To thrive in the new world, insurers must think big and small. In this climate of change and intense scrutiny, **RADAR** discovers trust between consumers, insurers and regulators is critical, and set to become increasingly important in the future. During **2018**, consider building partnerships on a micro and macro level with organisations that think differently from you and will therefore challenge the way you do business. Our ***insights*** reveal, as a society, we are no longer satisfied with businesses whose primary objective is generating a return for shareholders. People want to deal with businesses, including insurers, that contribute to society more broadly. Is your strategy long-term or short-term focused? This is a key question ***for insurance leaders***. Underwriters say there is great potential for growth, but all players are cautious, with some holding off for now, allowing time to assess cyber exposure and identify precise overlaps and gaps in their offerings. **TAYLOR FRY** sees some light at the end of the tunnel, as rate increases are evident through a hardening market. Access to affordable insurance and the risk of underinsurance is a hot topic, given exposure to a variety of naturally occurring events.

This is RADAR — TAYLOR FRY'S annual roundup of the nation's insurance landscape.

RADAR gives insurers an inside view of the industry, drawing on the most comprehensive and long-running survey of insurers and brokers in Australia, the JP Morgan/TAYLOR FRY General Insurance Barometer. In the survey, insurers tell us what they're thinking and, in RADAR, we distill what this means for the market.

We also take time to explore the latest trends, news and ideas in insurance. Our team reports on the drivers of major change in Australia and New Zealand throughout 2017, and pinpoints the challenges and opportunities in 2018 and beyond.

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Kia Ora New Zealand

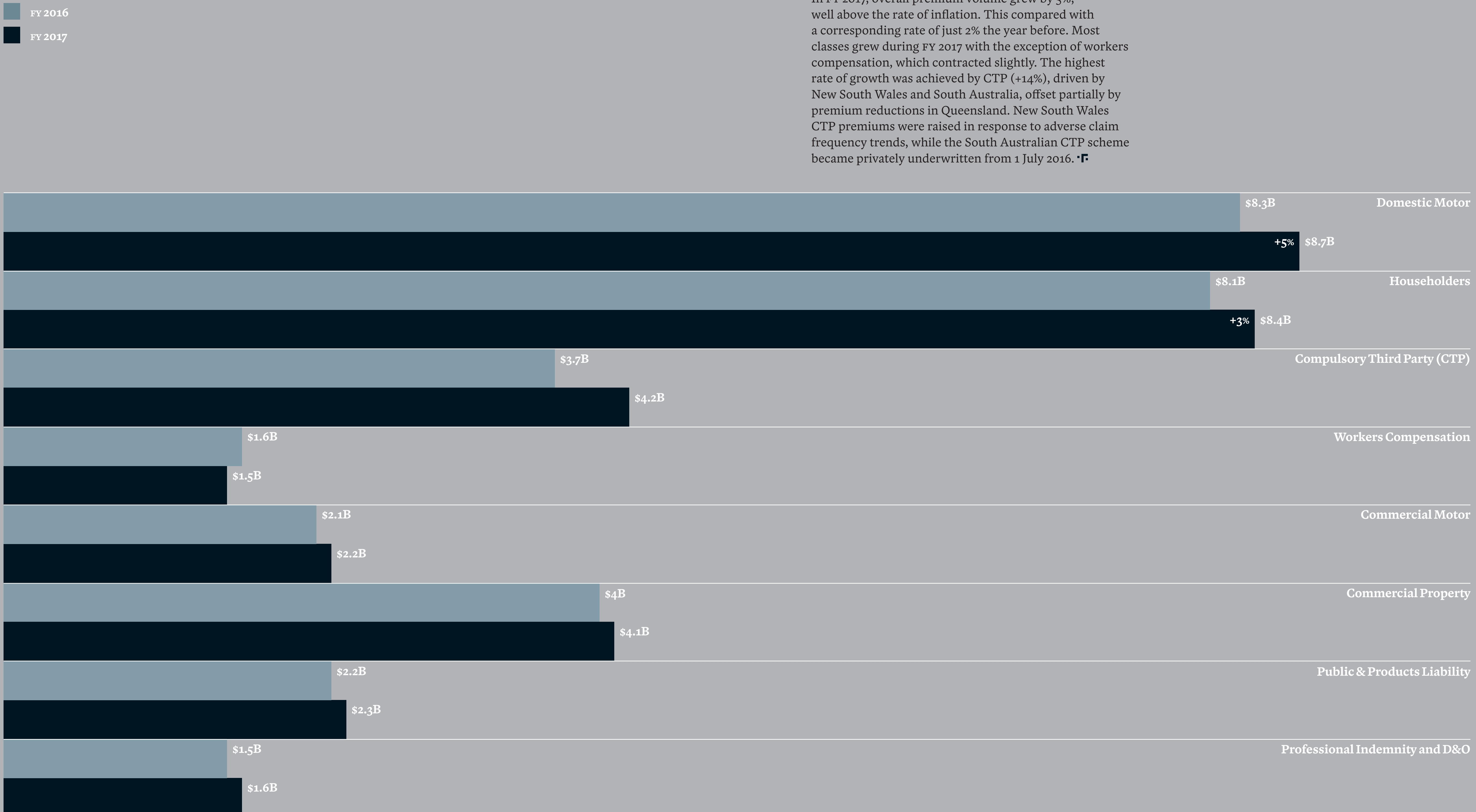
HINDSIGHT 2017

RADAR'S annual look back at the major classes of business underwritten in Australia and what was high on insurers' minds over the past 12 months. Here, we give an overview of how the market has performed in our industry focus, then zoom in on individual players in our company focus

INDUSTRY FOCUS

Straight from the source, here's our bird's-eye view of how the insurance year stacked up — from within the market itself …

Gross premium income



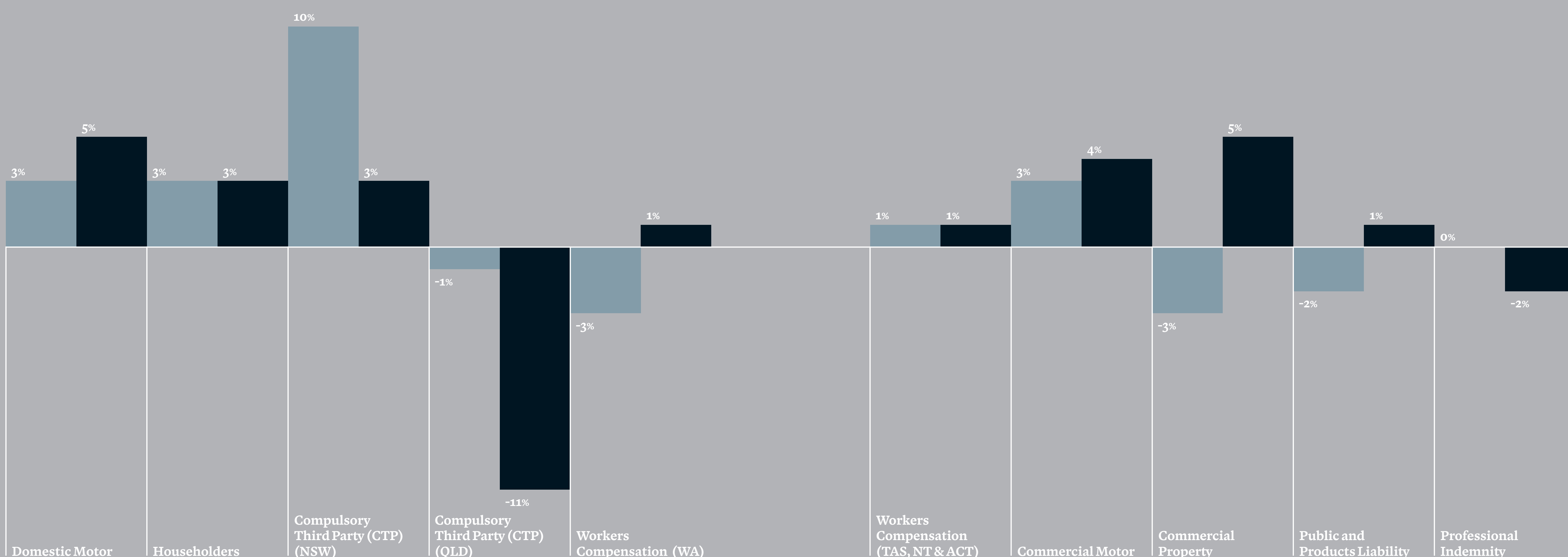
Source: APRA

Overall premium volume growth above inflation

In FY 2017, overall premium volume grew by 5%, well above the rate of inflation. This compared with a corresponding rate of just 2% the year before. Most classes grew during FY 2017 with the exception of workers compensation, which contracted slightly. The highest rate of growth was achieved by CTP (+14%), driven by New South Wales and South Australia, offset partially by premium reductions in Queensland. New South Wales CTP premiums were raised in response to adverse claim frequency trends, while the South Australian CTP scheme became privately underwritten from 1 July 2016.

Premium rate changes

FY 2016
FY 2017



Source: JPMorgan / TAYLOR FRY Barometer

Hardening rates for commercial motor and property, shallower turn for other commercial lines

Consistent with the growth in premiums, positive rate changes were achieved for most classes of business, with the exception of the Queensland CTP market (affected by the introduction of the National Injury Insurance Scheme) and professional indemnity.

A hardening market saw rate increases across most commercial lines during FY 2017. The biggest beneficiaries of the hardening market were commercial property and commercial motor, which both experienced healthy rate increases during FY 2017 after years of rate reductions. More modest rate increases were also achieved in public and products liability, and workers compensation.

Combined ratios

Industry profitability improved, but dependent on reserve releases

The industry experienced a slight overall improvement in profitability (measured by combined ratios) in FY 2017, following a similar improvement in FY 2016. Within personal lines, the 'flagship' classes of domestic motor and householders both experienced slight deteriorations, in part due to adverse catastrophe experience during FY 2017 (notably the effects of Cyclone Debbie and Sydney hailstorms). However, there were significant reductions in combined ratios for both New South Wales and Queensland CTP, due mainly to reserve releases

(responsible for a reduction of 42 percentage points in the overall combined ratio for CTP during FY 2017).

Despite healthy rate increases, commercial motor and commercial property saw only modest improvements in profitability. This was due to the same adverse catastrophe experience, which affected domestic motor and householders.

Early FY 2018 results are mixed

Industry results from the first half of FY 2018 indicate that commercial lines are continuing to improve, while key personal lines excluding CTP remain flat. The combined ratio for CTP increased significantly in the first half of FY 2018, primarily due to lower reserve releases. All commercial lines, excluding public and product liability, experienced lower combined ratios in the first half of FY 2018 compared with FY 2017, while longer-tailed classes continued to benefit from reserve releases. Public and products liability remained stable, despite an 8% reserve release. We note that half a year's worth of results should be treated with caution, as they may not capture inherent seasonality in some lines.

Source: APRA, JPMorgan / TAYLOR FRY Barometer

Plans underway for AASB 17

Based on the international accounting standard IFRS 17, the implementation of AASB 17 will necessitate more detailed reporting and may prompt insurers to re-evaluate their approach to pricing cross-subsidies.

Insurers are carefully working through interpreting the new standard which applies from 2021, including gap analysis to understand the required changes in financial reporting, data requirements and IT infrastructure, as well as business performance measurements.

Premiums in Northern Australia targeted

The Commonwealth Government has accepted the findings of the Northern Australian Insurance Premiums task force—namely, mitigating activities are the only way to reduce premiums on a sustainable basis—effectively signally that they will not intervene directly in the market.

The Australian Competition and Consumer Commission has been asked to undertake an enquiry into the prices, costs and profits in the insurance market for home, contents and strata insurance in Northern Australia, with the draft report due by November 2018.

Eyes on Royal Commission into misconduct

While the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry will largely focus on the banking sector, general insurers are also within scope and the Insurance Council of Australia's CEO Rob Whelan says the general insurance industry is "ready to contribute".

With the interim report due no later than September 2018 – insurers will be watching the Royal Commission closely.

ASIC turns up the heat on insurers

Following an extensive review of the most common forms of add-on insurance sold through car dealerships, ASIC concluded there was little if any financial benefit to buying these policies. Indeed, only $144 million in successful insurance claims were paid out over 2013-2015, compared with $1.6 billion in collected premiums. During late 2017 and early 2018, major insurers announced about $70 million in refunds for these policies, and ASIC expects this will grow to $122 million.

The Government has released a draft Bill proposing stronger protections for consumers of financial products and, as part of this, ASIC will have more power to intervene if insurance products have resulted in or are likely to result in significant detriment to retail consumers. ASIC is also looking into the surveillance and investigation processes used by insurers to identify fraudulent claims.

Competition in Productivity Commission's sights

In February 2018, the Productivity Commission released a draft report which made several recommendations aiming to improve competition in the general insurance market, including the addition of comparative pricing information on renewal notices and greater transparency where underwriters are using multiple brands for the same class of insurance. *We examine the implications on page 36.*

TOP CONCERN FOR INSURERS: REGULATORY CHANGE

The Barometer revealed particular unease among insurance leaders about the actual and possible impacts of inquiries affecting accounting, pricing, product design and product disclosures. Here's a brief snapshot of those activities with the most potential to affect the industry

COMPANY FOCUS

How has the year treated individual insurers? *Principal Actuary Kevin Gomes* breaks down the data to explore the highs and lows of an eventful 12 months ...

Insurance Profit Margins (% NEP)

How the three main listed insurers compare against industry profit margins historically and recently

Source: APRA data, Barometer (JP Morgan analysis)

Profit trends a mixed bag for large insurers

Looking at the three main listed insurers, based on APRA data for the first half of FY 2018, IAG shows an insurance profit margin (insurance profit as % of net premium revenue) of 18.8%, positioning well above the industry margin of 15.5%. QBE and Suncorp margins for the same period were both below industry average.

Getting behind the numbers

The insurance profit margin for IAG's Australian operations improved from the previous year (from 16.5% in the first half of FY 2017 to 18.8% in the first half of FY 2018) due to significant reserve releases ($78 million) on long-tail claims, a favourable natural peril experience below the allowance amount and a favourable credit spread movement.

The weak margin trend for Suncorp in the first half of FY 2018 was driven by deterioration in personal lines margin, due to reduced CTP premiums in New South Wales and Queensland, and a decline in commercial lines margin, due in part to higher operating expenses.

PICK OF THE CROP

A choice selection of performance results across the industry ...

Highest profit growth

Swann Insurance (Aust)

NPAT Growth
1495%

Net profit after tax FY17 ($M)
29.7

Net profit after tax FY16 ($M)
1.9

Worst loss ratio

MIPS Insurance

Loss Ratio FY17 (%NEP)
202%

Net earned premium FY17 ($M)
17.3

Worst expense ratio

Eric Insurance

UW Expense Ratio FY17 (%NEP)
64%

Net earned premium FY17 ($M)
90.9

Most solvent company

Aioi Nissay Dowa Insurance

Solvency Ratio (Capital Base / Prescribed Capital Amount)
10.8

Least solvent company

Domestic & General Insurance PLC

Solvency Ratio (Capital Base / Prescribed Capital Amount)
1.2

HOT TOPICS

The pressing issues peaking the industry's interest now and into the future

2

BIG LITTLE HIGHS

As general insurance undergoes transformation, it's the large *and* small things that count, and players will need agile thinking to flourish.
Senior Actuary Scott Duncan explains

Paradigm shifts are well underway in the general insurance industry, signalling a change from old-world thinking to new. To thrive in the new world, insurers must think both big *and* small. Big-picture items include understanding social changes, refreshing product offerings and ensuring agility to capitalise on opportunities. Thinking small involves placing yourself in the customer's shoes to build a better understanding of their lifestyle and requirements.

Here's our take on three areas undergoing the change from old world to new, and recent initiatives showing the way forward.

Partnerships

Old world: Partnering with organisations that share the same DNA, and will therefore complement your existing offerings. The old-world terminology used to describe the benefit of these relationships is 'synergies'.
New world: Building partnerships on a micro and macro level with organisations that think differently from you and will therefore challenge the way you do business.

Launched in 2016 and backed by a $75 million investment, IAG's Firemark Ventures is described as the 'strategic investment group within IAG for start-ups and emerging growth businesses'. Firemark is concerned with exploring:

- New and innovative sources of data
- Anything that has potential to impact the insurance value chain
- New business models and technologies that expand or redefine insurance needs.

In other words, IAG aims to think like a start-up and change the way it does business.

The customer

Old world: Primary focus is on the customer's short-terms needs. Companies attempt to create additional value by offering discounts for multiple products and customer loyalty.
New world: Developing a clear picture of the customer's life stage, their lifestyle and needs. Reorienting the business to support a holistic view of the customer and aiming to interact with the customer on a regular basis.

Suncorp allocated $142 million in FY18 to accelerate its marketplace strategy by creating a network of 'brands, partners, solutions and channels'. The intention is to build a platform that encourages greater customer engagement and connection, and builds loyalty. To Suncorp, the value is clear: 'Those [customers] who hold four products are nine times the value of those with just one product line.'

New products and services

Old world: 'Squeezing' customers into core products.
New world: Flexibility, flexibility, flexibility – building on partnerships and developing greater understanding of the customer in order to offer appropriate products and respond to new ways of owning and using assets.

Players are exploring opportunities to develop new products as risks to continued growth in traditional classes of business emerge. Examples include:

- **On-demand insurance.** For example, Trov, in partnership with Suncorp, provides 'on demand' insurance for phones, laptops, tablets, wearables, headphones and photography gear.
- **Micro insurance in the sharing economy.** Kevinsured.com offers cover for online interactions. Kevin uses blockchain and reviews the reputation of the buyer and seller in the transaction and presently, if approved, provides $100 of free cover.
- **Sharing economy.** 'Mobilise' is a platform that allows businesses to hire out equipment they are not using. Mobilise launched in association with Aon, which will source cover for the equipment while on hire.

ASK YOURSELF

How thoroughly do you understand your customer's life stage, lifestyle and needs?

Do you seek to interact with your customers on a regular basis and do you have the flexibility to tailor product offerings to their requirements?

The winds of change have swept through the CTP landscape in Australia over the past year

ALTERED STATES

Paul Driessen, Principal Actuary at TAYLOR FRY, says the market will take time to acclimatise

After months of effort, 2017 was transformative for insurers in the New South Wales CTP scheme, culminating in a scheme overhaul introduced on 1 December with the *Motor Accident Injuries Act* 2017.

Features of the new design include:

A reduction in average premium
The scheme was created keeping in mind the New South Wales Government target for a reduction in average premium of around $100.

Broader coverage
Treatment and care costs, and loss of earnings benefits, are provided in the first 26 weeks regardless of fault.

Improved timeliness
Liability does not impact initial treatment and income support, meaning faster treatment and benefits, and a faster return to life/work.

Defined benefits
The partial move to defined benefits shifts away from the previous lump-sum arrangement. Benefits are now paid as needed, improving consistency with other CTP jurisdictions and with an expectation of greater scheme stability and efficiency. It is worth noting here that treatment and care expenses beyond 5 years from an accident will be the responsibility of government insurer icare.

Restricted common law entitlements
Another change expected to reduce exaggerated and fraudulent claiming. Lump sums will compensate only for loss of past and future earning capacity, and general damages for seriously injured claimants (with a ‘whole person injury’ above 10 per cent).

While the new scheme broadens coverage to care for those at fault and addresses shortcomings of the old, it also introduces new risks, which will take several years of experience to understand and quantify, such as:

The adequacy of the scheme costing
Particularly given future events are subject to unpredictable economic, legal, social and behavioural forces. The scheme's cultural shift — from being adversarial in nature to offering support from day one — also presents costing challenges.

An untested threshold for claimants to receive continued benefits
After 26 weeks, a new definition of 'minor injury' will determine whether a claimant continues to receive benefits.

Fitness for work assessments
Are also new for the scheme and will be important in determining overall scheme costs. The 10 per cent 'whole person injury' threshold — a continued point of risk.

New dispute resolution mechanisms
Are in place at scheme pressure points, but remain untested.

In addition to these changes related to claimant benefits, the new scheme also formalises new rules for insurers around the **premium system**. Most notably:
A **Risk Equalisation Mechanism (REM)**, intended to address known industry-wide cross subsidies and improve insurer competition for high-risk policies. The mechanism is not intended to change the relative performance of insurers or to worsen their position below a minimum profit threshold.

Profit Normalisation
The adjustment of premiums and fund levies in case of excess profits or excess losses. One particular challenge is that application occurs at an insurer level while the triggers for action are set at an industry level. Industry profitability will take many years to be known with some certainty, deferring application for some time. These

THE CASE FOR CHANGE IN NSW
Here's a recap on the main drivers for CTP reform, as described by the State Insurance Regulatory Authority (SIRA).

Affordability
New South Wales premiums were the highest in the nation and predicted to continue rising. Affordability was decreasing, with premiums climbing to levels not seen in more than 15 years.

Efficiency
Benefits directly paid to claimants were less than 50% of the total premiums paid.

Timeliness of payment
Given the lump-sum nature of the previous scheme, only 6% of claims were paid in the first year, with 18 months the average time to settlement for minor injury claims.

Fraudulent & exaggerated claims
These were becoming an increasing feature of the experience, adding significantly to the cost of the scheme and the level of premiums paid.

changes represent considerable additional complexity in the New South Wales CTP market and significant challenges for insurers to manage in the future.

Compulsory Third Party around the country

Queensland
While the results of a 2016 scheme review by the regulator concluded there was no need for major reform, it went on to identify 19 recommendations to maintain and/or improve the Queensland scheme experience. In particular, that the regulator prioritise the issue of high insurer profits.

ACT
A citizen's jury of community members voted in March for a new far-reaching CTP scheme, covering all Canberrans regardless of fault. This includes medical and care costs for up to five years and a 'quality of life' benefit up to $350,000.

Those not at fault and with a serious injury (whole person impairment of at least 10 per cent) will have access to further compensation through a common law claim. Premiums are expected to reduce from an average of $556 to between $385 and $465 a year.

The ACT Government has committed to implement the jury's choice and is working to have draft legislation before the Legislative Assembly by the end of the year. But Canberra's legal profession strongly opposes the model, which it describes as "unfair, unjust and unnecessary". It has called for a Parliamentary Committee review before the proposed changes are debated in the Assembly.

South Australia
With fixed pricing restrictions, CTP policies have been issued by four private underwriters in South Australia since 1 July 2016 — AAMI, Allianz, QBE and SGIC (a subsidiary of IAG). Competitive pricing will be introduced at the end of the initial three-year transition period.

Although early days, much has been implemented by the regulator including the setup of a scheme performance framework, a compliance framework, and a review of local and overseas schemes, with a discussion paper on competition and options ahead.

ASK YOURSELF

Are you actively monitoring business volumes by segment to understand changes to your portfolio mix?

Have you revised your rating structure in consideration of the new scheme?

Have your boards been briefed on the principles of Profit Normalisation and the implication for future returns from this business?

INSIDE JOB

Cyber risk is entering a brave new world and causing a stir in the process

Actuary Tim Yip goes behind the scenes to glimpse the future

AT A GLANCE

- Underwriters are cautious in pursuing stand-alone cyber growth, and reinsurers believe immediately viable growth opportunities lie in sub-limited coverage, where cyber is added on to existing policies.
- Brokers emphasise business confusion about stand-alone cyber coverage and the variation in premiums across insurers, warning of the risk of price wars and under-insurance.
- Although cyber volumes have been steadily increasing, the market did not report a significant increase in stand-alone cyber premiums leading up to the new breach notification laws.

Large-scale cyber attacks are on the rise globally and while Australia's new breach notification laws are in place to address the problem, many businesses have been caught off guard. But where one sector sees challenge, another recognises potential, and the insurance market has quickly sensed it has a role to play.

The laws, which took effect on 22 February — 16 years after similar laws were introduced in the United States — require cyber security breaches of personal information to be disclosed to the Australian Information Commissioner and to the people whose data has been compromised. But it appears businesses are not only unprepared for the increasing threat but also for compliance to the new rules.

And we're not alone. In Britain, intelligence officials have warned of increasing corporate vulnerability and cyber crime is now a Tier One threat there, alongside natural disasters and terror. At the same time, a recent UK government survey found two-thirds of large companies are untrained to deal with an attack. Another survey, by international specialist insurer Hiscox, confirmed more than half of businesses in the UK, US and Germany are ill prepared to deal with these kinds of attacks.

Back home, in Australia, a 2017 survey conducted by Allianz Worldwide Partners, found more than half of small businesses either don't have cyber crime protection or assume it is covered through their business insurance. On top of this, thousands of businesses — up to 44 per cent of enterprises — are not ready for the new laws, according to cyber security specialist CyberArk in the *Financial Review*.

In this atmosphere of confusion and very real threat, our own Barometer survey of all players across the industry reveals a mood of anticipation, as opportunities are generated to insurers of all sizes and shapes, from the large incumbent players to the smaller niche entrants. Here's what they have to say:

Data: home vs away

Underwriters and reinsurers emphasise an increasing reliance on international data and partnerships with third-party providers to assist with exposure assessment and risk pricing. Despite this, underwriters say local data capabilities are improving rapidly, and reinsurers agree.

We note that while third-party partnerships ensure the availability of more fit-for-purpose products for businesses, they also reduce insurers' ability to differentiate themselves.

Growth: a tall order

Underwriters: see great potential for growth, but all players are cautious, with some holding off in the short term, allowing time to assess cyber exposure and identify precise overlaps and gaps in their offerings.

Brokers: agree on the chance for growth but are also concerned. They see increasing competition from new entrants and international players, and believe businesses are still confused about their needs, which, coupled with significant variation in insurer premiums, is leading to under-insurance.

Reinsurers: agree that premiums are expected to grow, but remain sceptical about the short-to-medium-term growth prospects of stand-alone cyber, viewing cyber sub-limited coverage, where insurers add on cyber cover to existing policies, as having immediate growth opportunities.

US experience shows us regulation will be a key factor in driving cyber insurance growth, providing plenty of challenges and opportunities to insurers in accurately assessing risk and offering competitive prices — making 2018 one of the most exciting years yet for cyber insurance in Australia.

ASK YOURSELF

Do you believe changes to mandatory breach notification laws will trigger an increase in demand for cyber cover?

Have you already launched or intend to launch a stand-alone cyber offering?

If so, are you seeking to obtain international data and/or form partnerships with third-party providers to assist with exposure assessment and risk pricing?

STAND BY ME

These days, it's not just numbers and process that drive financial strength, but trust and respect. *Senior Actuary Scott Duncan & Analyst Stephanie Russell* discuss the cultural shift towards holistic reasoning

A central theme emerging from the Royal Commission into Misconduct in the Financial Services Industry is the breakdown of trust between institutions and their customers. Ultimately, trust is compromised when institutions fall short of their customers' expectations, whether through poor product design, short-sighted corporate strategy or damaging interactions with customers.

In this climate of change and intense scrutiny, trust between consumers, insurers and regulators is critical, and set to become increasingly important in the future. Here, we explore APRA's take on the concepts of trust and social licence.

Lights, APRA, action!

APRA's mission is to ensure institutions meet their financial promises to customers within a stable, efficient and competitive financial system. Until recently, the levers of capital adequacy, risk management and governance structures were viewed as the primary means through which APRA ensured promises were met under all reasonable circumstances. However, APRA now says there has not been "... enough focus on the equally important need to maintain strong community trust" when it comes to ensuring financial stability. It is clear APRA now expects more.

Unpacking social licence

APRA has recently stressed the importance of 'social licence' — the idea that institutions must earn and maintain the trust of the communities in which they operate. Ultimately an expression of the quality of the relationship, social licence is dynamic and must first be earned, then maintained over time. APRA's position is

that social licence is fundamental to ensuring the long-term financial health of institutions and has stated that it goes "hand-in-hand with ensuring strong capital and solvency ratios".

But, you may ask, isn't trust something that falls under ASIC's umbrella? After all, as Australia's corporate, markets and financial services regulator, ASIC's mandate states it contributes to the financial wellbeing of all Australians by "promoting investor and consumer trust and confidence". Yes, there will inevitably be some regulatory overlap, as trust emanates from the entirety of an institution's activities rather than conduct in a single area. However, it's worth recognising that APRA and ASIC are approaching trust from different perspectives — APRA views trust as facilitating the delivery on financial promises, while ASIC sees it as a crucial element of overall market fairness and efficiency.

Moving beyond

Trust and social licence continue to receive increased media attention. In addition to ARPA's focus on trust, we believe trust between consumers and insurers is now more important than ever, due to:

- Changing social expectations: as a society, we are no longer satisfied with businesses whose primary objective is generating a return for shareholders. People want to deal with businesses (insurers included) that contribute to society more broadly.
- Greater consumer empowerment: technology has facilitated greater choice and the ability for individuals to be heard.
- Profitability and sustainability are built on trust: actions in the short term drive long-term value.

Above all, insurers must remember that trust takes years to earn and seconds to lose.

ASK YOURSELF

Where is your organisation likely to fall short of community expectations and what are you doing to address these areas?

Are all your products and processes transparent and fair?

Is your strategy long-term or short-term focused?

NO CONTEST

The recent Productivity Commission's damning draft report cited three recommendations to fix the 'illusion' of competition. *Principal Actuary Kevin Gomes* reveals the good and the bad for insurers

Several criticisms of the general insurance market were a key feature of the Productivity Commission draft report, released on 7 February 2018, following an inquiry into competition in the Australian financial system.

Concerning for general insurers was the Commission's unfavourable evaluation of the deceptively high market concentration within the industry, noting "many general insurers provide insurance under multiple brands" creating "the illusion of more competition than actually exists". They were also disparaging of the poor quality of information provided to consumers, which led to confusion on product differences.

The draft report included three recommendations, which aim to improve competition in the general insurance market:

1. Comparative Pricing Information on Insurance Renewal Notices—Renewal notices for general insurance products should transparently include the previous year's premium and the percentage change.

What it means for insurers

- Additional work and expense to modify renewal slips to show the requested comparative pricing information, and additional work in handling customer enquiries regarding price changes.
- If implemented, this change would likely lead to a reduction in renewal rates, as policyholders who have undergone a price increase are more likely to shop around. This in turn may affect an insurer's ability to put through pricing changes, even where these changes are warranted by the underlying risks.

2. Transparency on Insurance Underwriting — The product information shown on an insurer's website should also disclose any other brands underwritten by the same insurer for that particular form of insurance.

What it means for insurers

- May compromise the effectiveness of insurers' brand management strategies. For brand clarity purposes, insurers may also wish to include information on product differences (if any) between different brands.

3. Phase out distortionary insurance taxes — State and territory taxes and levies on general insurance should be phased out from mid-2018.

What it means for insurers

- Clearly an initiative which would be welcomed by insurers, with many having previously expressed concern regarding the distortionary effects of state taxes and levies.

Insurers are currently participating in a consultation process and hope to shape the final recommendations. The industry will eagerly await the finished report, due to be released in July 2018 for the Federal Government's consideration.

ASK YOURSELF

If adopted, would the recommendations in the draft Productivity Commission report cause you to rethink your product offering, pricing and/or brand management strategies?

Are you intending to participate in the consultation process?

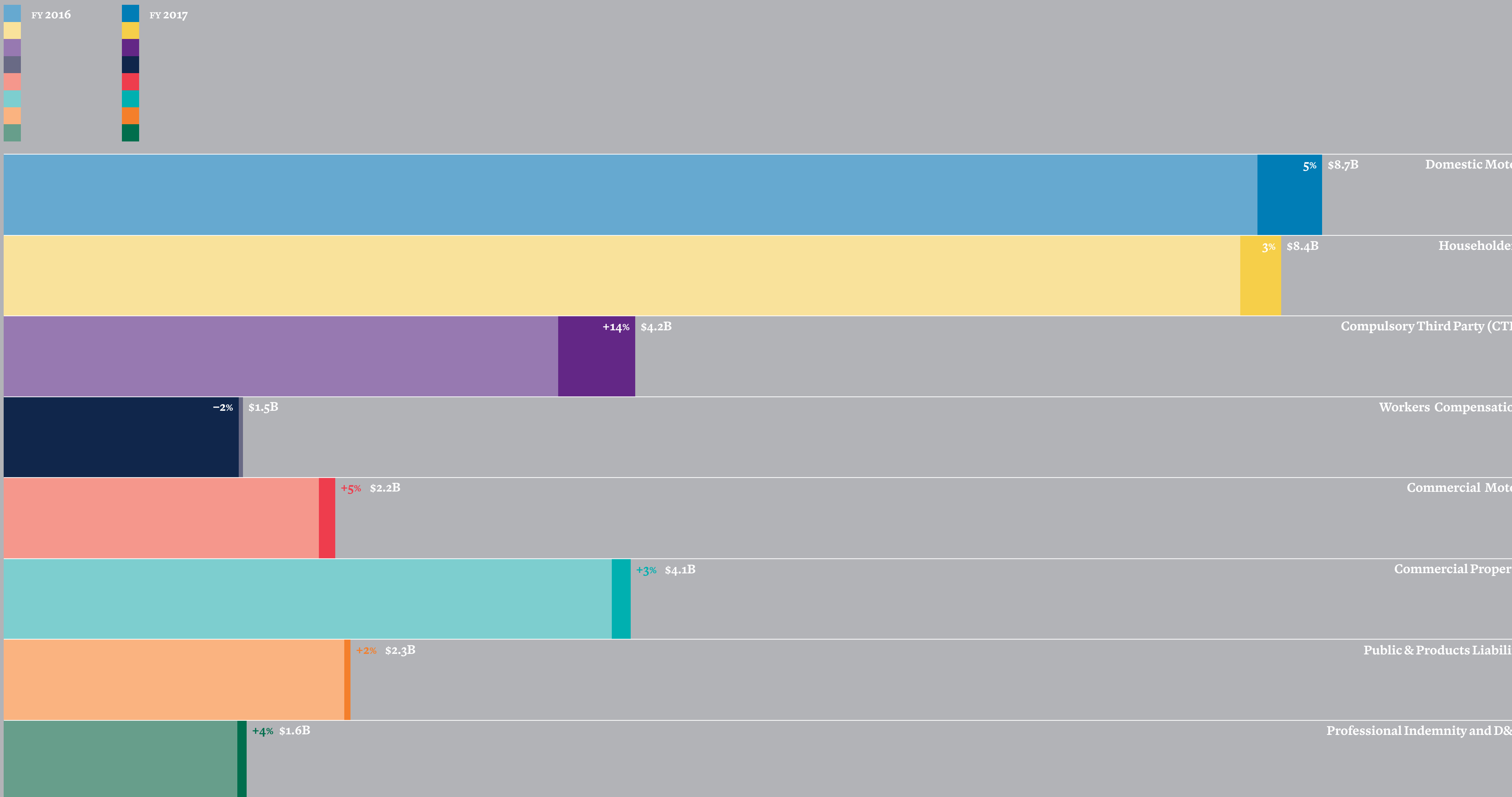
CLASS ACTS

Take a deep dive into each major line of business for a snapshot of recent performance. Before jumping in to the class-by-class detail, have a high-level look at the mix of gross premium income by class in FY 2017, and what's changed from FY 2016

3

Gross premium income by class of business

% shown is change from FY 2016



Source: APRA

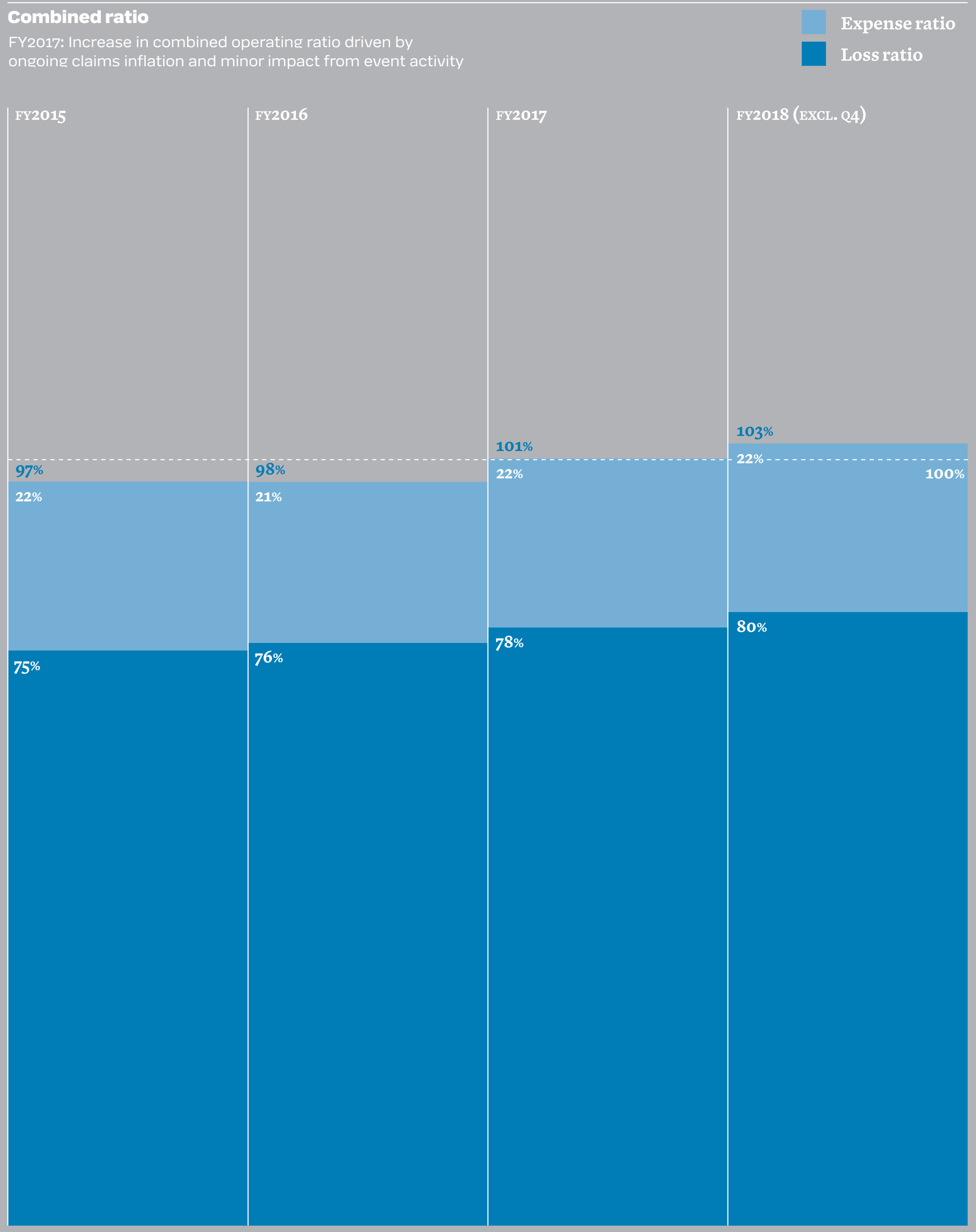
DOMESTIC MOTOR

Increasing use of smart technology in vehicles is helping to keep claim frequency under control, but it's also driving up the cost of repairs. As a result, insurers require premium-rate increases to maintain profitability, although this is difficult to achieve given tough ongoing competition

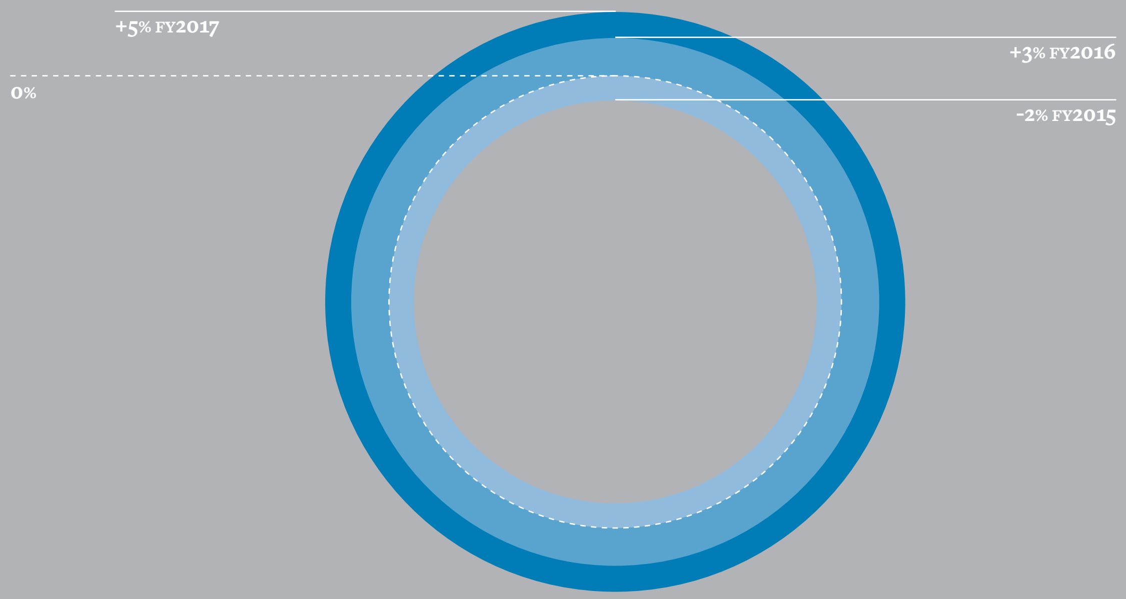
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

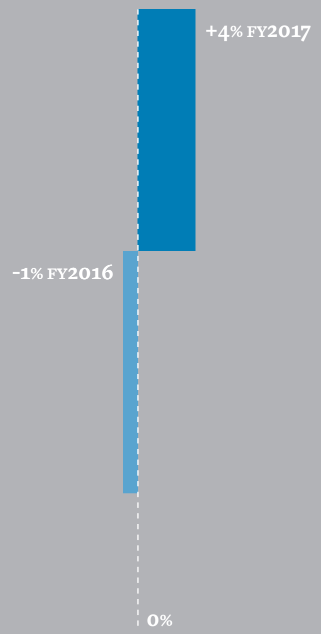
FY2017: Increase in combined operating ratio driven by ongoing claims inflation and minor impact from event activity



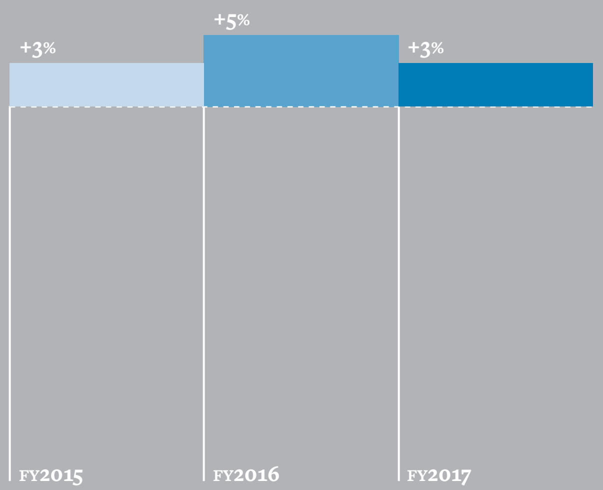
Change in premium rates



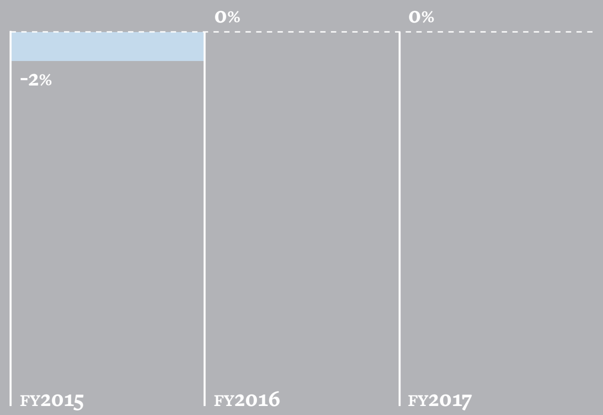
Contribution of event activity above (below) 'normal' allowances to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — DOMESTIC MOTOR

- The cost of parts is subject to higher inflation than the cost of vehicles, creating challenges for insurers (according to IAG, a $15,000 Hyundai now contains $150,000 in aftermarket parts)

- There has been an increase in 'right to drive' claims over the past few years, whereby not-at-fault drivers are claiming for the cost of a replacement car which is paid for by the insurer of the at-fault driver

- In response to ASIC's review of add-on products sold through motor dealers, insurers offered more than $70 million in refunds to customers during 2017 (expected to grow to more than $120 million) and re-evaluated their product offerings

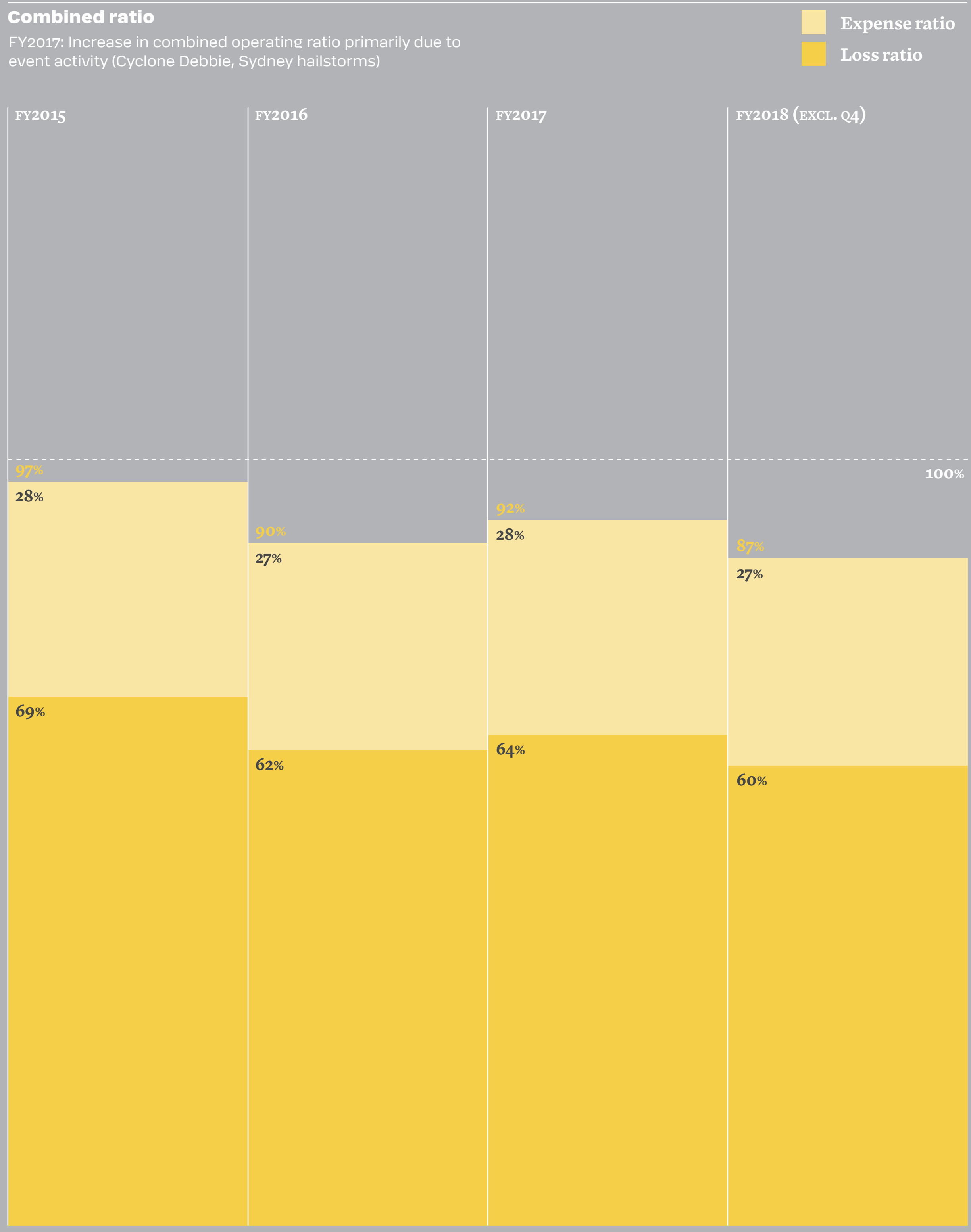
HOUSEHOLDERS

Lower levels of construction activity have alleviated labour and material shortages, which had driven up the cost of claims in recent years. As a result, claims inflation started to ease during 2017, despite unfavourable weather events that occurred during the year

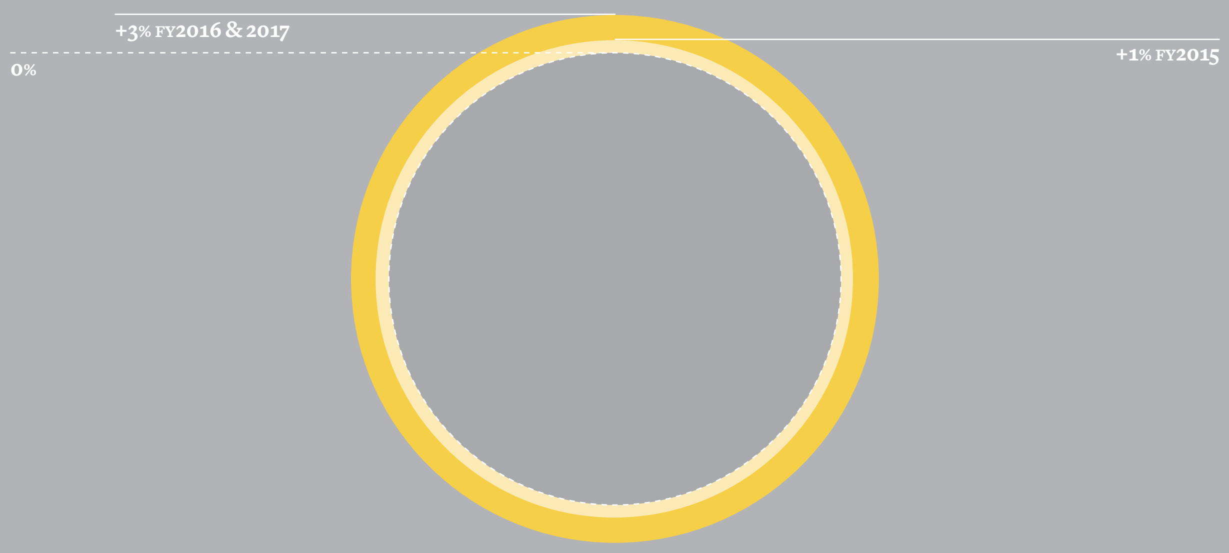
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

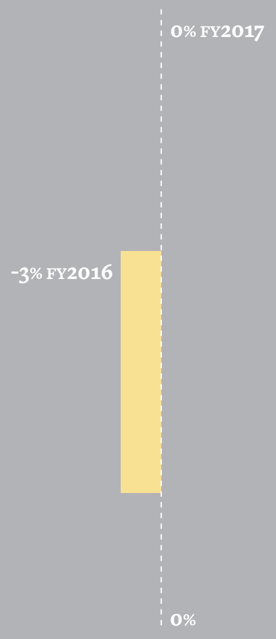
FY2017: Increase in combined operating ratio primarily due to event activity (Cyclone Debbie, Sydney hailstorms)



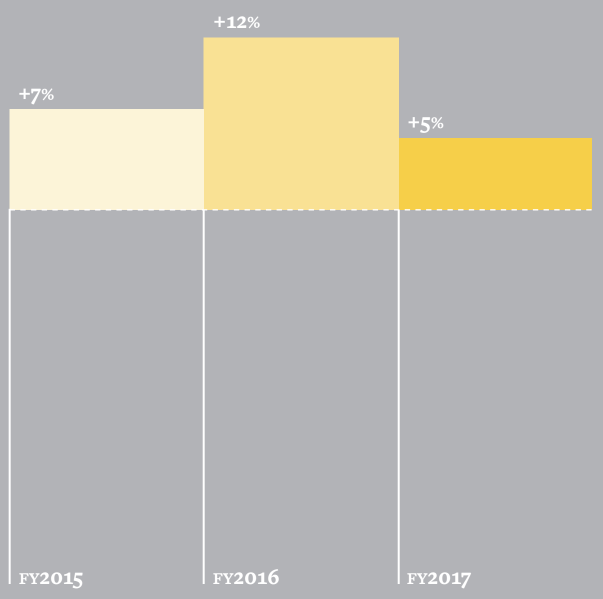
Change in premium rates



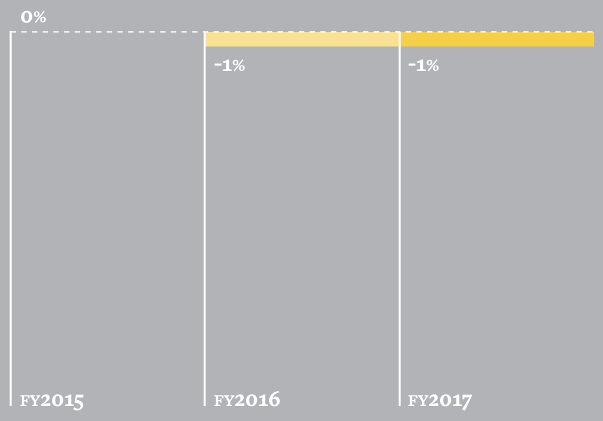
Contribution of event activity above (below) 'normal' allowances to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — HOUSEHOLDERS

- The removal and subsequent backflip of the New South Wales Emergency Services Levy from 1 July 2017 added cost for insurers, some of which may be passed on to consumers through higher premiums

- The growth of the sharing economy has prompted insurers to consider how they might alter their products to accommodate or exclude this exposure

- Affordability and underinsurance continue to remain an issue, exacerbated by the pressures of low wage inflation

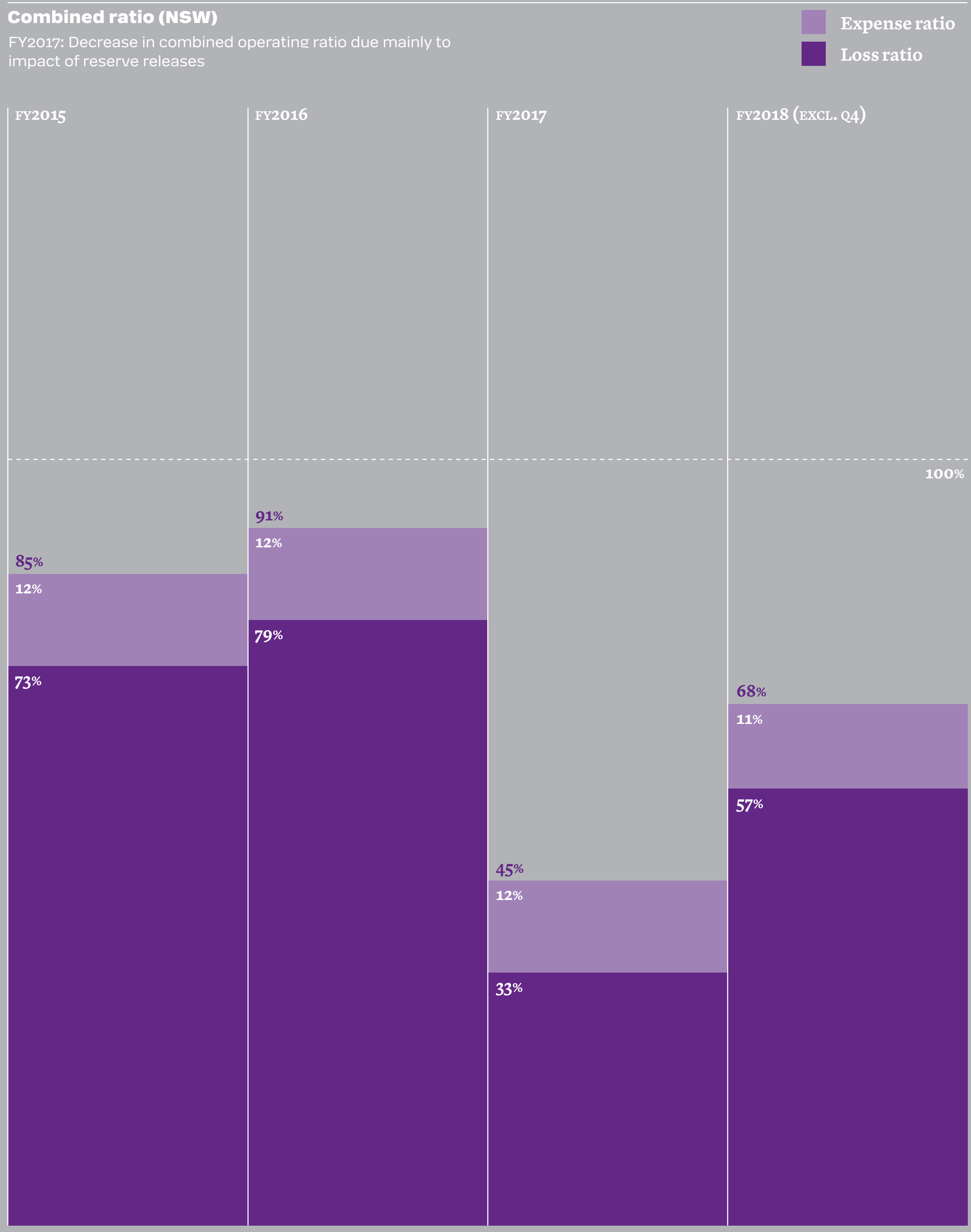
COMPULSORY THIRD PARTY

In New South Wales, the upward trend in claim frequency over recent years has been addressed by several initiatives, including changes to legal-cost regulations and fraud mitigation efforts. Under the new scheme, a slightly lower frequency is expected, despite expanded coverage. The noticeable rise in Queensland CTP frequency is primarily at the lower end of the spectrum (minor/whiplash injuries)

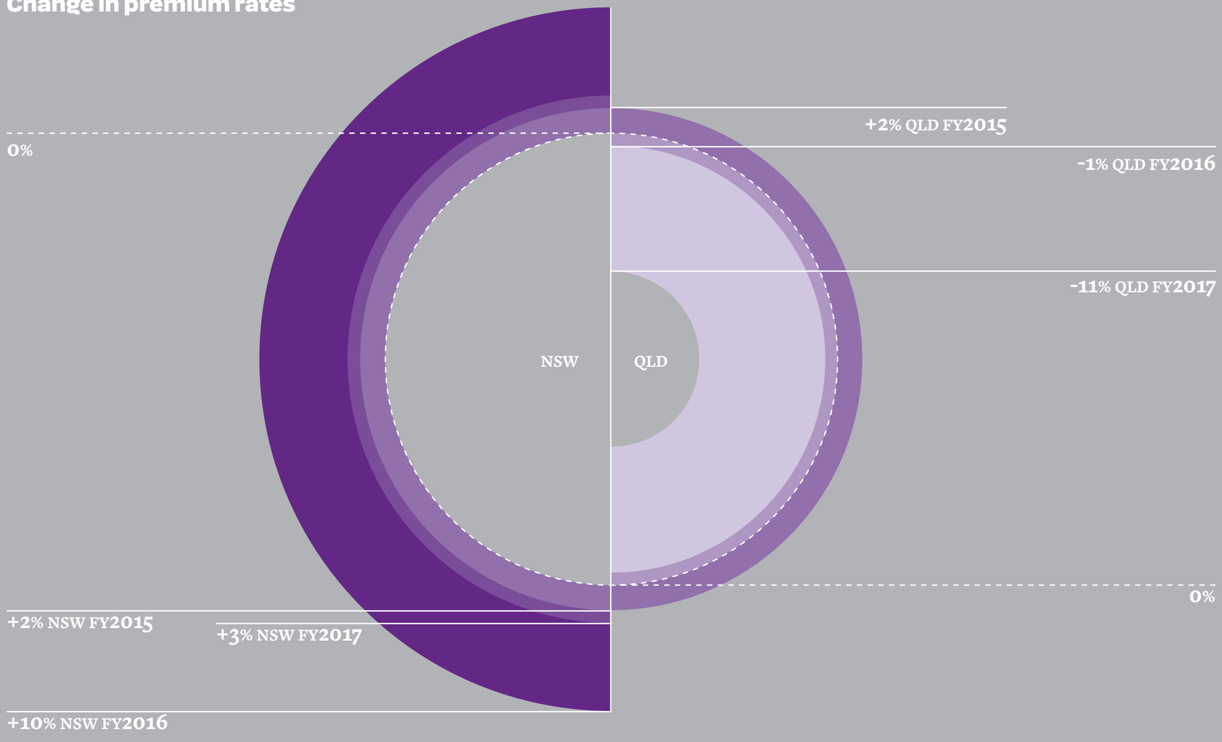
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio (NSW)

FY2017: Decrease in combined operating ratio due mainly to impact of reserve releases

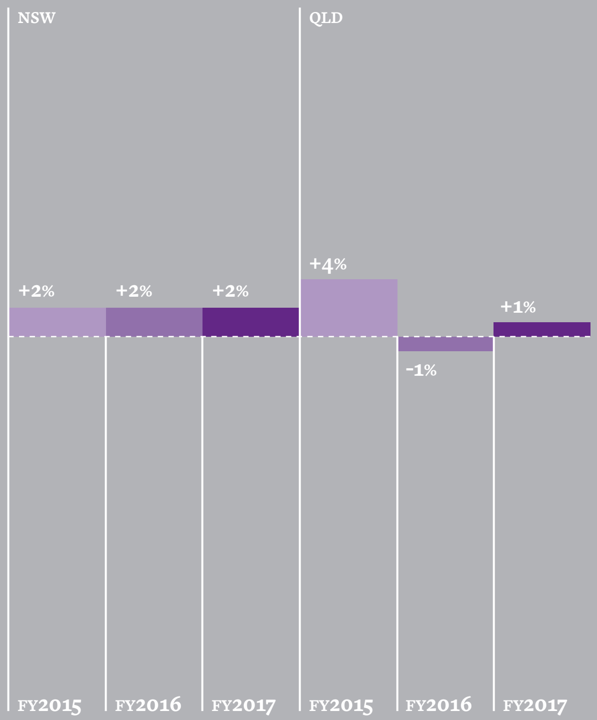


Change in premium rates



Contribution of reserve strengthening (releases) to combined ratio

Claims inflation



Change in claim frequency

ON THE RADAR — COMPULSORY THIRD PARTY

- New South Wales profitability will be under increased pressure due to the 2017 scheme reforms, and lower expected reserve releases. The new injury thresholds introduce additional uncertainty

- The Queensland scheme review indicated no major reforms are required. The regulator continues to look at ways to improve affordability and efficiency, including targeting claim farming activity

- South Australian CTP is transitioning to a competitive scheme. Interim fixed pricing arrangements are due to expire by 1 July 2019

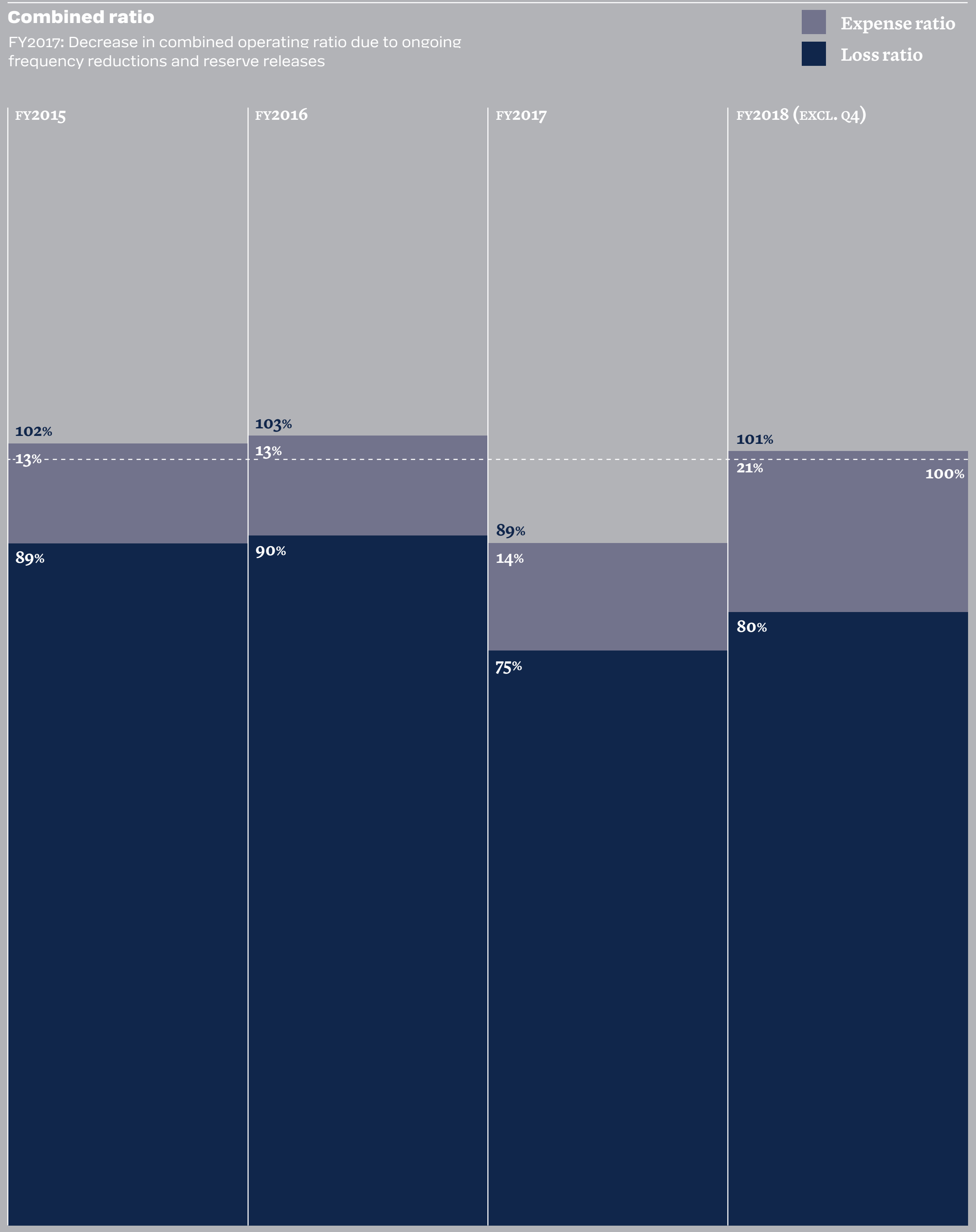
WORKERS COMPENSATION

Nationally, there was mixed claims experience. Fewer blue collar jobs in the mining states reduced claim frequency, but many jurisdictions felt concern over the increase in claim duration, which was partly influenced by tighter economic conditions. Low wage growth is being reflected in the premium pool, increasing competition among insurers who seek to meet higher top-line growth targets

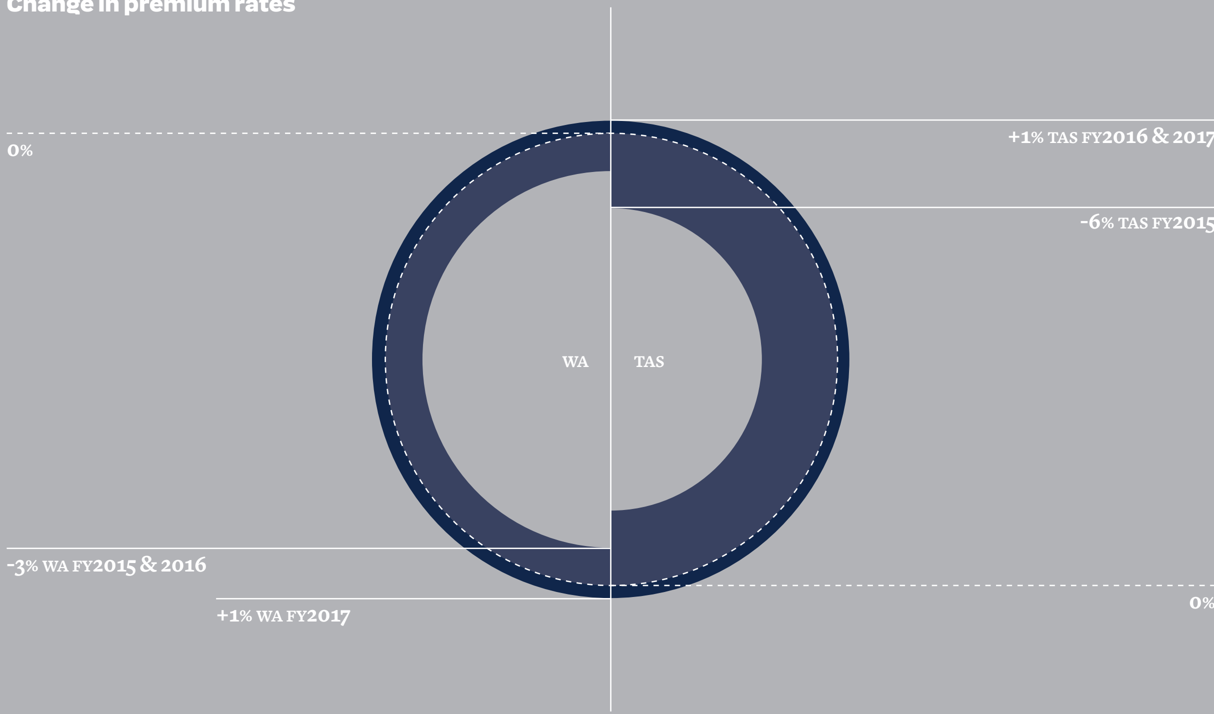
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

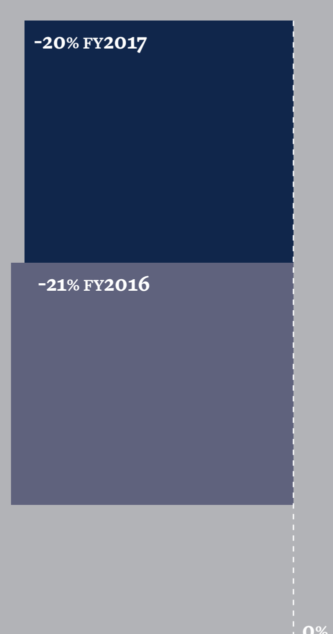
FY2017: Decrease in combined operating ratio due to ongoing frequency reductions and reserve releases



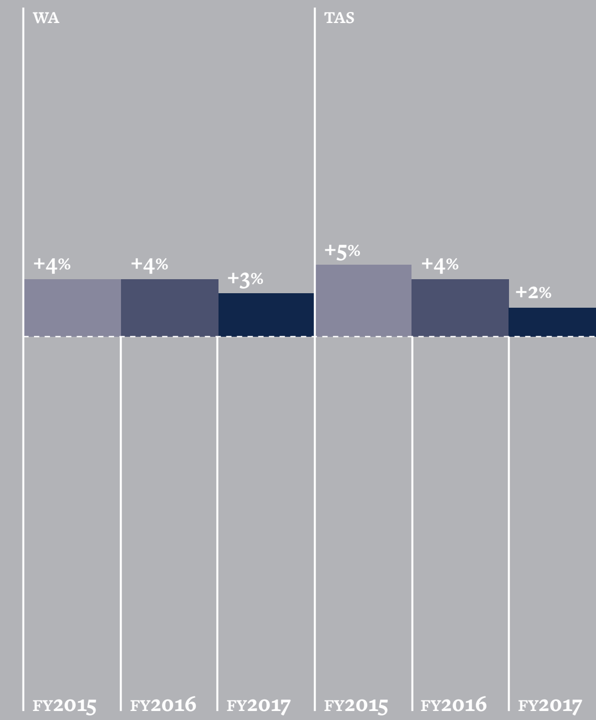
Change in premium rates



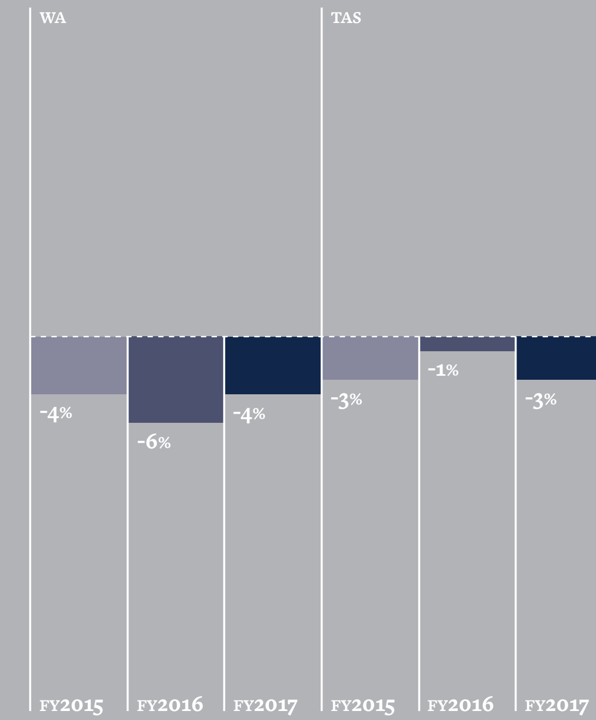
Contribution of reserve strengthening (releases) to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — WORKERS COMPENSATION

- Competition among insurers in the privately underwritten jurisdictions has led to some insurer premium rates being lower than those recommended by scheme regulators – increasing the risk of underpricing

- The burden of changing state-based legislation (such as the extensive New South Wales reforms) may make the option of a consistent national framework under the Comcare scheme more attractive to larger employers

- The future of work (for example, the 'gig economy' and the definition of 'a worker') will be an area of increasing consideration for all schemes

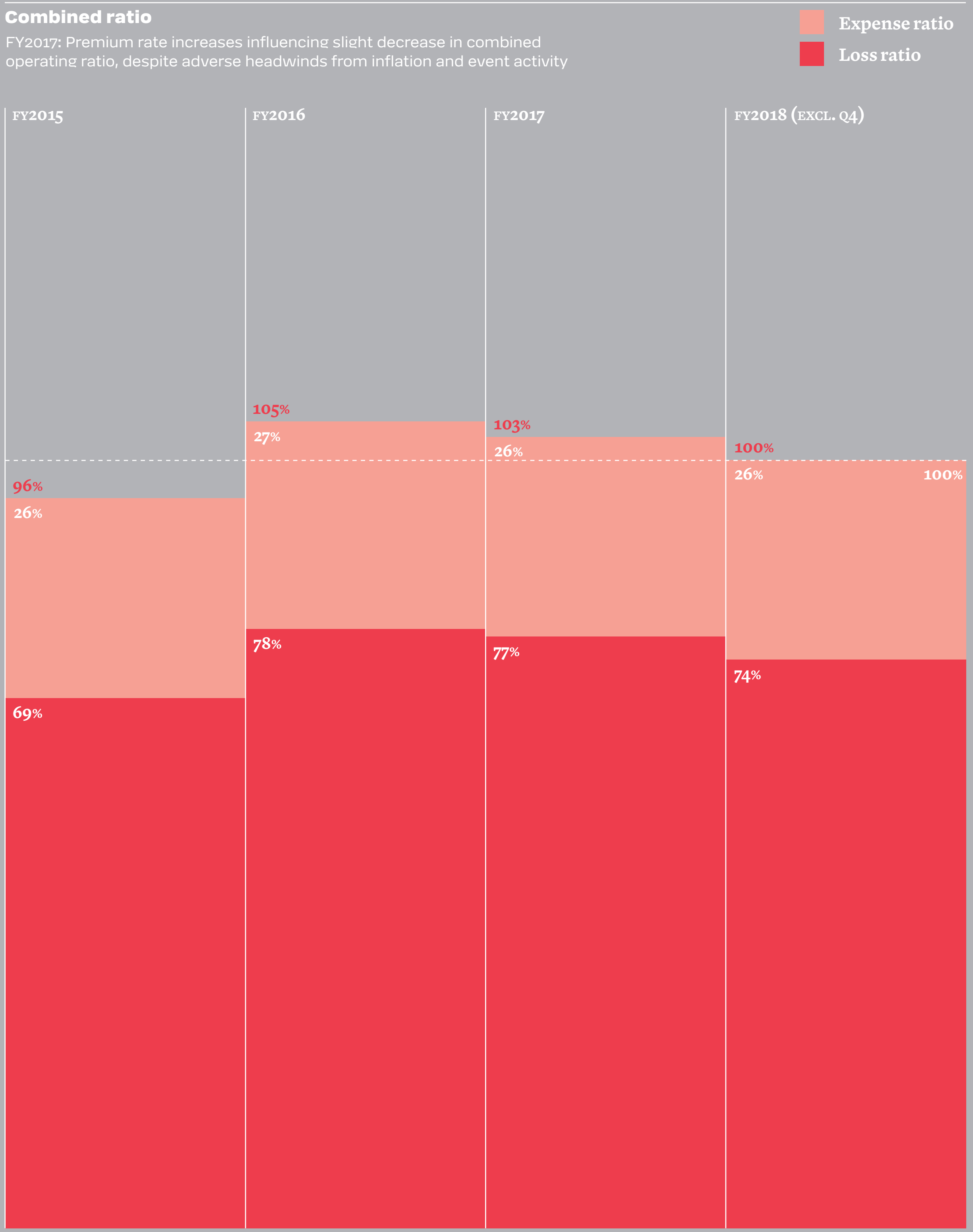
COMMERCIAL MOTOR

This class is experiencing the same adverse claim-cost headwinds as domestic motor, but profitability impacts are exacerbated instead by the usual cyclical premium pressures associated with underwriting commercial classes. We observe some light at the end of the tunnel, however, as rate increases are now evident through a hardening market

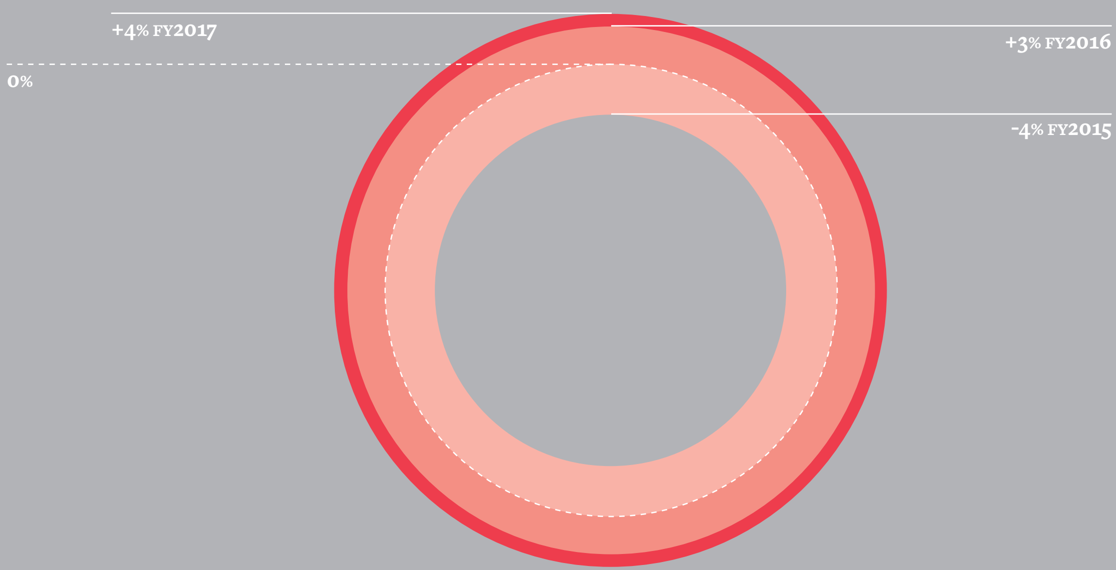
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

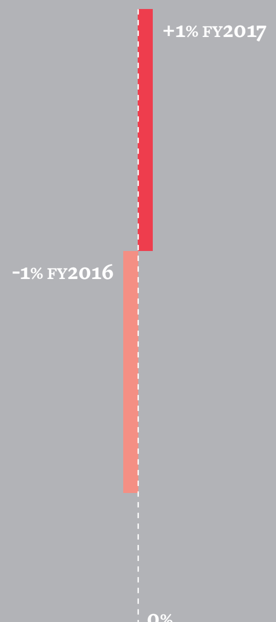
FY2017: Premium rate increases influencing slight decrease in combined operating ratio, despite adverse headwinds from inflation and event activity



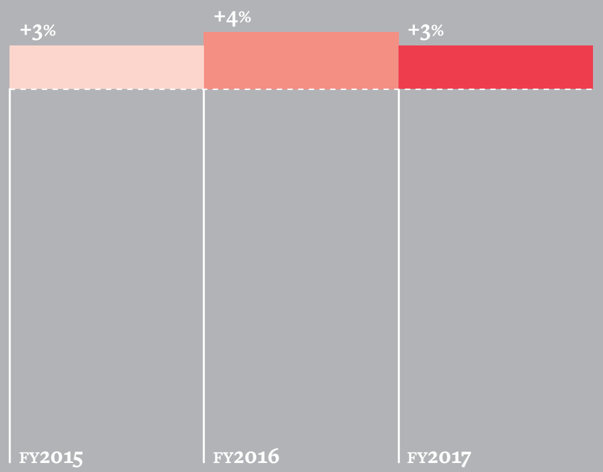
Change in premium rates



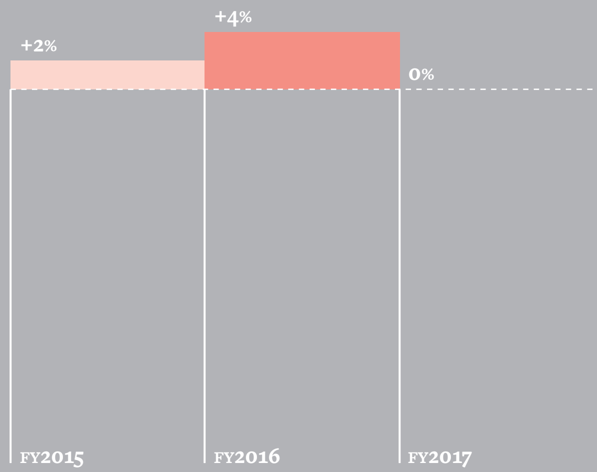
Contribution of event activity above (below) 'normal' allowances to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — COMMERCIAL MOTOR

- Australia's weakened currency is increasing the cost of imported parts
- Best-practice claims management is seen as key to restoring profitability
- Insurers intend to move the conversation away from premiums and onto other aspects of their value proposition — though it's unclear how this will play out

COMMERCIAL PROPERTY

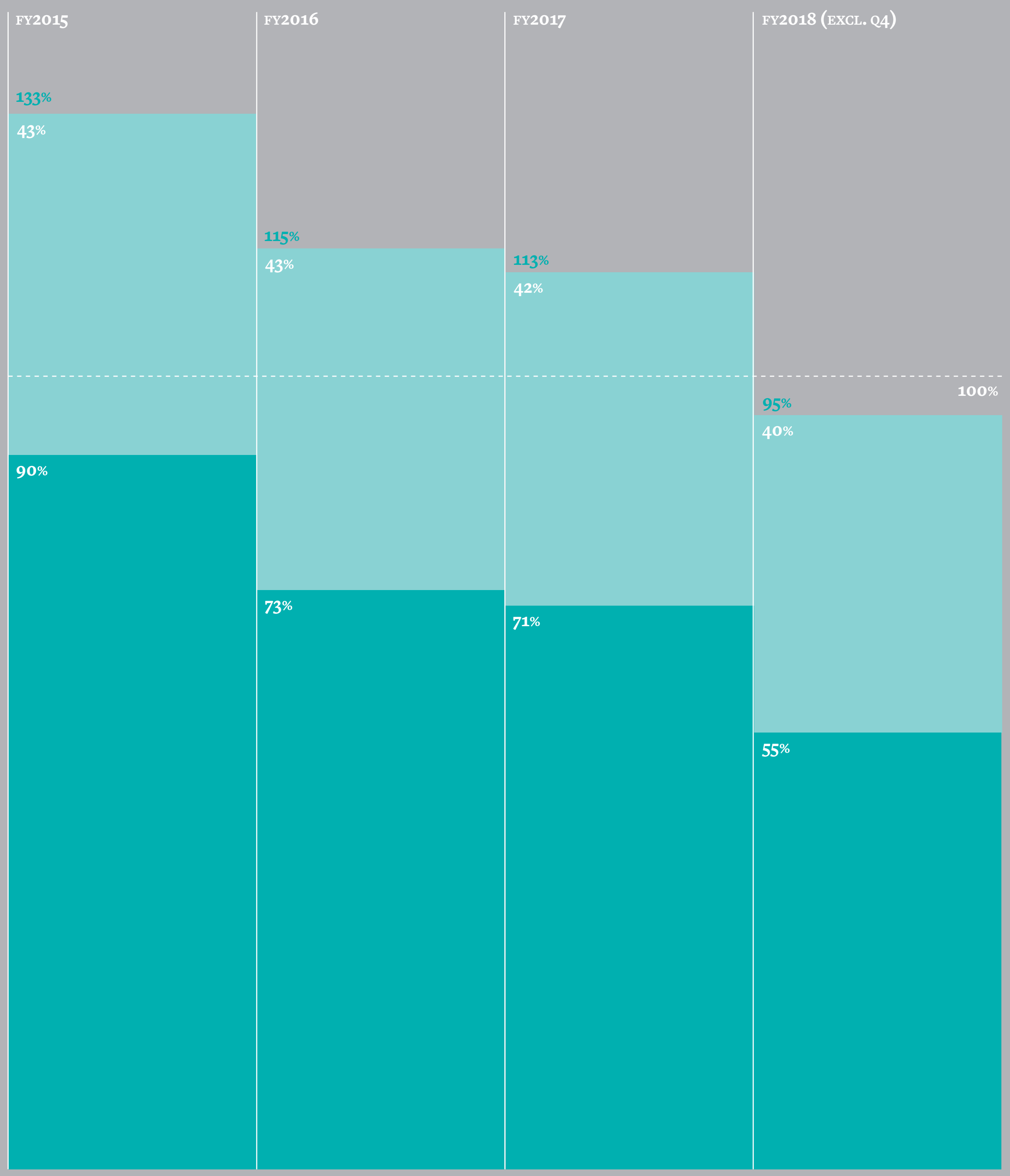
Premium rates are increasing for the first time in the past five years, as insurers draw a line in the sand, notwithstanding abundant capacity. Hardening rates are evident across all segments of the market — including large corporate risks — a sure sign the cycle has turned

Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

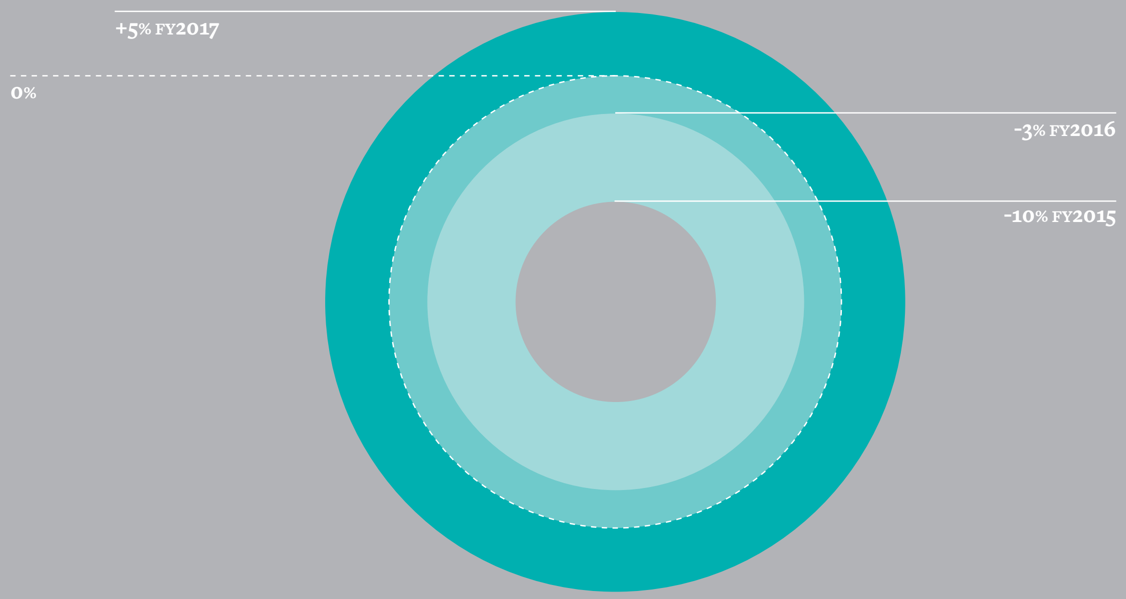
Combined ratio

FY2017: Premium rate increases from hardening market influencing slight decrease in combined operating ratio, despite adverse event activity (Cyclone Debbie)

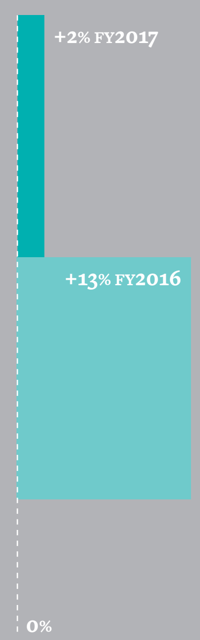
Expense ratio
Loss ratio



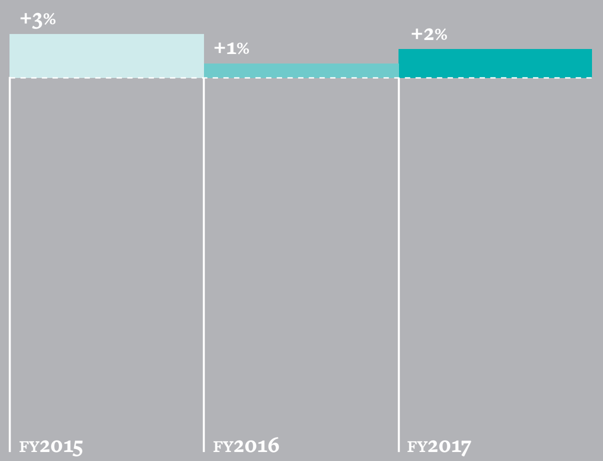
Change in premium rates



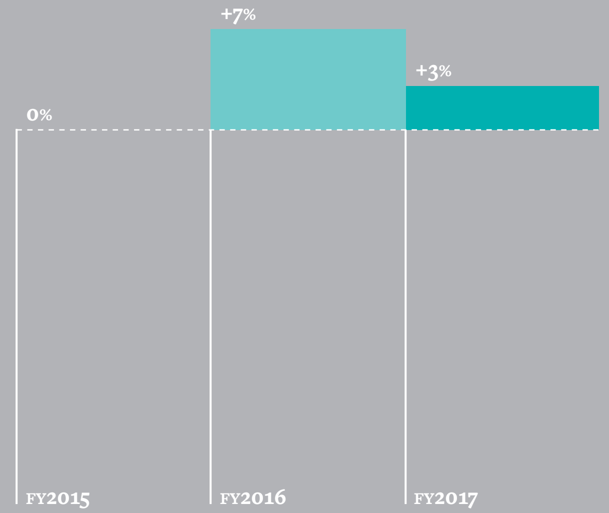
Contribution of event activity above (below) 'normal' allowances to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — COMMERCIAL PROPERTY

- Insurers are struggling to differentiate their value proposition, making pricing the 'go to' lever
- Underwriting performance is heavily influenced by catastrophic events, prompting insurers to seek higher quality data for location-based risk pricing
- The industry is concerned recent catastrophic events overseas will exert upward pressure on reinsurance rates in the Australian market

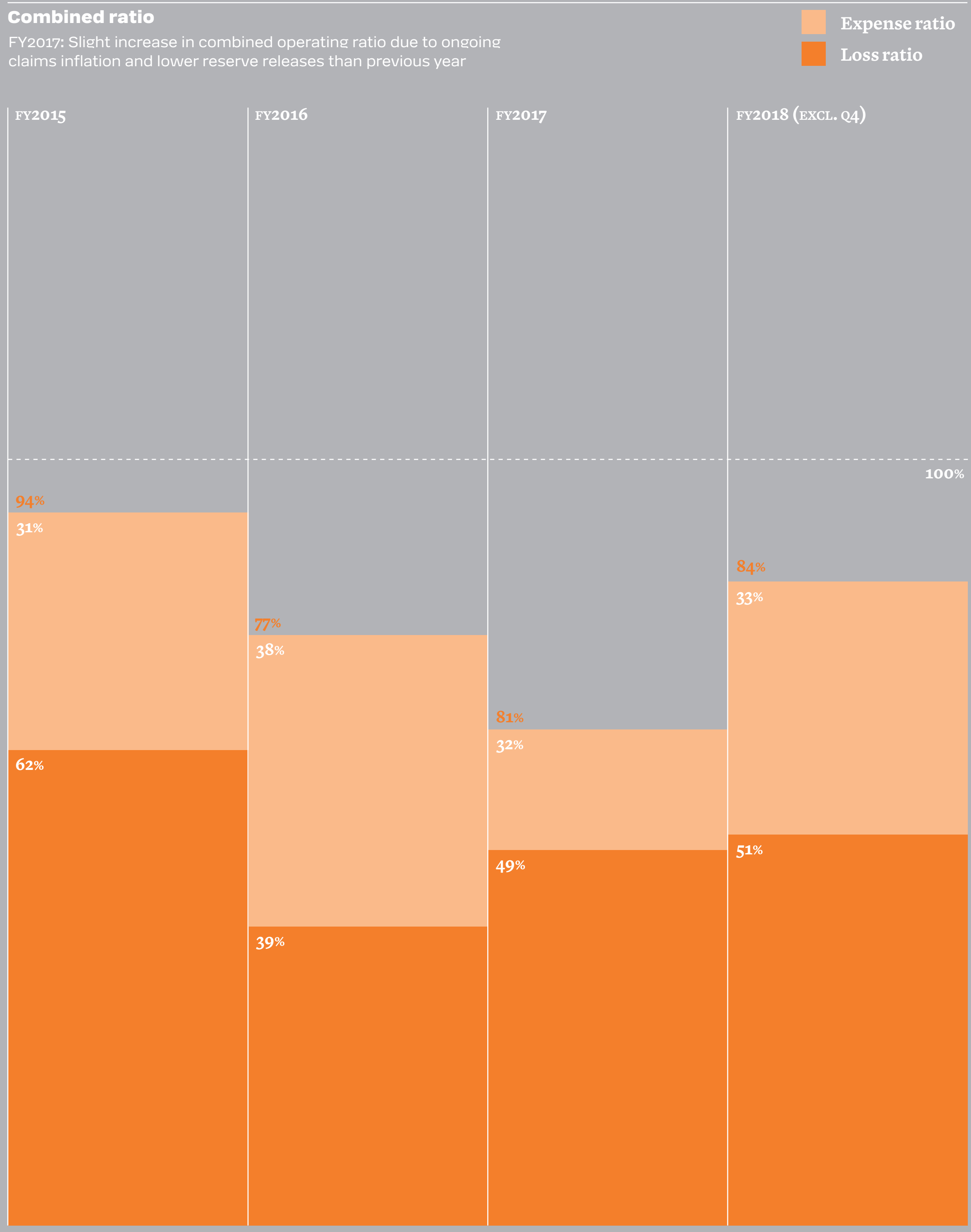
PUBLIC & PRODUCTS LIABILITY

Strong competition and excess capacity are constraining rate increases, while the profitability for some insurers has been affected by adverse outcomes on class actions. Still, overall profitability levels remain reasonable

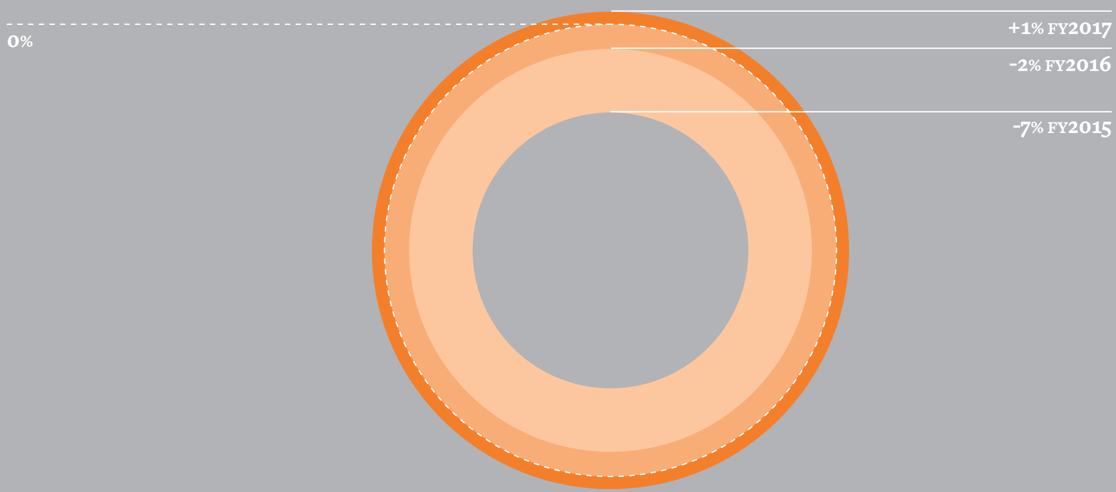
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

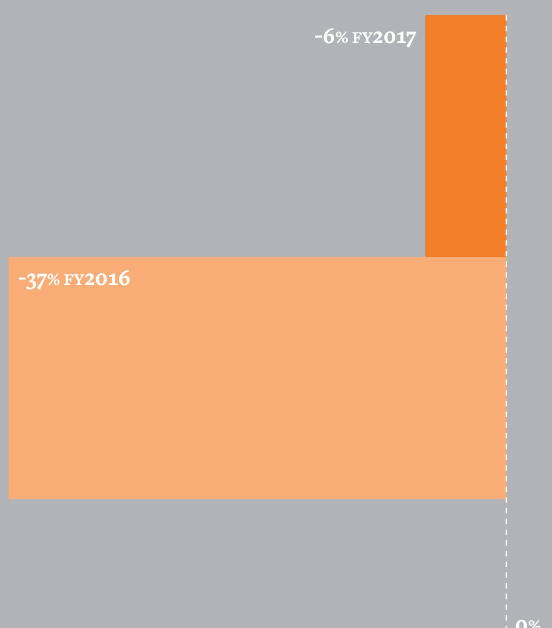
FY2017: Slight increase in combined operating ratio due to ongoing claims inflation and lower reserve releases than previous year



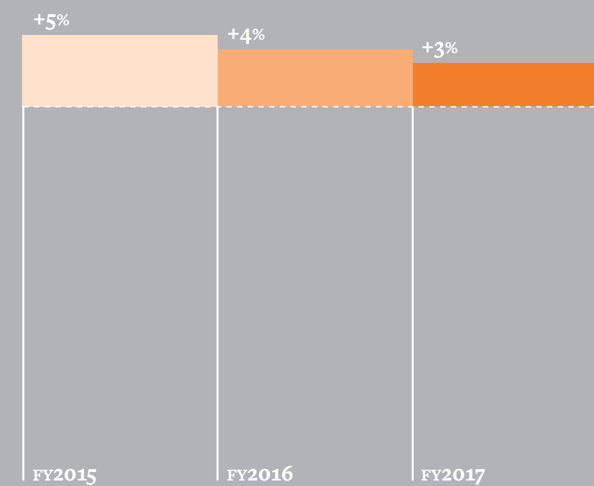
Change in premium rates



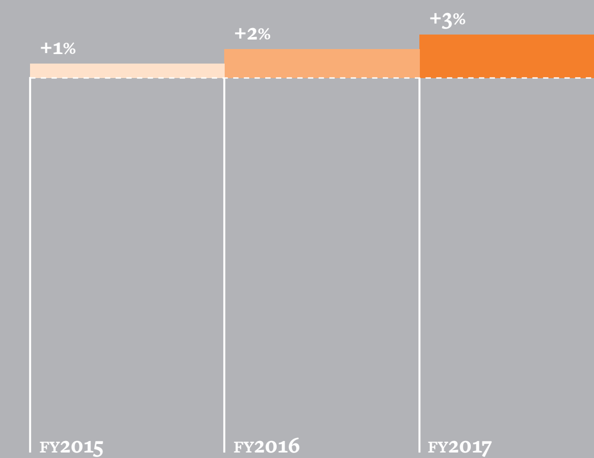
Contribution of reserve strengthening (releases) to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — PUBLIC & PRODUCTS LIABILITY

Insurers are continuing to benefit from relatively benign court and tort systems, despite adverse outcomes on certain class actions

New insurers are entering into the market locally as well as in London and Asia (including Lloyds). This has resulted in plenty of cheap capacity, driving down rates

Years of reserve releases in Public Liability raises the question: will the surplus stockpile run out?

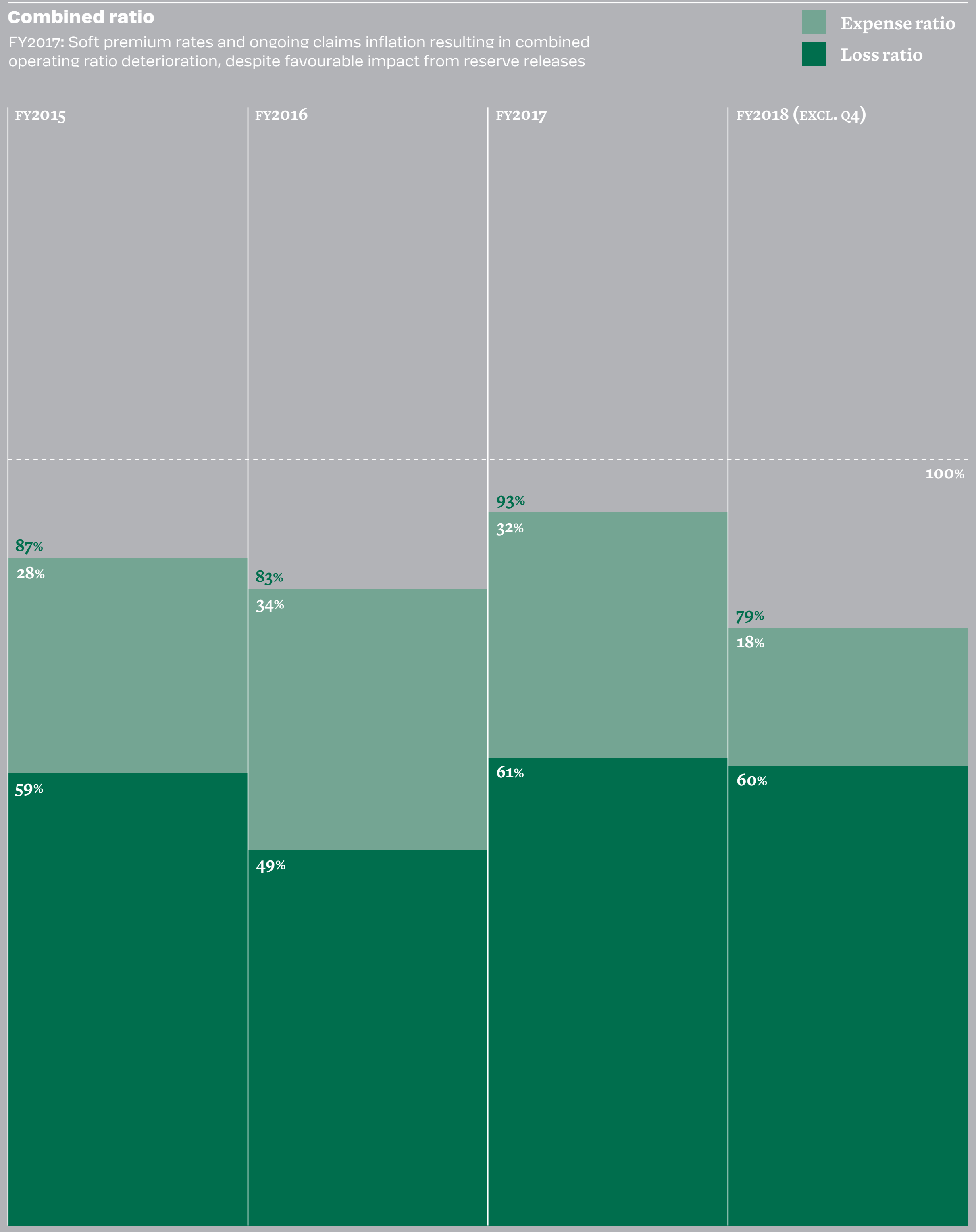
PROFESSIONAL INDEMNITY AND D&O

The data shows a shallower turn in the cycle for casualty lines such as Professional Indemnity, compared with hardening conditions for Commercial Property. High premium rate increases in D&O are in response to very poor claim trends, including significant class-action activity

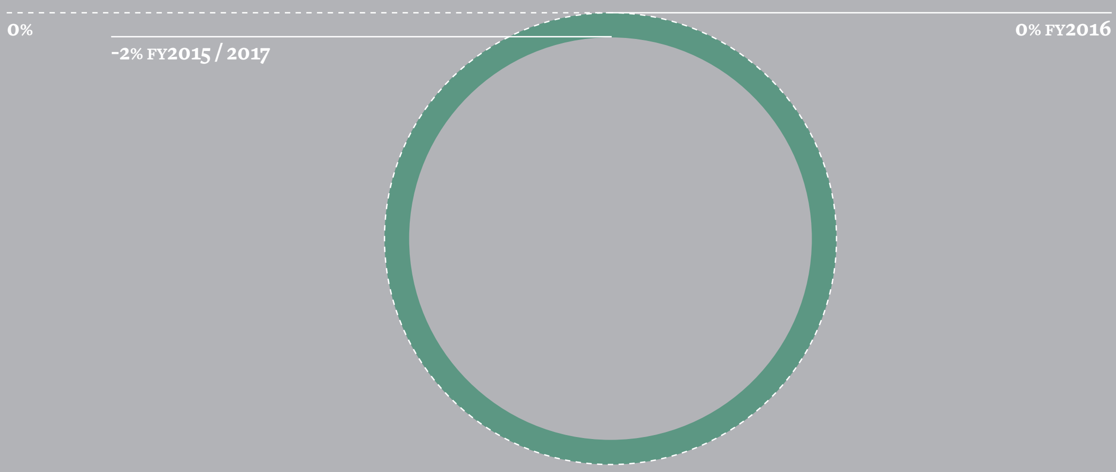
Source: 2017 J.P. Morgan / TAYLOR FRY General Insurance Barometer, APRA

Combined ratio

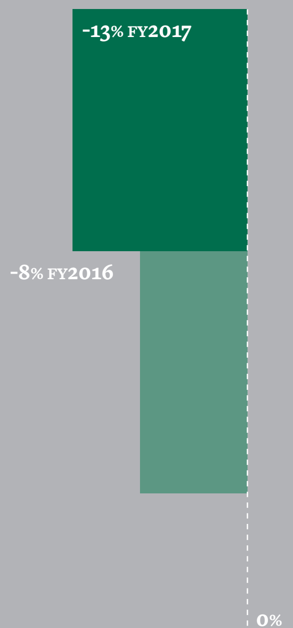
FY2017: Soft premium rates and ongoing claims inflation resulting in combined operating ratio deterioration, despite favourable impact from reserve releases



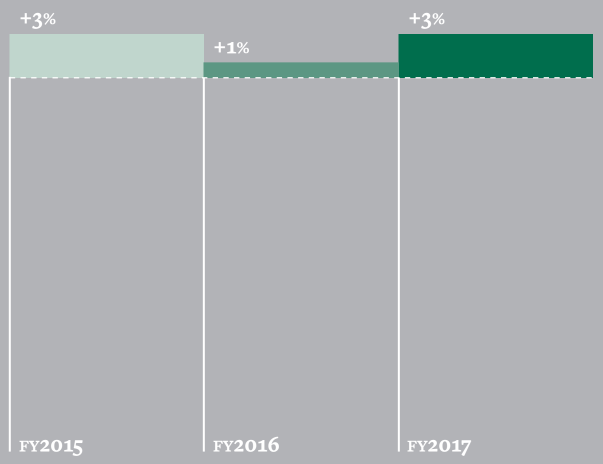
Change in premium rates



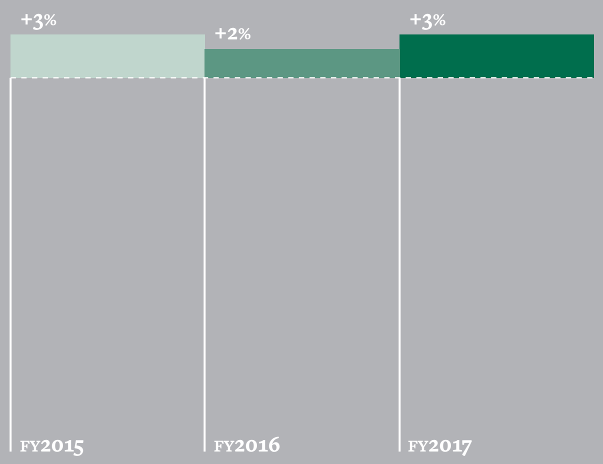
Contribution of reserve strengthening (releases) to combined ratio



Claims inflation



Change in claim frequency



ON THE RADAR — PROFESSIONAL INDEMNITY AND D&O

- The D&O market is transitioning from an actively competitive environment with abundant capacity to an increasingly cautious environment with selective capacity placement

- Given the importance of D&O cover to allow directors to fulfil board responsibilities, significant withdrawal of capacity would have serious repercussions

- While cyber insurance represents a new product opportunity for insurers, 'silent cyber' exposures (referring to coverage for cyber events under existing liability covers) are an area of concern

KIA ORA NEW ZEALAND

Our roundup of the year's major Kiwi happenings and a view to what lies ahead …

4

ISLAND HOPPING

Trip across the Tasman for Wellington-based *Senior Actuary Ross Simmonds's* reflections on a busy year of natural peril events, and regulatory changes on the horizon

As 2017 drew to a close, increased insurance profits were a highlight of the New Zealand insurance market. The increase, which occurred primarily during the six months ending 31 December 2017, was driven by strong growth in gross written premiums aligned with improving underlying profit margins.

This margin improvement was aided by the relatively low level of natural peril-related claims during this period — which offered welcome relief from the second half of CY2016 and first half of CY2017, when insurers experienced more than $2 billion in losses related to the Kaikoura earthquake.

Motor premium increases, in particular, supported improvement in results for personal lines, following a multi-year trend of increasing loss ratios — although motor claims cost inflation remains an area of focus for insurers. As for premium growth, this is expected to continue, despite price increases affecting policy renewals. Potential headwinds still exist, as New Zealand insurers consider the trifecta impact of climate change, technological advancement and regulatory review.

Heavy weather

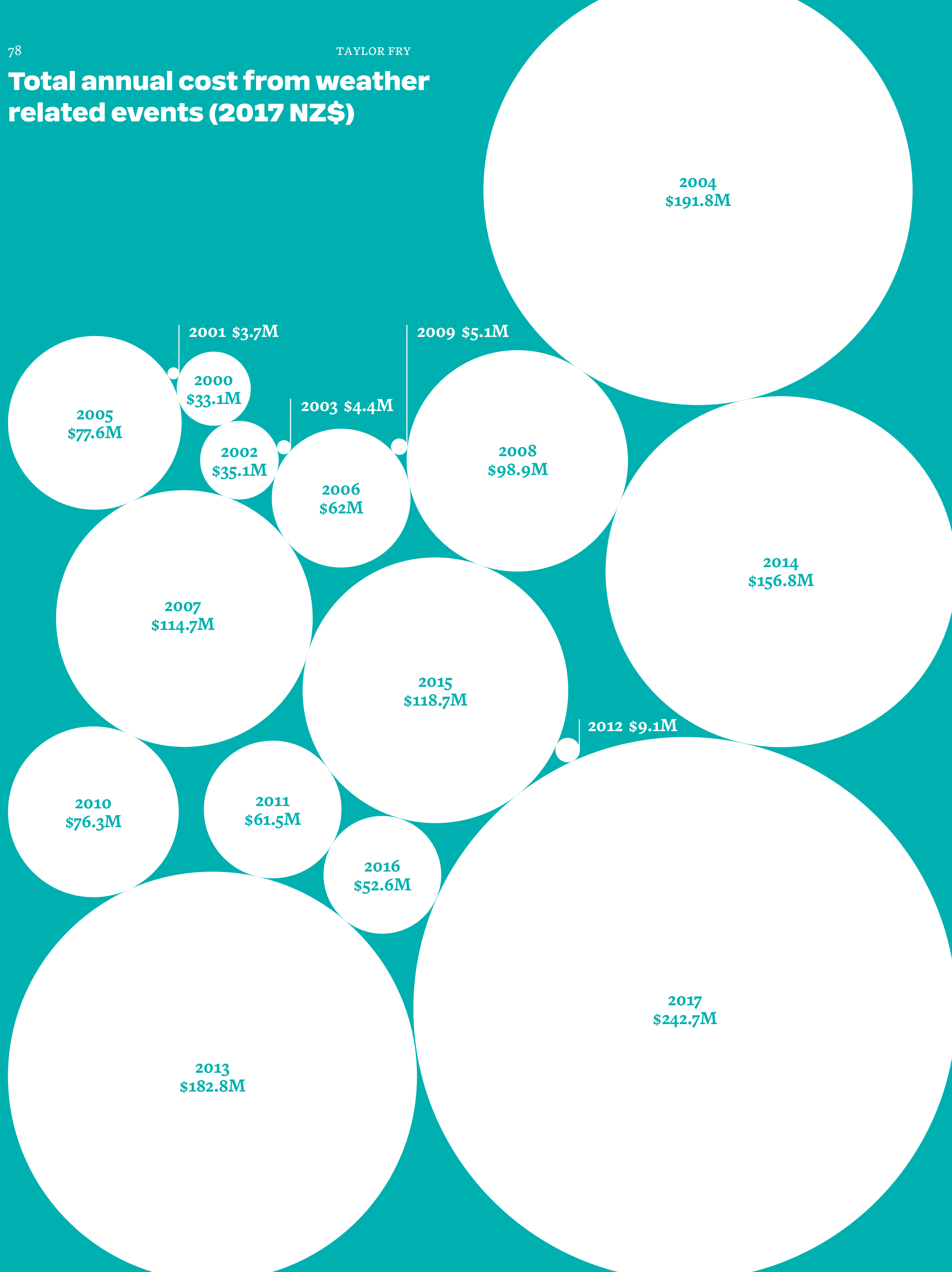
Access to affordable insurance and the risk of underinsurance is a hot topic, given New Zealand is exposed to a variety of naturally occurring events. This was illustrated emphatically by recent cyclones Fehi and Geta, which wreaked havoc across the country in February 2018. With this in mind, premium affordability will likely be an ongoing consideration for New Zealand insurers and policyholders.

Increases in losses related to climate change factored prominently in CY 2017, with last year being the worst on record for weather-related losses, at $243 million (most of which relates to events in the first half of the year, which impacted results in the second half of FY 2017). The single largest loss related to the remnants of cyclone Debbie. While significantly weaker by the time it reached New Zealand's shores, Debbie still caused more than $90 million in losses.

Fire and brimstone

Significant coastal erosion caused by storms and associated tidal surges has occurred in several areas, bringing people's attention to the issue of insuring coastal property. As a result, negative impacts on coastal property values are inevitable.

Total annual cost from weather related events (2017 NZ$)



Source: Insurance Council of New Zealand

Last year was also notable for insurers due to the Port Hills fire in Christchurch. Bushfires are not uncommon in New Zealand, but they are usually small, and away from populated areas and infrastructure. The Port Hills fire was the first in New Zealand to result in large losses — $18.3 million — and serves as a reminder of the increasing potential for destructive fires along with the increasing frequency and severity of droughts.

In a tight spot

Pressures on premiums have also been exacerbated by increases to the following government-controlled components:

- **The Fire Service Levy** on property, residential contents, vehicles and boat insurance. The increase was substantial at nearly 40 per cent, from 7.6c per $100 of cover to 10.6c. Changes to the design of the levy are also being considered, and expected to be effective from 1 January 2019. This aside, a topic for debate is whether the costs of operating the fire service should continue to be funded by the Fire Service Levy or general taxation, considering non-policyholders also benefit from the service.
- **The Earthquake Commission (EQC) levies** on property and residential contents insurance. These were designed to help rebuild the National Disaster Fund after the Christchurch and Kaikoura earthquakes, in which more than $900 million of claims were received. The Government also announced intended reforms to the EQC Act to simplify and improve the scheme, in light of experience with recent earthquakes. The reforms include standardising claims excess, no longer providing residential contents insurance and — most importantly for private insurers — requiring EQC claimants to lodge claims with their private insurer.

Potential regulatory changes will also be weighing on insurers' minds, with the Reserve Bank of New Zealand (RBNZ) currently reviewing the *Insurance (Prudential Supervision) Act 2010.*

On top of this, the RBNZ has tested the compliance levels of insurers with financial strength rating and solvency disclosure requirements. Overall, it found insurers to be well short of the minimum requirements, with 53 per cent of participants assessed as complying at a 'low' or 'poor' level. Only 22 per cent received an assessment of 'good' or 'excellent'. Common issues included:

- Not meeting the requirements to disclose the financial strength rating when writing to policyholders entering into and/or renewing an insurance contract
- Incorrect or incomplete solvency disclosure in financial statements
- Incorrect, incomplete and/or out-of-date website disclosures

Interest in the regulatory review is high, with 42 individual submissions to the RBNZ's issues paper on the review rationale and potential issues it may cover. A final options paper is expected in mid-2019, with staged consultation on topics including overseas insurers, distress management and supervisory processes through 2018.

The level of non-compliance the review has identified will undoubtedly influence the RBNZ's thinking as it considers changes to the Act. Already, the message from the RBNZ is clear: the level of compliance "needs to markedly improve". Whatever the RBNZ decides, insurers will need to be prepared. In the words of legendary Motown artist Sam Cooke, 'A change is gonna come'.

THE POWER OF NOW

There's no time like the present to anticipate regulatory change, as the Reserve Bank of New Zealand reviews the Insurance (Prudential Supervision) Act 2010. Here are our key tips to help insurers prepare.

Ensure you understand and meet the disclosure requirements. Insurers are responsible for making sure intermediaries meet these disclosure requirements.

Ensure disclosures are clear and prominent. They cannot be buried in fine print or lengthy terms and conditions documents.

Ensure the actual solvency capital, minimum solvency capital, solvency margin, and the solvency ratio are disclosed in the financial statements. Commentary on these items should use consistent terminology to avoid confusion.

TAYLOR FRY is an actuarial and analytics consultancy with offices in Sydney, Melbourne and Wellington.

We were established in 1999 by *Greg Taylor*, *Martin Fry* and *Alan Greenfield* to provide straightforward general insurance actuarial advice to insurers and government. We now also offer sophisticated analytics and modelling services to a diverse range of public and private sector clients.

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