of Things, nanotechnology, blockchain);
- Operational resilience;
- Pandemic outbreak/infectious disease - (e.g. health and workforce issues, restrictions in movement);
- Retention of key people; and
- Well-being, diversity and inclusion.

Aon Risk Management Services

Aon offers holistic risk management services to help clients identify, assess and manage existing and emerging risks. We assist with the selection and implementation of appropriate risk transfer, risk retention and risk mitigation strategies and provide the right advice following a major claim. We add distinctive, long-term value to optimise your overall insurance programme and enhance your risk management.

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