TAYLOR FRY

RADAR 2021

Our class-by-class insights for insurers

FY2021

Welcome

Welcome to Taylor Fry's RADAR, our take on the most important trends and happenings affecting insurers today, amid the dramatic economic and social change of the past months.

On the following pages, we draw on the latest APRA data, combined with our knowledge and decades of experience inside the industry.

Across three years of results, our analyses break down each line of business to help insurers benchmark their performance, and assess strategies and goals.

We also summarise investments and solvency over the same period to give you an overview of how the market is tracking more broadly.

By highlighting the challenges and opportunities in these particularly testing times, we offer you a clear picture of the industry, where it's headed and your place within it.

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DOMESTIC MOTOR

FY21 was one of the most profitable years on record, with an average combined ratio of 85%. Restrictions on movement led to fewer cars on the road, reducing claim frequency. As life returned to some level of normality, however, loss ratios increased over the year towards pre-COVID-19 levels.

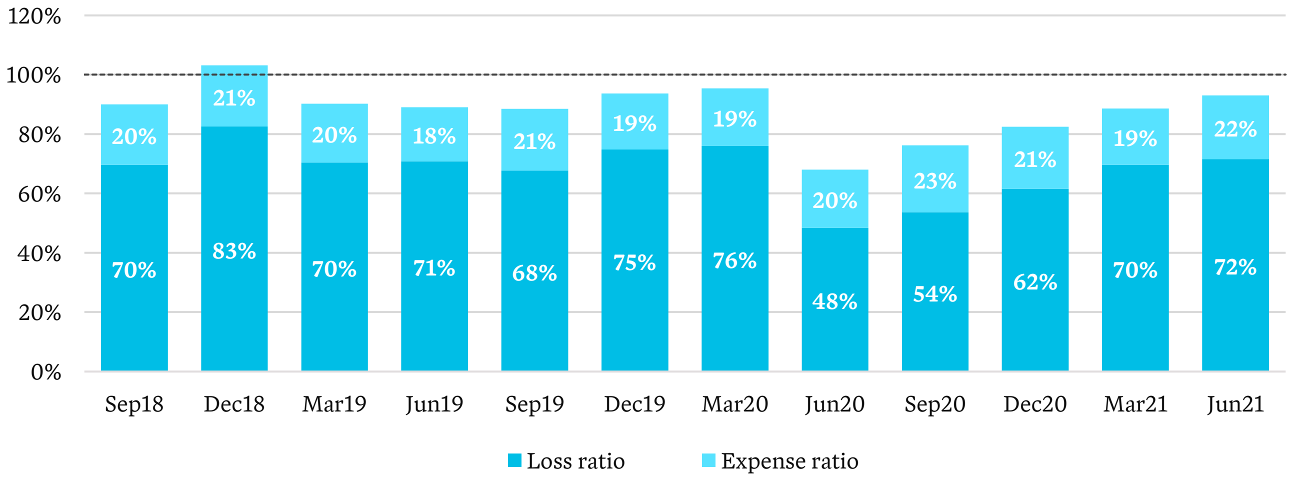
We expect loss ratios will again decrease over the next few quarters to reflect current restrictions. Preparation for new consumer regulations were also a focus. Ensuring customer value will continue to be an important consideration, especially as profits increase with continuing lockdowns.

Premiums grew by 8% due to a 4% increase in risks written and a 4% increase in average premiums. Increased competition for market share between Suncorp and IAG is constraining price increases in some segments (although recent loss ratios and current lockdowns suggest no immediate need to increase premiums). Competition will likely intensify as new entrants such as KOBA (underwritten by Eric Insurance Limited) offer data-driven usage-based insurance.

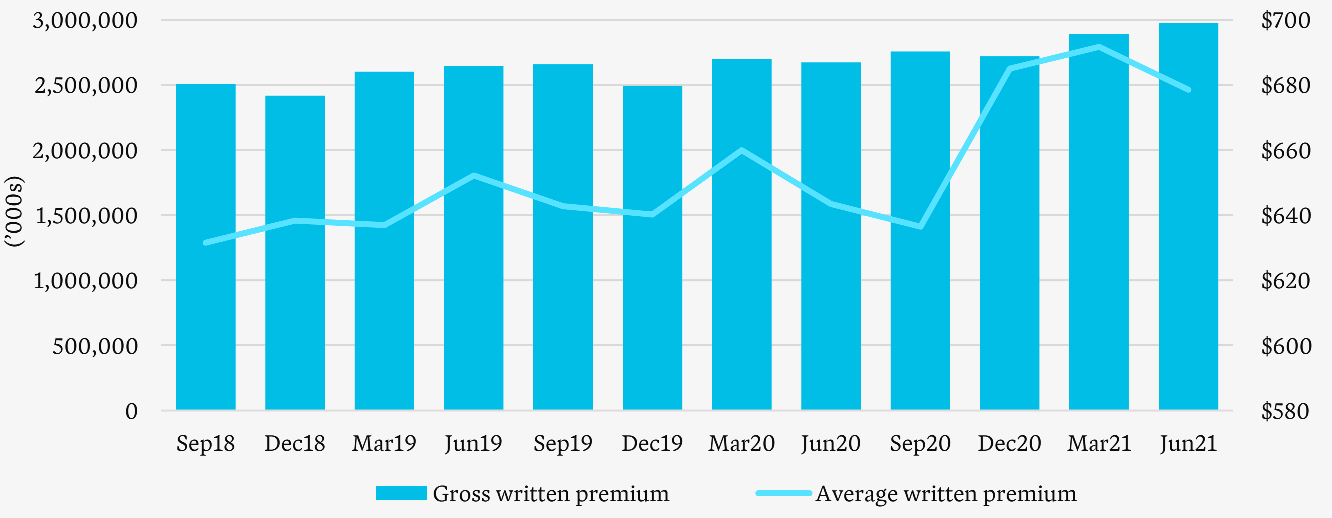
Loss ratios increased from historic lows, as traffic volumes returned to pre-pandemic levels. The impact of new restrictions due to the Delta strain are likely to result in loss-ratio reductions over the next few quarters. In early outbreaks, some insurers provided premium deferrals to offset hardship. Youi is currently offering a 15% premium refund for the next two months to customers using their car less during lockdown.

Repair and replacement cost pressures continue to increase claims cost inflation. Production shortages combined with a surge in the demand for new cars is placing pressure on average claim sizes and increasing wait times for consumers. The growing use of vehicle technology is also increasing repair costs. In time, autonomous vehicles may pose significant disruption as liabilities and risks are redefined.

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back

- ⬇ Price competition
- ⬇ Preparing for consumer regulations
- ⬇ Increasing repair costs
- ⬇ Production shortages
- ⬆ Lockdowns reducing vehicle use
- ⬆ Technology increasing safety

Looking ahead

- ⬇ Manufacturers offering insurance (e.g. Tesla)
- ⬇ Autonomous vehicle disruption
- ⬇ Compliance obligations with new regulations
- ⬆ New car sales up
- ⬆ Ongoing lockdowns

HOUSEHOLDER

This class is a major challenge for insurers. Year-on-year premium rate increases, including a 6% increase in FY21, have not been enough to restore profitability. The FY21 combined ratio was 103%, up from 101% in FY20, with catastrophic losses continuing to impact profitability.

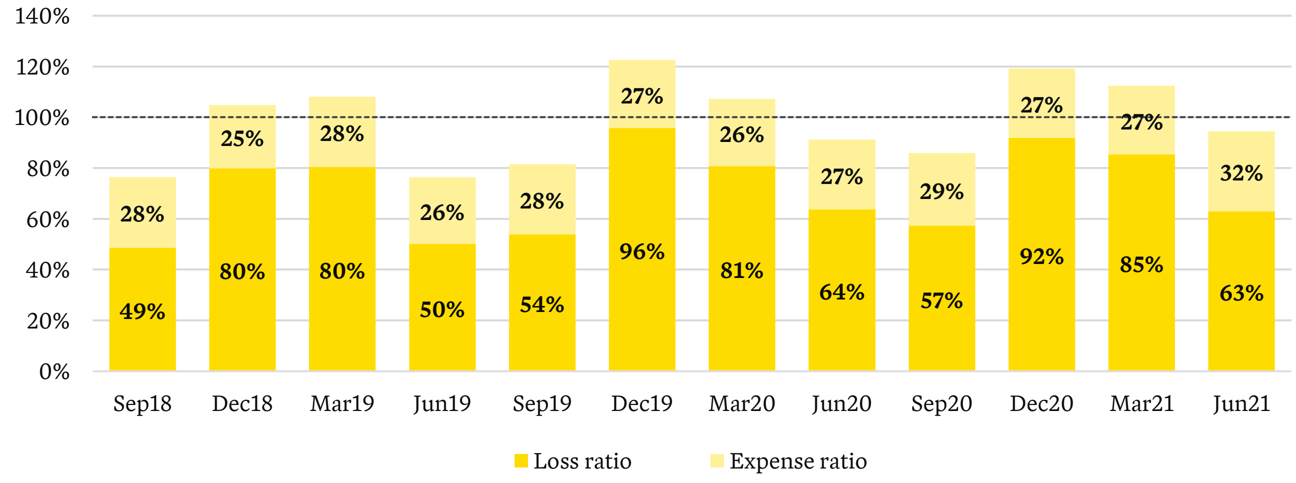
Climate change will increase the frequency and severity of catastrophic losses in future, placing further pressure on premium rates and on affordability. The solution will require a holistic approach to mitigation with government, insurers, homeowners and corporates working together to focus on long-term benefits.

Insurers are alert to the impact of more frequent, severe natural disasters on premium rates, coverage, capital and reinsurance. To mitigate the impact of climate change, the Australian Government recently launched the National Recovery and Resilience Agency to provide policy and program advice. With $600m to invest in mitigation and disaster preparation, it's a first step on a long, windy road to reducing the impact of catastrophic losses.

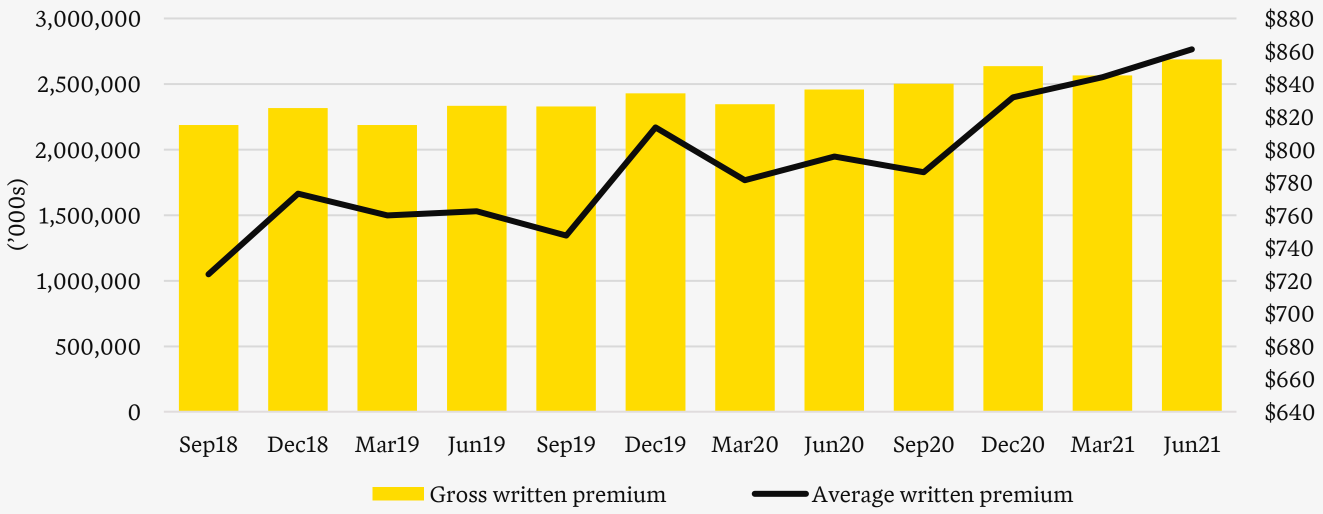
Insurance affordability is a growing issue leading to underinsurance and households choosing not to take out insurance. Premiums increased by 9% over the year, driven by a 6% increase in average premiums. The planned Northern Australia reinsurance pool is due to start in July 2022. Exactly how the pool will operate is not clear at this stage, but industry and community consultation is underway to help achieve clarity and work towards better outcomes for all.

COVID-19-induced supply stresses, strong building activity and natural catastrophes are adding to cost pressures. The cost of timber and labour has increased, which is in turn increasing the cost of building repairs and putting pressure on policy limits. Cost pressures will only dissipate in the short term if there is a willingness to use alternative products (e.g. steel frames) and construction activity returns to average levels.

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back

- Natural disasters
- COVID-19 social impacts (e.g. reduced burglary claims)
- Cost and availability of reinsurance
- Harder market
- COVID-19-induced cost of repair pressures

Looking ahead

- Climate change, natural disasters
- Reinsurance pool potential for improved affordability
- Cost and availability of reinsurance
- El Nino – Southern Oscillation (ENSO) outlook neutral
- Access to/cost of building materials
- Reinsurance pool uncertainty

COMPULSORY THIRD PARTY

Combined ratios for all jurisdictions fell below 100% in FY21, after several years of increases. Traffic volumes, claim numbers and claim costs reduced over initial COVID-19 lockdowns, with traffic and associated claims bouncing back as vehicles returned to the roads.

Looking ahead, rolling lockdowns and Delta strain uncertainty will likely place downward pressure on claim costs in the near term. Reserve releases have been a regular feature for some years, leading to a suspicion that more recent loss ratios will reduce further over time.

↘

Average rates in NSW continued to reduce following introduction of the new scheme in 2017. This reflects ongoing competition, further strengthened by Youi's entry in December 2020. Damages claims experience is slowly building, and ultimate scheme cost will depend on how this evolves. Excess profits will eventually be returned to policyholders through the regulatory Transitional Excess Profits and Loss mechanism.

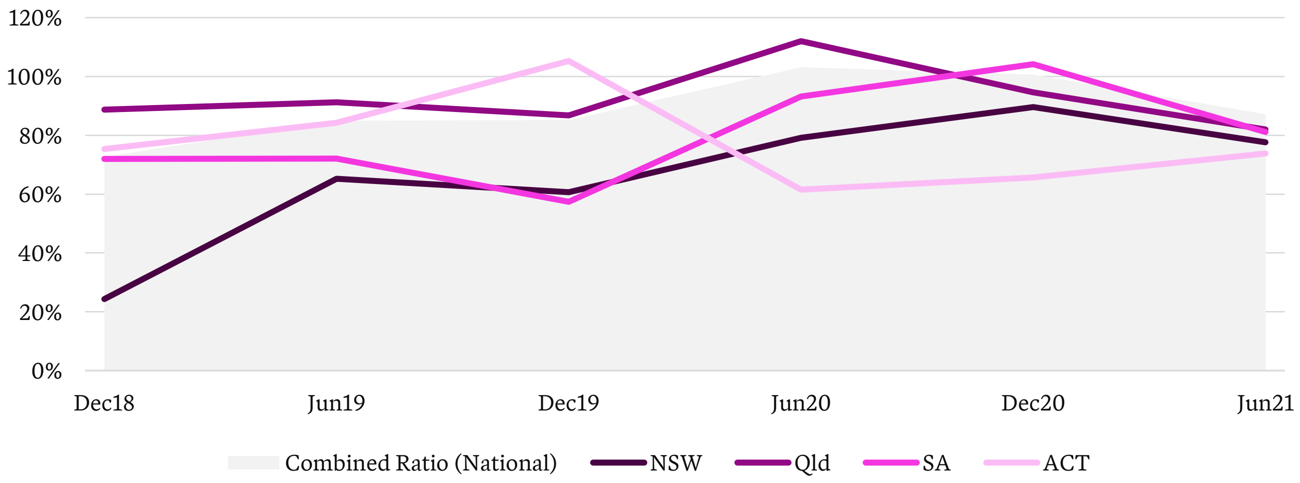
↘

Insurer profits in Qld received a boost over the year, as claim lodgements were reduced due to COVID-19 lockdowns and the introduction of car crash scammer ('claim farming') legislative reforms. Factors limiting that boost are premiums having now responded to the impacts of these reforms, and traffic volumes returning to pre-COVID levels.

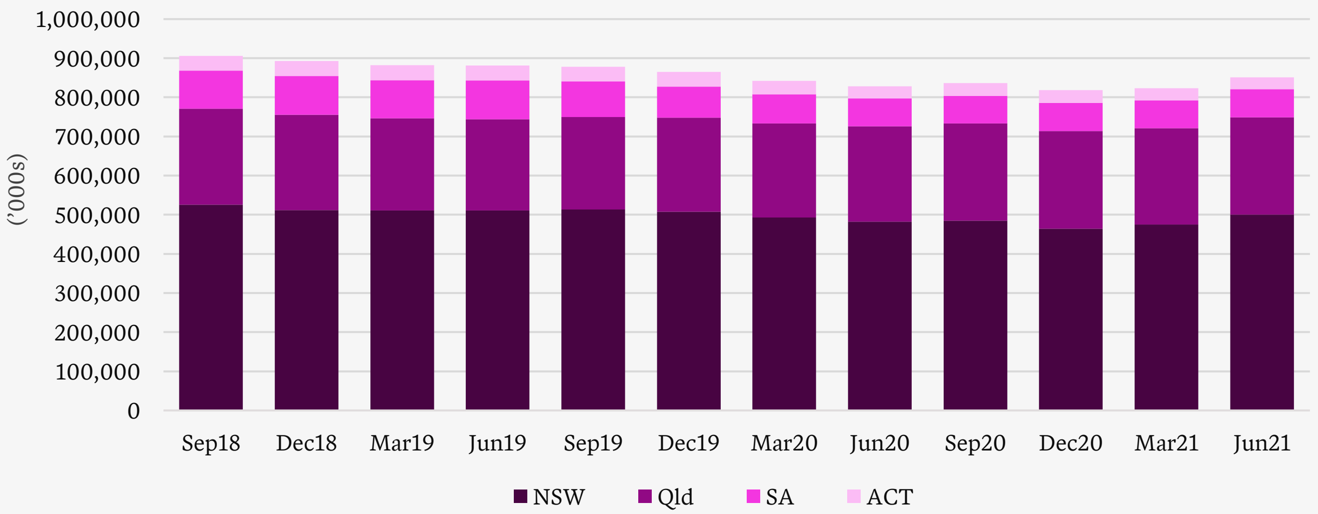
↘

Competition created a dynamic marketplace in SA. When competition began on 1 July 2019, all insurers decreased premiums by 28% for an annual Class 1 private passenger vehicle policy. Over 2020 and 2021, insurers began differentiating on price – with some increasing premiums – which may impact the marketplace in the coming year. We expect it will be some years before the ultimate cost of these early scheme years is well understood.

Gross loss ratios
Reporting half year



Gross earned premium
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back

- ⬇ Uncertainty due to marketplace reforms
- ⬇ Low interest rates
- ⬆ Benign superimposed inflation
- ⬆ Lower traffic volumes during pandemic

Looking ahead

- ⬇ Regulator focus on insurer profitability
- ⬇ Reducing reserve releases
- ⬇ Psychological claims
- ⬆ Continued lockdowns in major centres

WORKERS COMPENSATION

Combined ratios overall remained steady at 97% in FY21, vs 96% in FY20, but experience differed across states. Despite the number of risks written reducing by 5% in FY21, GWP increased by 22% following a 4% reduction in FY20 due to the impacts of COVID-19 on employers. The reduction in risks written combined with the increase in GWP led to a 28% increase in average premium.

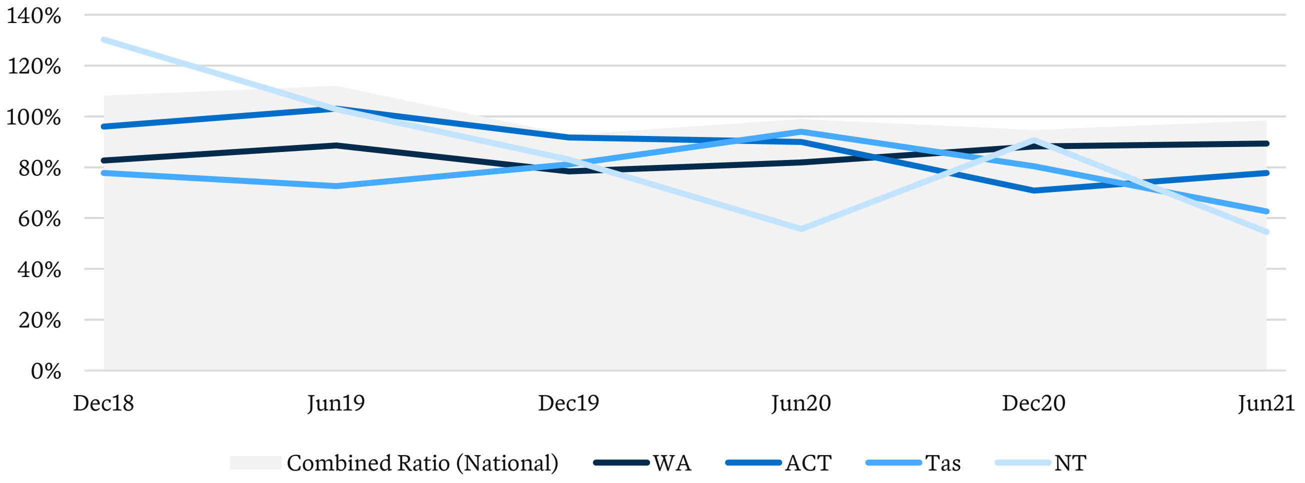
COVID-19 has impacted some industries and employers more than others, resulting in a change in industry mix and an increase in average premium.

COVID-19 has had less of an impact on claims experience than initially expected (at least in the short term). The material decline in return-to-work rates and increases in claims cost expected at the start of the pandemic have not materialised at a scheme level. This is likely due to low numbers of COVID-19 cases in WA, TAS and NT, and in ACT, until now.

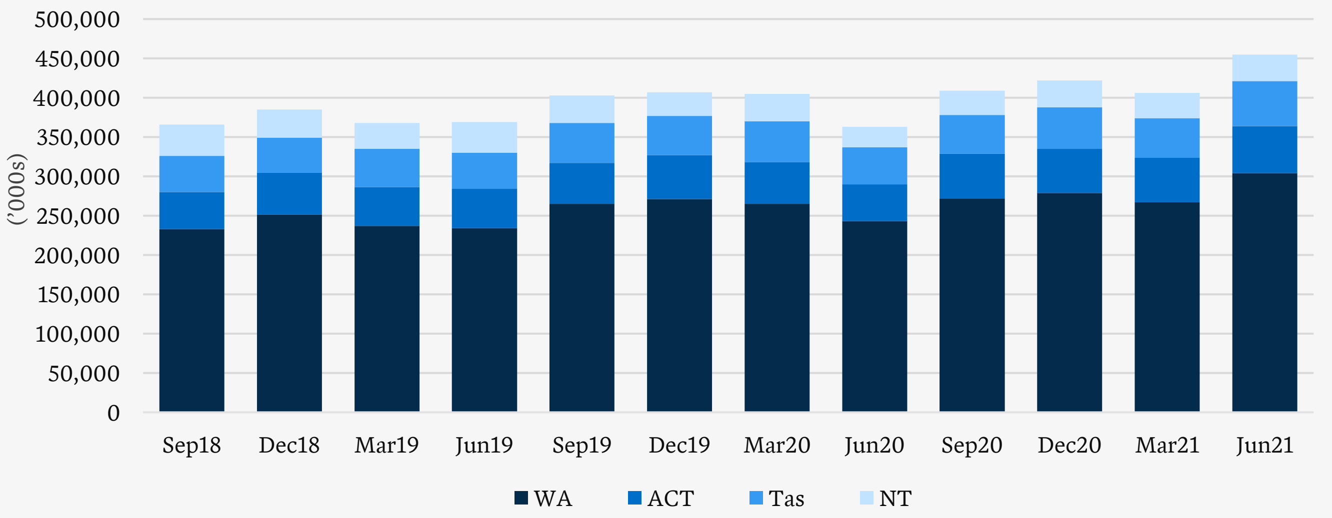
Mental health injuries are a key issue arising from the impact of COVID-19 restrictions. Changes in work demands, restrictions on movement and working from home are placing pressure on employees, increasing the risk of psychological claims. In some publicly underwritten states, primary mental injuries have increased and this is likely to be a future cost pressure for privately underwritten states. Identification and treatment of secondary mental injuries is another emerging issue.

With different pandemic impacts across industries, it's increasingly important for insurers to manage the cross-subsidies in their portfolio. Record low interest rates will also place upwards pressure on premiums in future.

Gross loss ratios
Reporting half year



Gross earned premium
Reporting quarter



At a glance

Factors adding or easing pressure in the market

Looking back

- ⬇ Lower return-to-work rates for covid-affected industries
- ⬇ Increasing mental health claims
- ⬇ Low investment returns placing pressure on premiums
- ⬆ Telehealth supporting early intervention

Looking ahead

- ⬇ Ability of employers to provide covid-safe workplaces
- ⬇ Pressure on attendant care costs
- ⬇ Continued lockdowns placing pressure on return to work
- ⬆ Focus on wellbeing through technology (e.g. mental health apps)

COMMERCIAL MOTOR

FY21 was a profitable year for commercial motor insurers, with an average combined ratio of 87%, although this has been increasing quarter on quarter to pre-pandemic levels as restrictions eased. Commercial motor insurers benefitted from increased demand for online shopping and home delivery, accelerated by restrictions. COVID-19 restrictions also led to a reduction in the number of cars on the road, driving down claim frequency and reducing loss ratios.

↘

Over the year, the 8% premium volume growth was fueled by a 12% increase in the number of risks written – an increase that more than offset the 4% reduction in average premiums. The reduction in average premiums is at least in part due to a change in the mix of vehicles insured with an increase in delivery vehicles. The reduction in average premiums followed four years of rate increases as insurers lifted rates to restore target profitability.

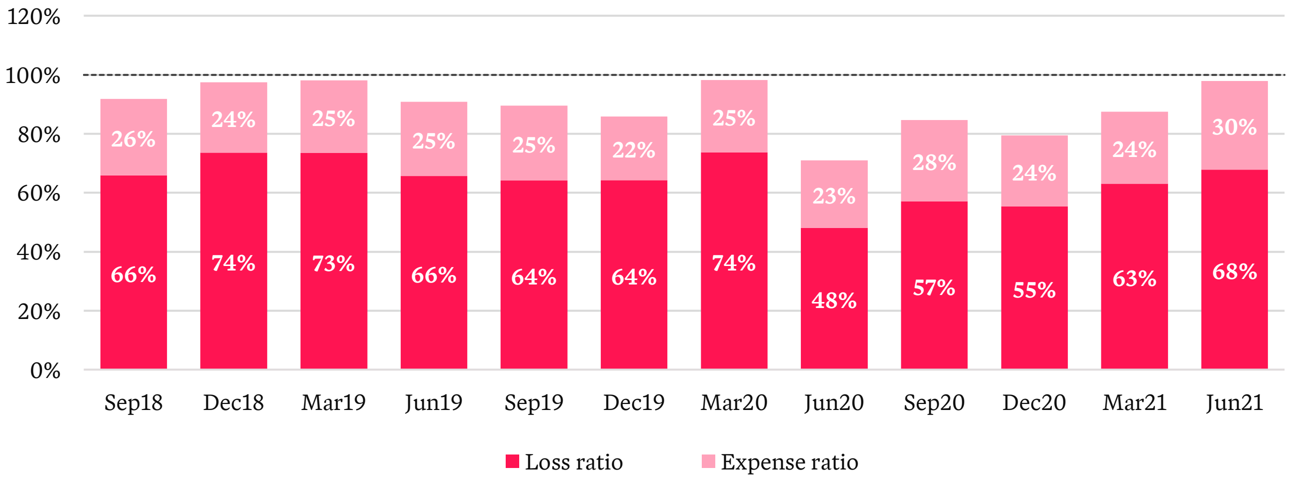
↘

Loss ratios were at historic lows, driven by a reduction in the number of vehicles on the road and fewer claims. Loss ratios quarter-on-quarter started to increase from June 2020 as restrictions were relaxed and traffic increased towards pre-pandemic levels. The current lockdowns impacting most Australians are expected to lead to reductions in loss ratios in future.

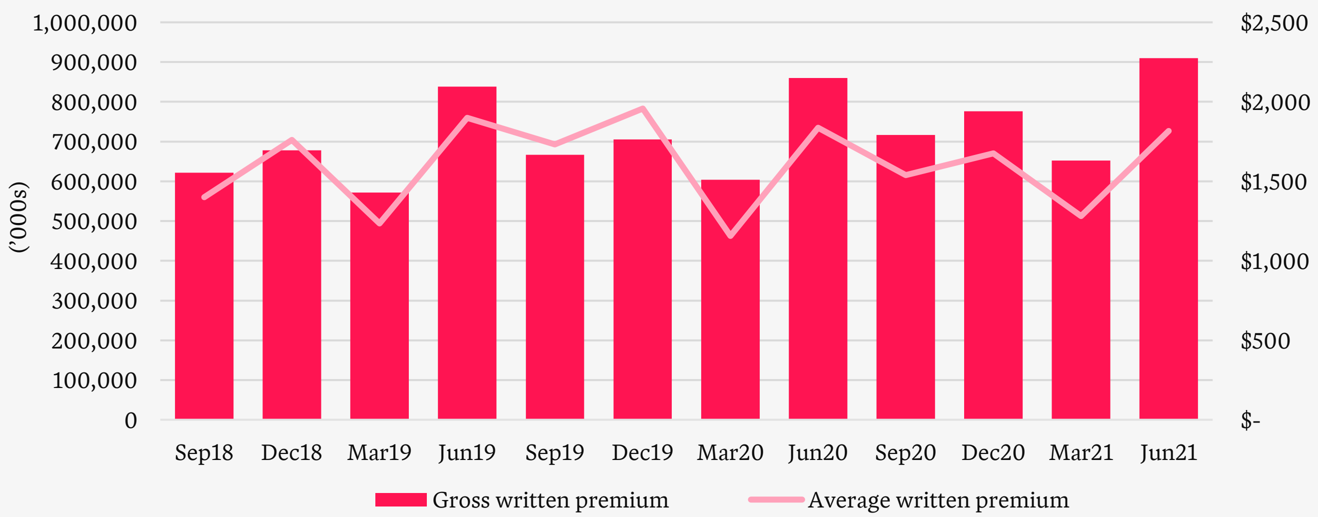
↘

Vehicle repair and replacement cost pressures are expected to continue – The increased use of technology in vehicles and production shortages are impacting the cost of repairs and wait times for customers.

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back

- ↓ Technology and vehicle repair costs
- ↑ Demand for commercial vehicles
- ↓ Fraudulent claims from businesses under pressure
- ↑ Fewer vehicles on the road
- ↓ Halloween hailstorm Q420

Looking ahead

- ↓ Insurance offered by vehicle manufacturers
- ↑ New car sales resulting in top-line premium growth
- ↓ Autonomous vehicles (although some way off)
- ↑ Restrictions leading to fewer cars on the road and fewer claims

COMMERCIAL PROPERTY

Average premium rates have flattened over FY21 following four years of consistent increases. Profit trends remain poor, mainly due to catastrophic event claims and COVID-19-related business interruption (BI) claim provisions.

Following the Bushfire Royal Commission report, industry and government are currently implementing its recommendations to help ease claims pressures and improve outcomes for insurers and their customers. This includes the launch of the National Recovery and Resilience Agency in May 2021 to strengthen communities against natural disaster events amid ongoing climate change challenges.

↘

After four successive years of rate hardening since the insurance cycle turned in 2017, rates have flattened over the past year. Whether this represents another turning of the insurance cycle is unclear, given profitability remains poor.

↘

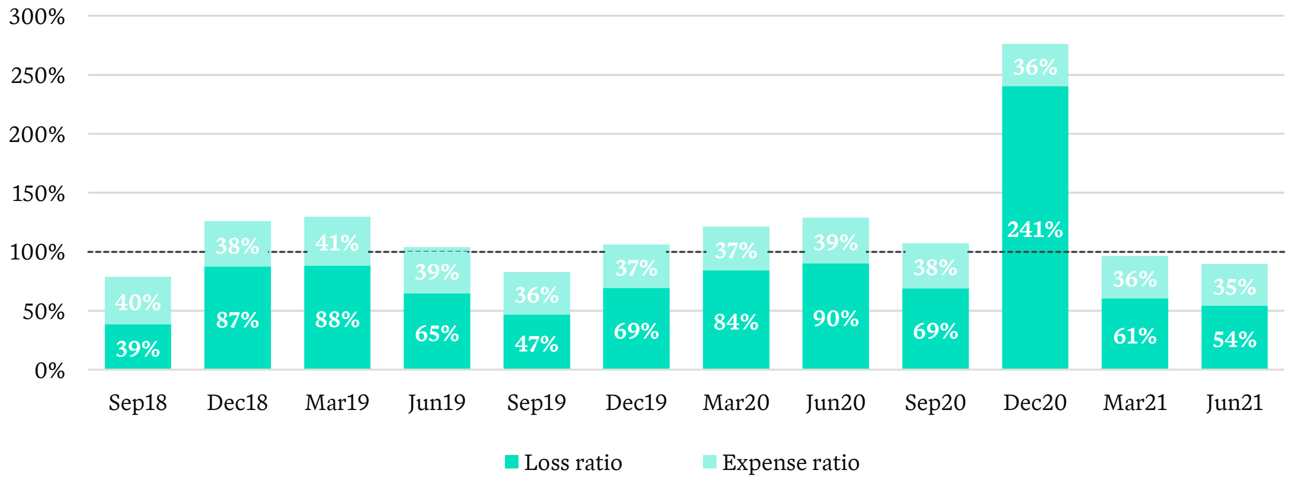
An adverse ruling for insurers in the first COVID-19 BI test case resulted in significant strengthening of claim provisions, which are clearly reflected in the December 2020 combined ratio. Insurers await the outcome of the second BI test case in September 2021 to help firm up estimates of BI liabilities.

↘

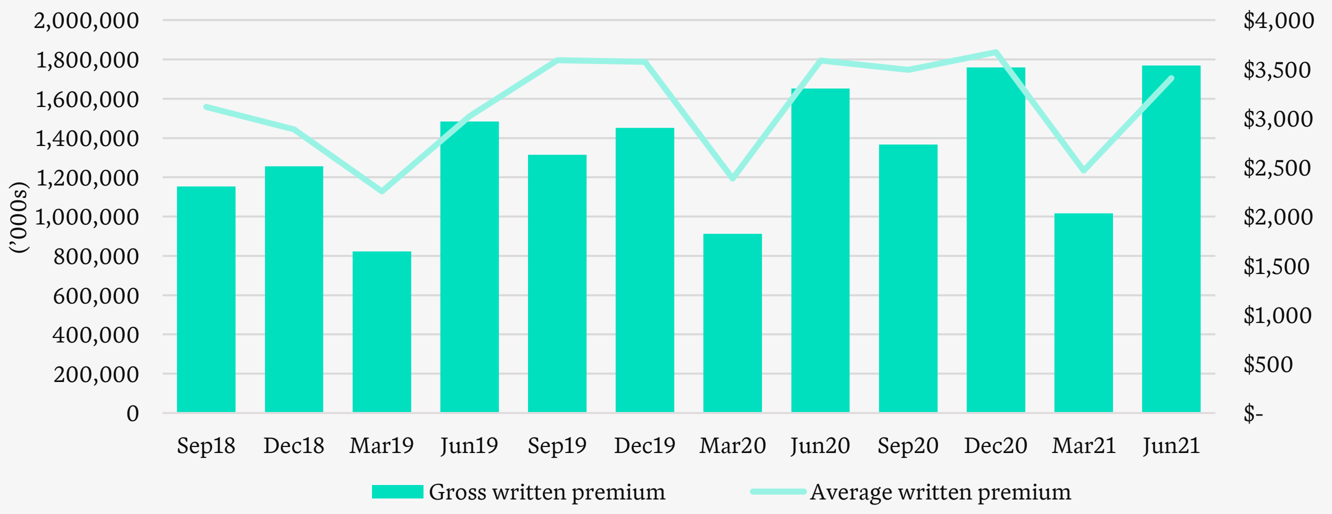
Losses were affected by several catastrophic events during FY21, but not to the same extent as the year before, when the December 2019 bushfires ($2.3B*) and January 2020 hailstorms ($1.7B*) occurred. The largest event over FY21 was the Halloween hailstorm in central Qld ($0.9B*).

*Total industry loss

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance

Factors adding or easing pressure in the market

Looking back

- ↓ Natural disasters
- ↓ COVID-19 impact on BI cover
- ↓ Reinsurance costs
- ↑ Harder market

Looking ahead

- ↓ Climate change (increased natural disasters)
- ↓ Cost and availability of reinsurance
- ↓ Further BI reserve increases
- ↓ Signs of rates flattening
- ↑ Reduced COVID-19 uncertainty as BI test cases resolved
- ↑ Implementing royal commission outcomes (government focus on risk mitigation)

TRAVEL

With borders remaining closed and frequent lockdowns, travel remains the line of business most affected by COVID-19. Insurers have tried to respond with new domestic offerings and some level of pandemic coverage. This has been limited by reinsurers becoming more sensitive to pandemic covers, with differential terms commonplace in new contracts this year.

Travel insurers are following the vaccine rollouts closely, including their effectiveness on new COVID-19 strains and their impact on travel patterns. A key challenge will be designing products consumers value, while controlling exposure to future pandemics.

↘

Premium refunds to those unable to travel due to government restrictions are reflected in the June and September 2020 quarters. Premiums had started to climb again, especially with the operation of the trans-Tasman bubble in the latest quarter (since closed), but are a long way off pre-COVID-19 levels.

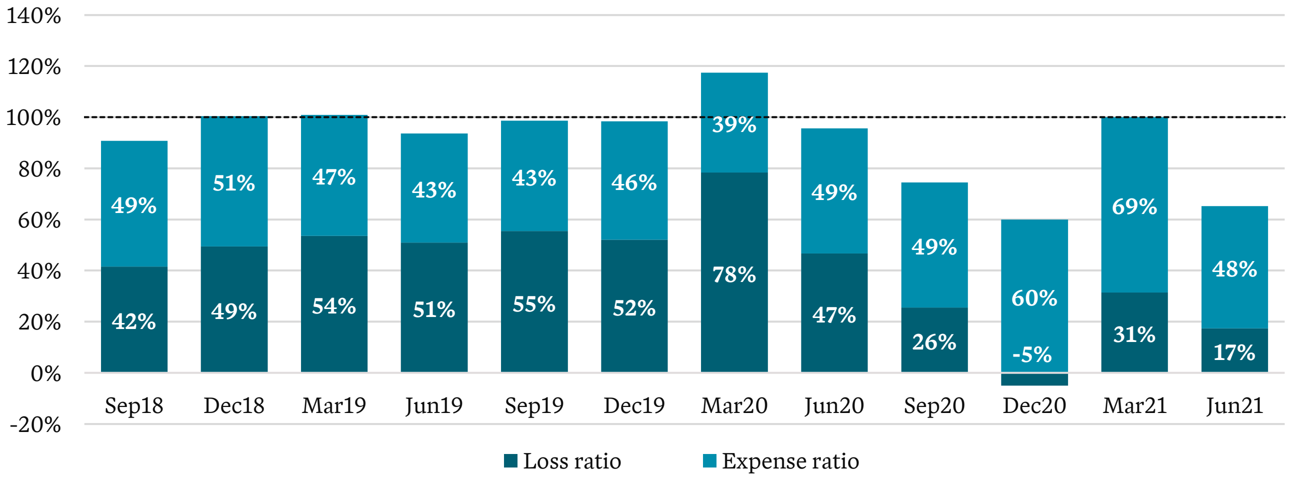
↘

Loss ratios saw a spike in the March 2020 quarter – due to COVID-19-related cancellation claims – but drops in subsequent quarters, as pandemic exclusion clauses kicked in and border restrictions limited use of annual multi-trip policies. Loss ratios in the latest quarter, relating mostly to trans-Tasman and domestic trips, have remained low.

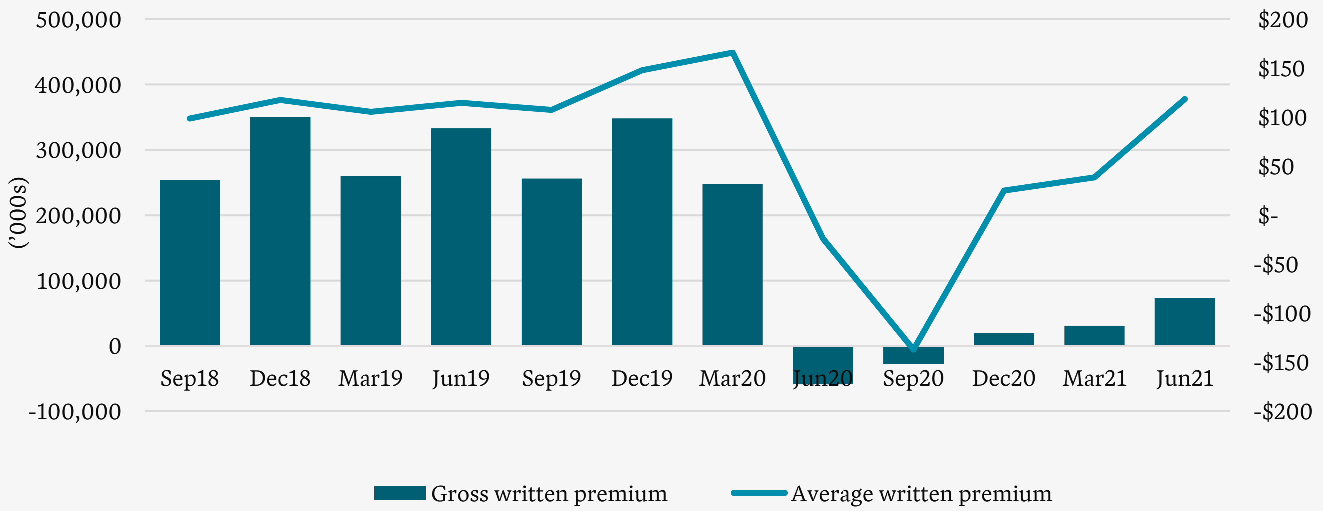
↘

Expense ratios had been trending upwards over the year, reflecting loss of scale due to a shrinking premium pool, as insurers continue to make deep cuts. Travel insurers need to carefully balance controlling expenses during this period, while retaining enough expertise to hit the ground running when travel resumes and be able to innovate with products that are fit for purpose in the current environment.

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back

- ⬇ COVID-19 claims
- ⬇ Border closures
- ⬇ Fixed expenses
- ⬇ Consumer complaints
- ⬆ Pandemic exclusions

Looking ahead

- ⬇ Reinsurance capacity
- ⬇ Reinsurance pandemic exclusions
- ⬇ Continued border disruptions
- ⬇ New consumer-centric regulations
- ⬆ New product offerings
- ⬆ Vaccine rollouts
- ⬆ Pent-up travel demand
- ⬆ Fewer participants/ hardening market

PUBLIC & PRODUCTS LIABILITY

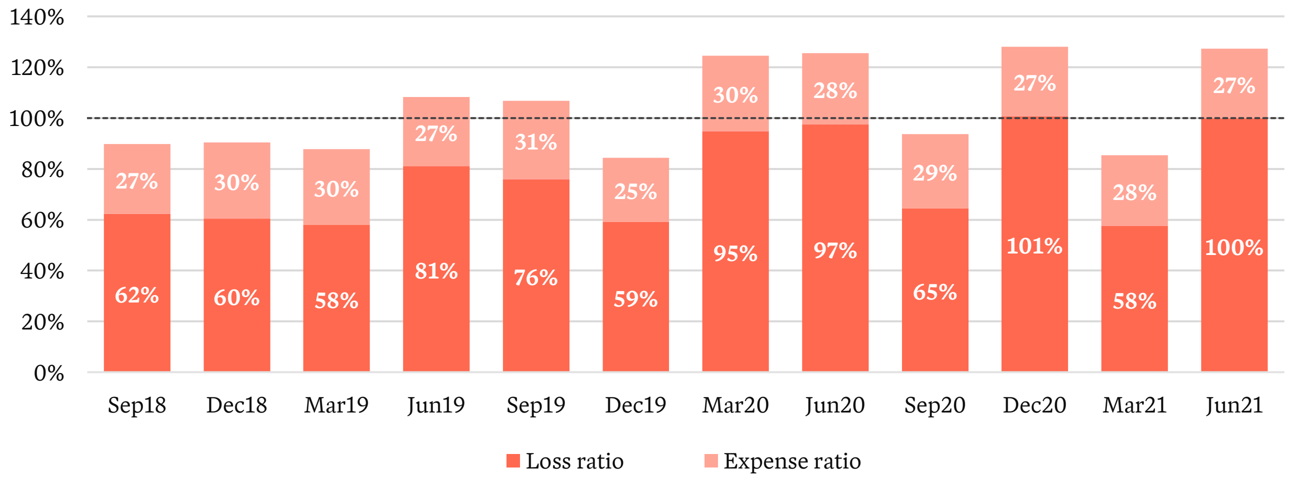
Overall profitability was poor, impacted by reserve strengthening arising from older accident years, likely on account of latent claims (such as sexual abuse claims), while COVID-19 lockdowns and consequent changes in consumer behavior had a mixed impact on public liability risks.

Reserve strengthening adversely impacting profits – Despite rate increases, overall profitability remained poor, particularly in the December 2020 and June 2021 quarters where the combined ratio peaked at 128%. This is partly attributable to prior period reserve increases, totaling 23% of net earned premium over FY21. Mild reserve releases contributed to an improvement in profitability in the March 2021 quarter.

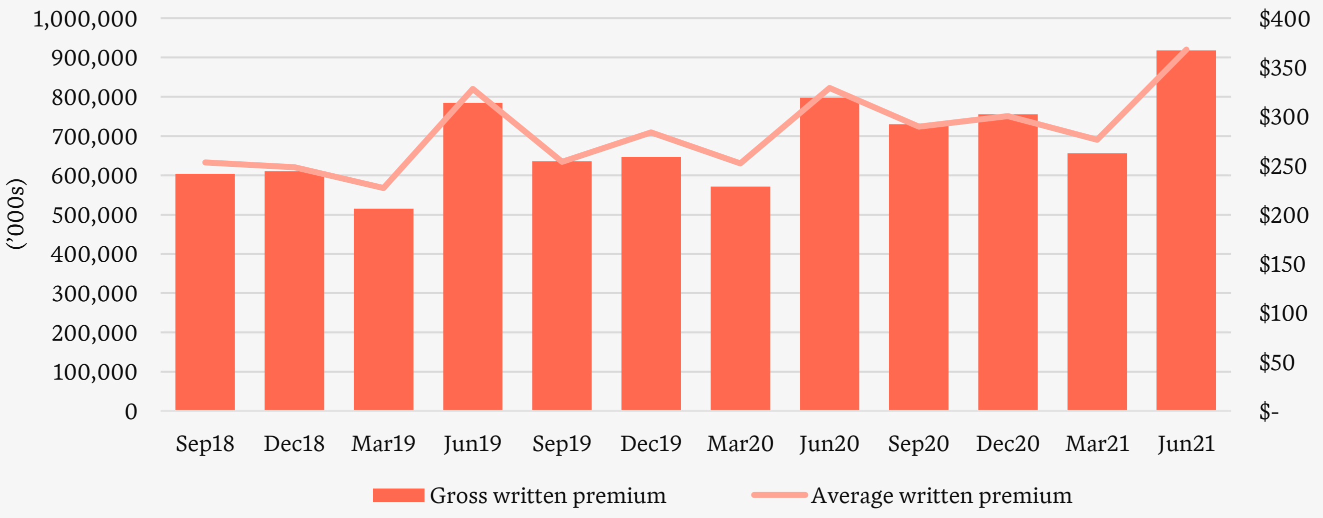
COVID-19 impact mixed – Public liability risks were impacted by lockdowns and changes in consumer behavior. Increased foot traffic resulted in higher risk exposure for some sectors (e.g. supermarkets), while lower sales and temporary store closures resulted in decreased risk exposure for other sectors (e.g. restaurants, cafes and department stores).

Affirmative cyber – Several insurers have reviewed their commercial lines policy wordings to explicitly exclude cyber risks, thereby requiring policyholders to take out a stand-alone cyber insurance policy if they wish to be protected.

Combined ratio
Reporting quarter



Total premium volume ($)
Reporting quarter



At a glance
Factors adding or easing pressure in the market

Looking back		*Looking ahead*	
⬇ COVID-19 impacts increased risk for some sectors	⬆ COVID-19 impacts decreased risk for some sectors	⬇ COVID-19 impact uncertainty	⬆ Increasing certainty as vaccination rates improve
⬇ Low interest rates	⬆ Harder market	⬇ Reserve strengthening	⬆ Hardening rates
⬇ Reserve strengthening (e.g. sexual abuse claims)	⬆ Removal of non-affirmative cyber		

PROFESSIONAL INDEMNITY

This class has been profitable, albeit volatile, in recent years, benefitting from premium increases and prior period reserve releases. Insurers remain concerned by poor results in D&O (particularly Side C covers), PI covers for building professionals and medical malpractice.

Some have responded by offering less attractive terms (increased premiums and excesses, reduced coverage and further exclusions), prompting some companies to consider self-insuring or setting up captives for their PI/D&O covers. Looking ahead, D&O claims may increase as cybersecurity, the pandemic and climate change continue to test directors and officers.

➘

Elevated combined ratios in the September and December 2020 quarters were partly due to prior period reserve increases, which totalled a considerable 14% of net earned premium across the two quarters. Medical malpractice, in particular, continues to be unprofitable. Pressures include increasing civil litigation claims, strains on medical professionals due to pandemic demands, and reducing premium from fewer elective surgeries.

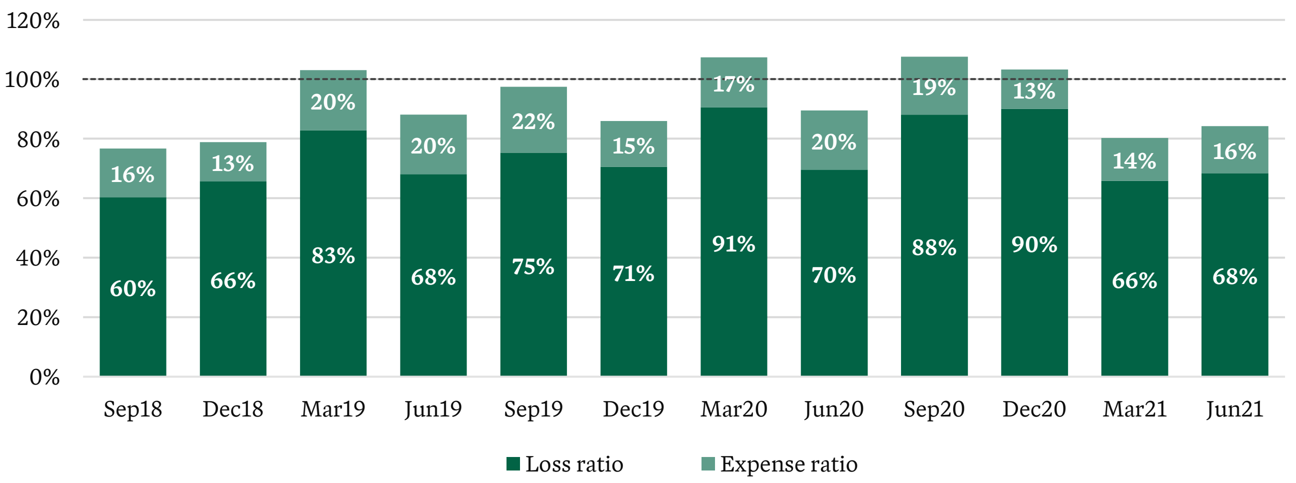
➘

Cybersecurity, COVID-19 and climate change are complex, emerging risks that company officers need to manage, and which may put upward pressure on D&O claims. Rising class actions over several years have also adversely affected D&O claims, but recent regulatory changes may reduce class actions in future. Some changes include temporary, COVID-related continuous disclosure relief and government reforms requiring litigation funders to hold an Australian Financial Services Licence.

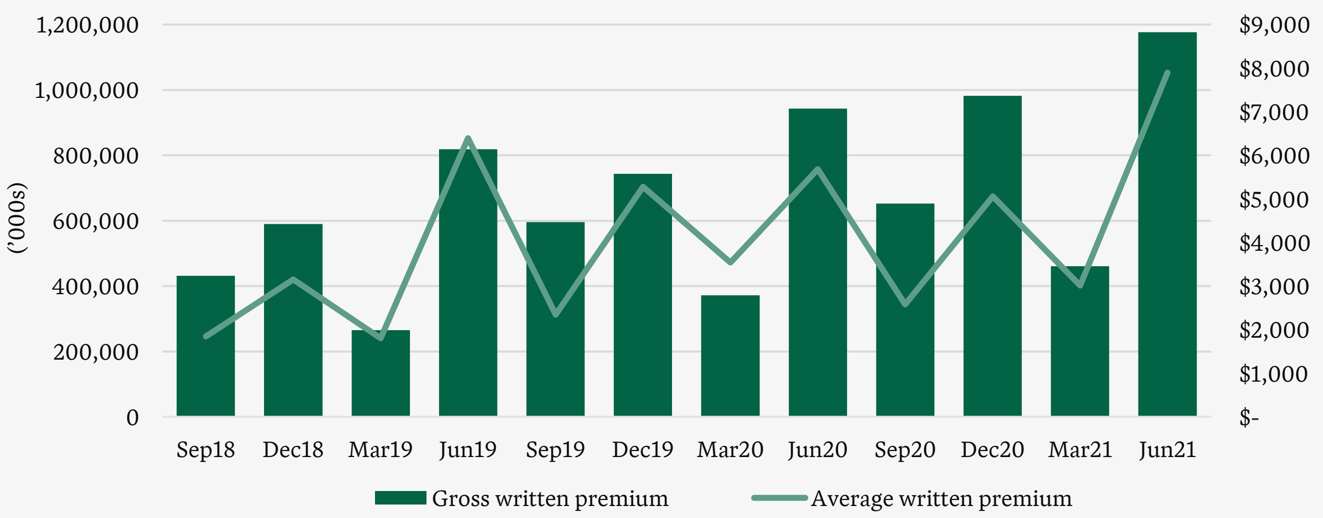
➘

In the built environment, risk of claims against industry professionals is emerging. Among them, building surveyors may face an increase in claims for damages, arising from ongoing combustible cladding risks and defective apartments. Property valuers could also suffer, through a potential surge in residential mortgage defaults caused by the COVID-19 recession.

Combined ratio
Reporting quarter



Total premium volume
Reporting quarter



At a glance
Factors adding or easing pressure in the market

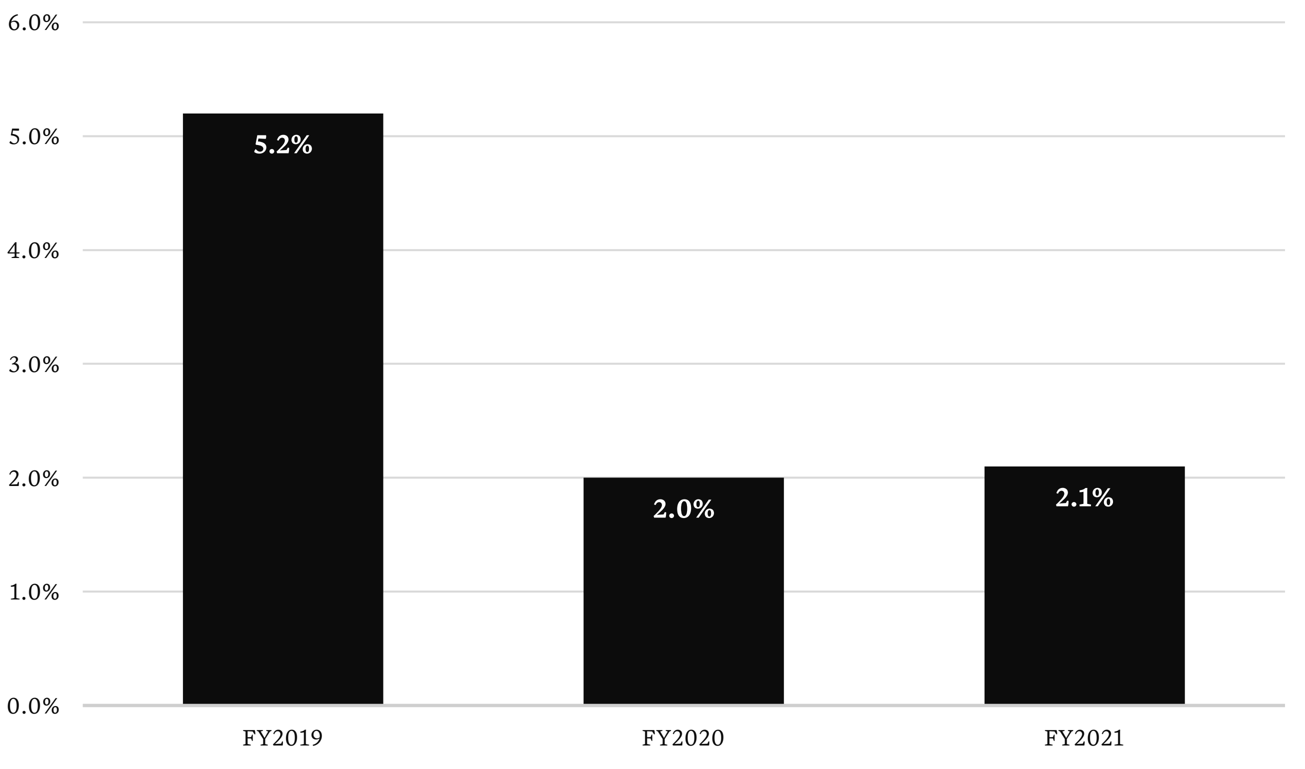
Looking back		*Looking ahead*	
⬇ Rising D&O risk	⬆ Harder market	⬇ Risk of claims in the built environment	⬆ Litigation funding reform
⬇ Reduced reinsurance capacity	⬆ COVID-related continuous disclosure relief	⬇ Reduced reinsurance capacity	⬆ Hardening rates
⬇ Low interest rates		⬇ Reserve strengthening	⬆ Affirmative cyber
⬇ Reserve strengthening		⬇ Increasing complexity of D&O responsibilities	

INVESTMENTS

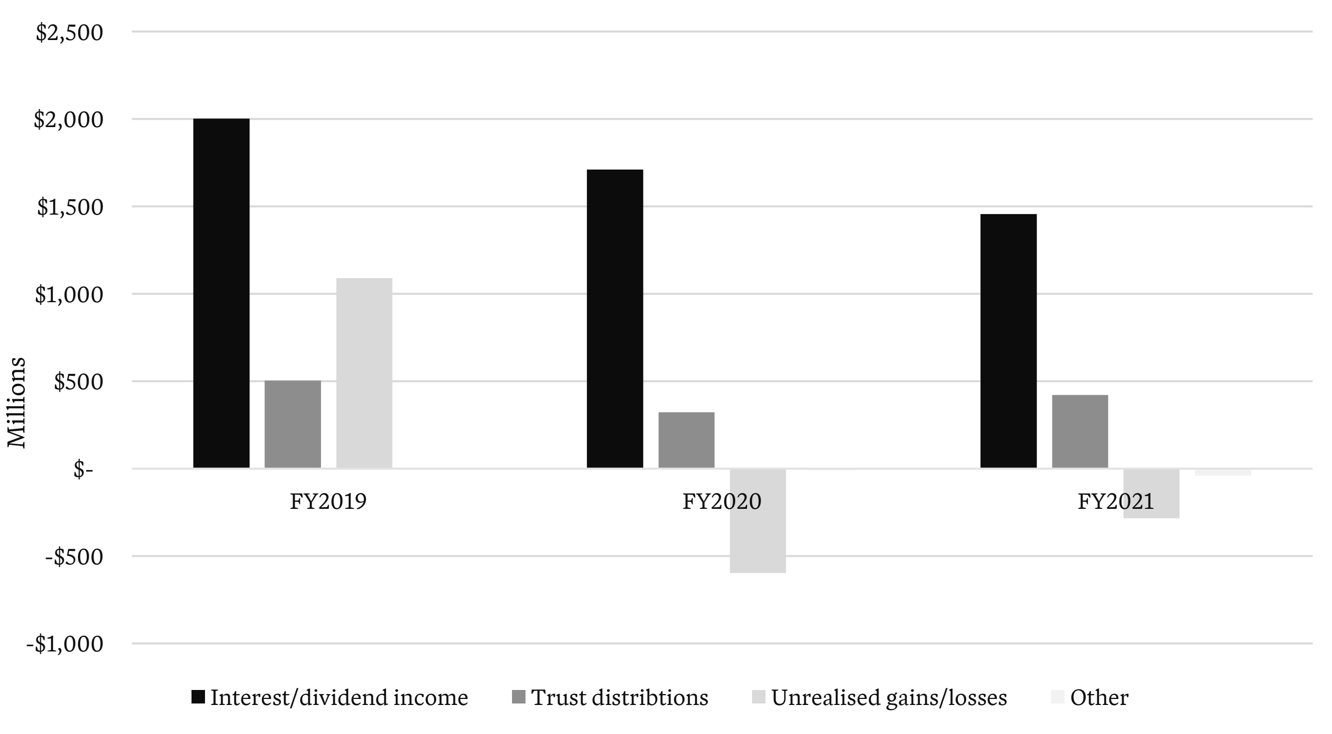
Insurers sustained an average annual investment return of 2.1% during FY21, in line with returns seen during FY20. The figure remains lower than longer term average investment returns, and this continues to put pressure on insurer profitability.

Performances for different asset classes have been mixed. Equity returns over FY21 have been strong, but the benefits for insurers have been modest, given their relatively low exposure to shares. The price of high-security fixed-income assets continues to remain inflated relative to the pre-covid environment, reflecting a general move away from riskier assets and a ‘flight to quality’.

Investment returns
Reporting year



Investment income breakdown
Reporting year

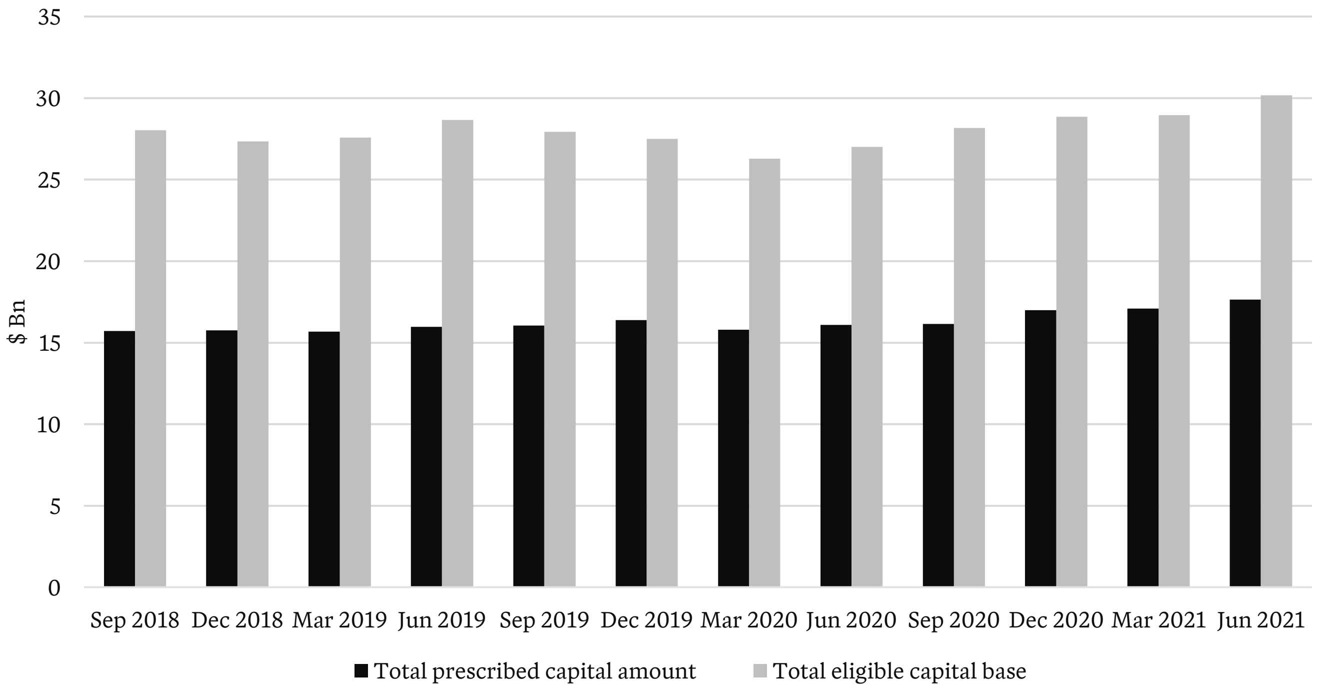


SOLVENCY TRENDS

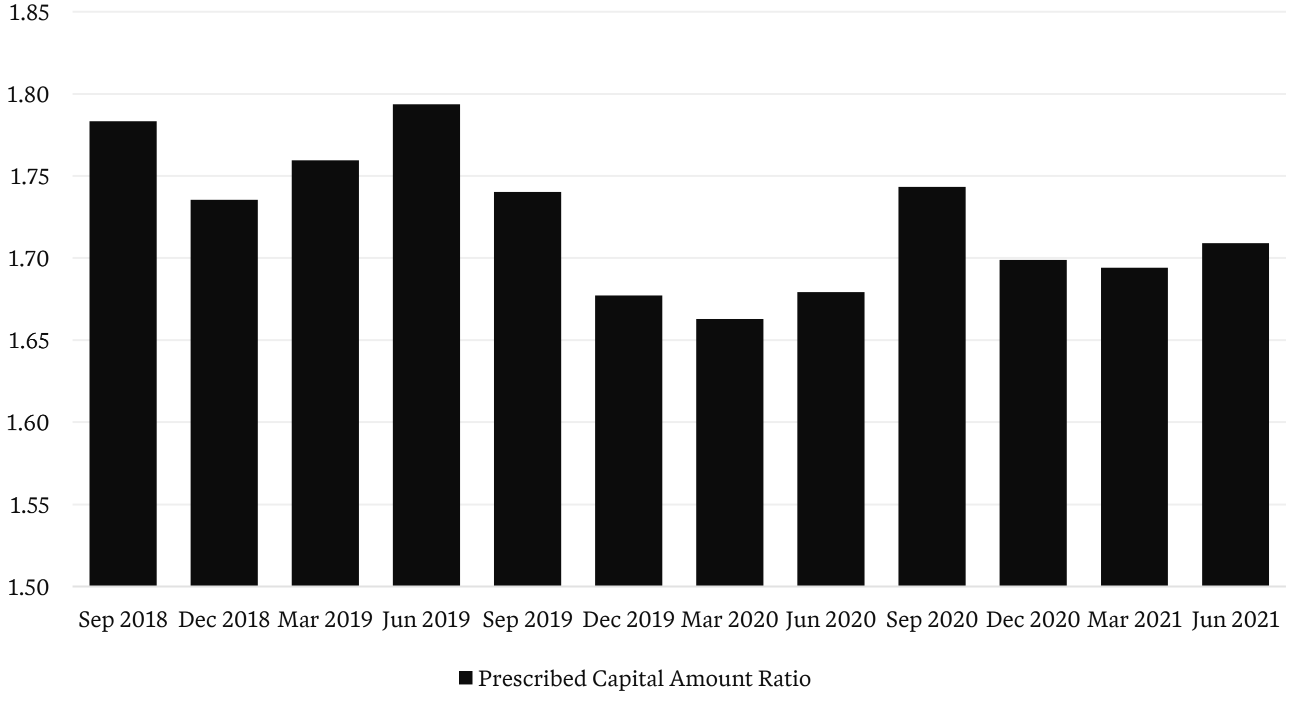
Solvency has steadily increased over the past year, from 1.68 as at 30 June 2020 to 1.71 as at 30 June 2021. This follows a stepped reduction in FY20, driven by the December 2019 bushfires and January 2020 hailstorms. However, it's still markedly lower than in previous years (1.79 at 30 June 2019, 1.82 at 30 June 2018, 1.85 at 30 June 2017).

Increases in prescribed capital adequacy – arising from the raising of significant additional business interruption reserves in the December 2020 quarter – coincided with additional capital raised from the market, combining to neutralise the impact on overall industry solvency.

Capital base vs Prescribed capital amount
Reporting quarter



Prescribed capital amount coverage ratio
Reporting quarter



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Our actuarial and analytics consultants support our clients in making strategic decisions to enhance the financial health of their organisations, and benefit communities, people and society.

We are creative problem solvers – from physicists and engineers to mathematicians and computer scientists. This variety strengthens our advice to meet the needs of our clients and their customers.

Our innovations have led to changes in government policy in Australia and New Zealand, and continue to break new ground, particularly in the social sector. Qantas liked our approaches in analytics so much, it bought a 51% stake in our business in 2015.

Across our offices in Sydney, Melbourne and Wellington, we value our people as individuals, offering a flexible working environment, with limited hierarchy and where everyone shares equally in the rewards.

We are mindful of our effect on the planet and have been carbon neutral since 2006.

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