



INDUSTRIAL SPECIAL
RISK AND GENERAL
LIABILITY INSURANCE
MARKET INSIGHTS
Australia Q2 2020

AON



OVERVIEW

Globally, successive years of poor insurer performance have been driven by more frequent and severe natural catastrophe (CAT) events, rising attritional loss and social inflationary pressures affecting long-tail classes of business.

These trends have been exacerbated by increasing competition in the sector through a surplus of capital, with non-traditional capital sources attracted to the industries' perceived non-correlated returns to investment markets (in a low global interest rate environment).

Despite recent portfolio remediation undertaken by insurers, the excess capital in the industry has hampered insurers' attempts to notably improve underwriting performance:

- Standard and Poors (S&P) revised their outlook for the global reinsurance sector to negative in May, and predicted the sector will not earn its cost of capital in 2020¹. Something the industry has struggled to do in the past three years.
- S&P also expects the top 20 global reinsurers to post a combined ratio of 101%-105% in 2020², but the underwriting loss could be even higher if insured COVID-19 losses exceed US\$30bn for the industry.

Locally, the unprecedented bushfires at the start of the year followed by the COVID-19 pandemic have only exacerbated these trends. According to APRA, the net combined underwriting ratio for general insurers in Australia has deteriorated to 111% for the March 2020 quarter, or an after-tax loss for the industry of AU\$997m.³

Insurers are now experiencing a dual shock affecting both sides of their balance sheet:

- Worsening short and long-tail claims records despite several quarters of stringent portfolio management
- Financial market turmoil throughout the COVID-19 pandemic leading to an AU\$81m investment loss for the industry in Australia in the most recent quarter⁴.

We are seeing increasingly aggressive action taken by insurers to firm up underwriting performance in the current environment.

1, 2 S&P Global Ratings (18 May 2020), COVID-19 pushes global reinsurers farther out on thin ice; sector outlook revised to negative, <https://www.spglobal.com/ratings/en/research/articles/200518-covid-19-pushes-global-reinsurers-farther-out-on-thin-ice-sector-outlook-revised-to-negative-11489774>

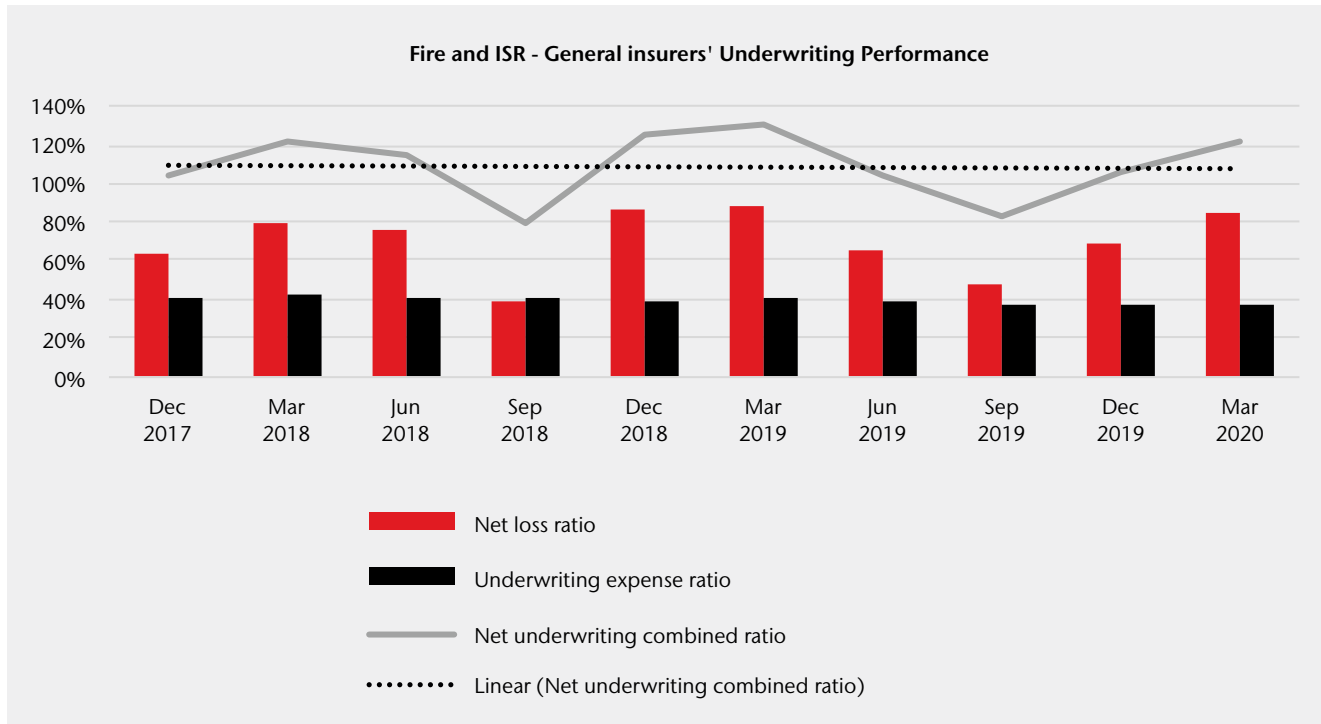
3, 4 APRA (2020), Quarterly general insurance statistics, <https://www.apra.gov.au/quarterly-general-insurance-statistics>

What does this mean?

Continued challenges for purchasers are ahead. It is more important than ever to have a clear renewal strategy, engage early with insurers, and differentiate individual risks to achieve the best outcomes.

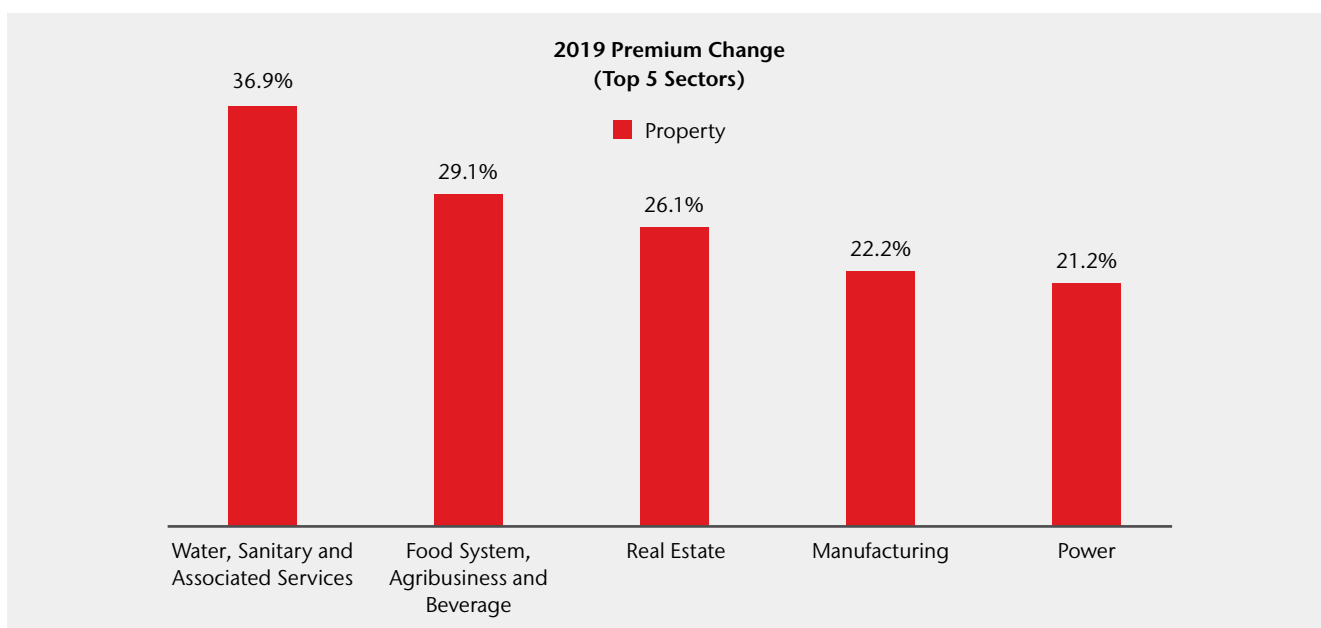
INDUSTRIAL SPECIAL RISK

For the first quarter, the net underwriting combined ratio for Fire and Industrial Special Risk (ISR) risks in Australia deteriorated to 121% mainly driven by large losses sustained from bushfire and hail events. Despite successive quarters of sustained underwriting discipline, pushing pricing and narrowing coverage terms and conditions, the combined ratio trend for the Fire and ISR risk code largely remains unchanged. Only two quarters have recorded a combined ratio of <100% since December 2017.



Source: APRA (2020), Quarterly general insurance statistics, <https://www.apra.gov.au/quarterly-general-insurance-statistics>

Rate momentum continues to gather pace in 2020, with premium change on our large complex property book averaging 26% in 2019 increasing dramatically for those in high hazard occupancies and those in occupancies with very low rating bases, such as Real Estate.



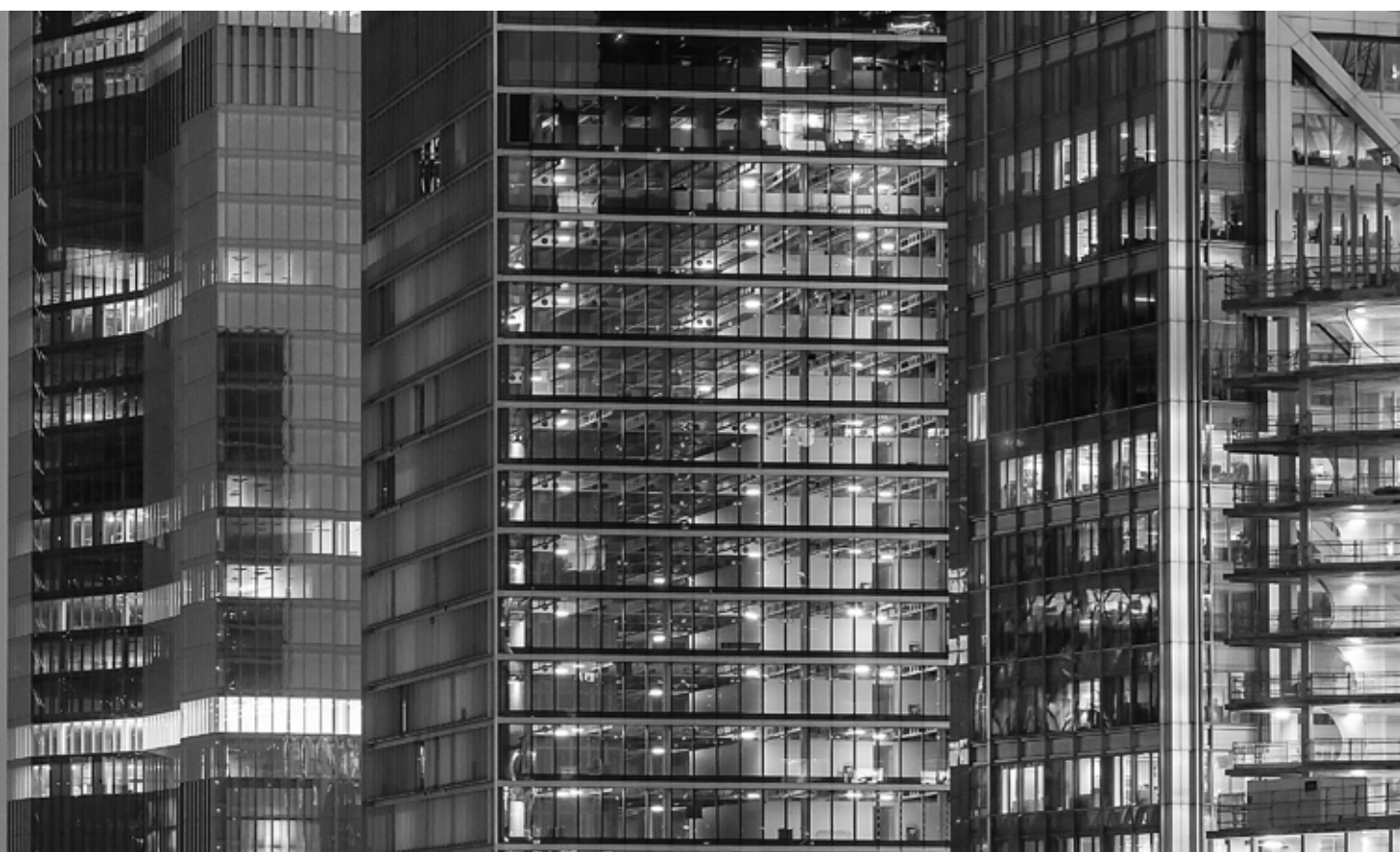
Source: Aon proprietary data – Australian property accounts with Gross Written Premium (GWP) >\$500k

The market conditions have continued to deteriorate into 2020. Insurers are proactively managing their line sizes to minimise portfolio volatility, while continuing to apply notable rate pressure and more restrictive terms and conditions.

Secondary CAT perils, such as hail, bushfire and drought, are under particular focus from insurers. These perils are problematic to predict, price, and for insurers to manage their overall portfolio accumulation too.

With more restricted capacity deployment by insurers, the last 15-20% of property placements are frequently becoming the hardest to place. We are seeing cases where opportunistic capacity is deployed at pricing greatly in excess of the program lead. Aon Client Treaty, a critical tool in the transitioning market, is helping prevent the 'tail wagging the dog'.

We also note coverage is being heavily restricted or excluded entirely for business interruption (BI) extensions such as infectious disease and contingent business interruption covers. Insurers are applying greater scrutiny to insureds who cannot substantiate their declared values with either an independent asset valuation or formal BI worksheet. Co-insurance (average) provisions are being mandated by many insurers in their absence.

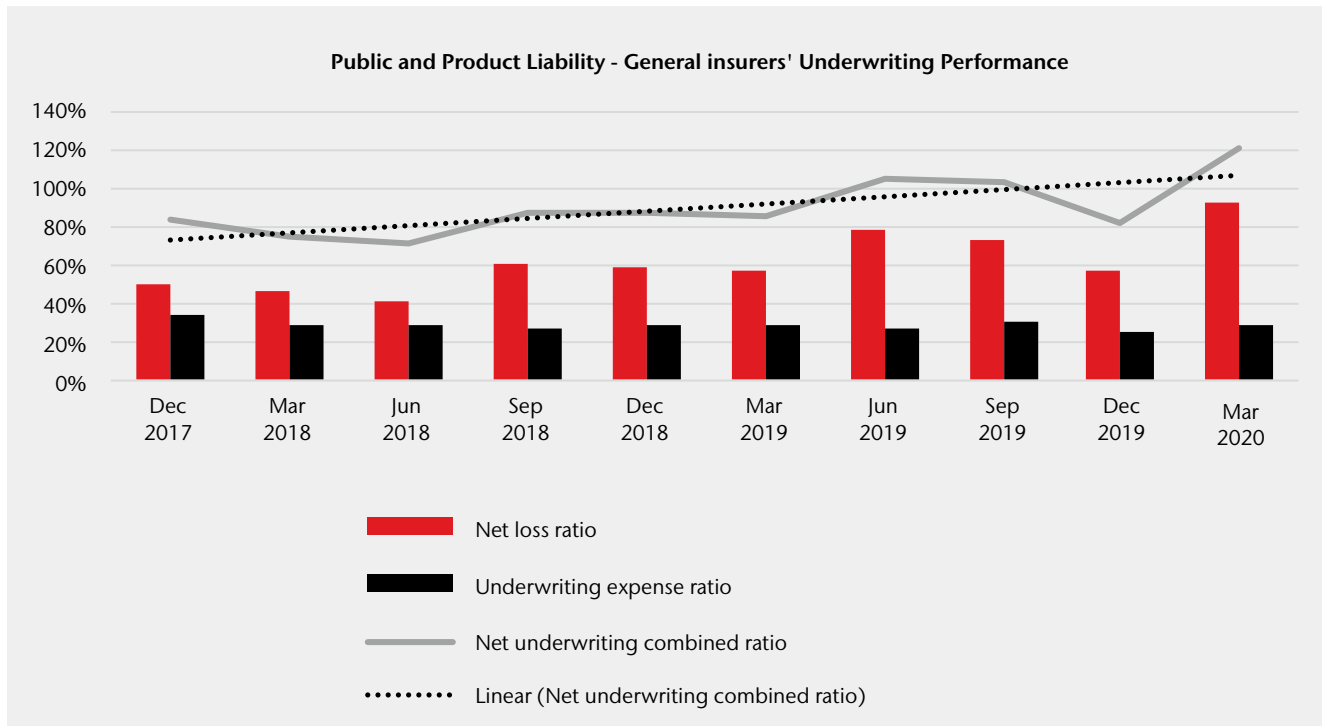


How to differentiate?

- It is critical to plan and prepare well in advance of renewals to secure the best outcomes. Ensure you have a Plan A, B and C and understand what coverage extensions are 'nice to haves' rather than 'essentials'. It is important to know these in advance as they will be useful negotiating tools.
- Detailed, quality underwriting information has never been more important. Insurers are placing a heavy premium where there is uncertainty on risk profiles.
- Consider the impact of different limit and retention structures on your balance sheet well in advance of renewal negotiations – what can you afford to retain vs transfer to the insurance market? It is critical to take a pro-active approach to this, particularly for complex or high hazard placements.

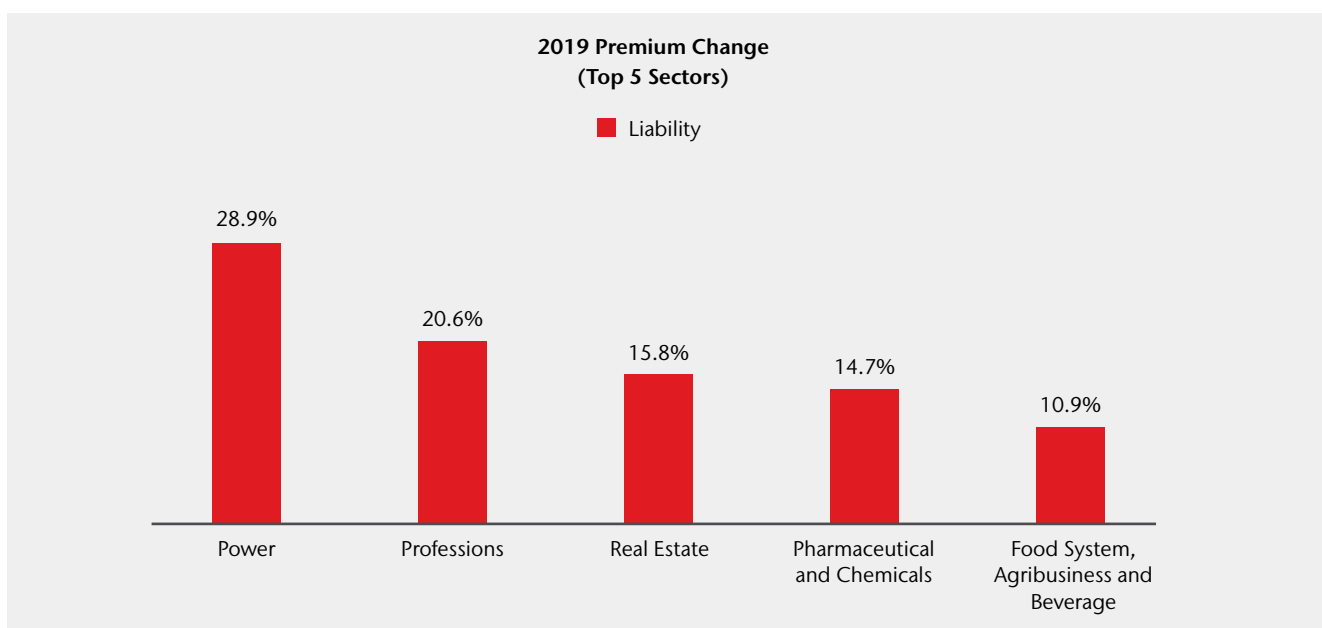
GENERAL LIABILITY

Similar to the ISR market, the Australian General Liability (GL) net underwriting combined ratio has deteriorated to 125% in the March 2020 quarter. This has been exacerbated by the rising costs of insurance claims resulting from factors such as increasing litigation, broader definitions of liability, more plaintiff-friendly legal decisions and larger compensatory jury awards.



Source: APRA (2020), Quarterly general insurance statistics, <https://www.apra.gov.au/quarterly-general-insurance-statistics>

These results have been underpinned by historical pricing that has been deemed inadequate by the market for some industry segments and has led to complete rate corrections within both primary and excess layers, with a particular focus on payback periods and rating adequacy. In 2019 we saw rating increases across the board for clients in a number of industries and we expect this trend to continue in 2020.



Source: Aon proprietary data – Australian liability accounts with GWP >\$250k

Increasing deductibles can be a good tool to alleviate premium increases but in some cases, it doesn't prove to be fruitful, as the premium savings are not appropriate or proportional to the increased self-insured retention. However, this strategy should still be considered.

For most insurers there is an ongoing focus on limit deployment and capacity management, more so than we have seen historically. In the first two quarters of 2020 we have witnessed some insurers have adopted a 'take it or leave it' approach, a sign that the market is continuing to gather pace and catch up with corrections which have recently taken place in other major classes.

Coverage has also been a major area of focus with underwriters concentrating particularly on 'non-traditional' coverage included under programs, such as cover for Professional Indemnity. Such coverage is either being wound back or passed onto more specialised teams to be underwritten and priced. The usual wording 'frills' once enjoyed in softer market conditions are also being reviewed and, in some cases, removed or attracting additional premium charges.



How to differentiate?

- Quality information is critical for a positive renewal outcome. The GL market is asking more questions than ever before as they seek to understand exposures that had previously been ignored in the softer market.
 - If information can't be obtained it is proving extremely difficult to remarket or restructure accounts and provide competitive tension across towers, or to simply replace capacity lost due to incumbents' markets winding back or completely withdrawing lines.
 - It is proving much easier for markets to simply exclude an exposure if it cannot be underwritten or where inadequate information is provided.
- Insurers are keen to understand how clients manage and mitigate their third-party exposures, in particular contractual liabilities. Market presentations or meetings with insurers' risk engineers to quantify and qualify certain risks can often be useful in attracting or retaining capacity.
- Developing multiple strategies and fall-back positions is prudent given the GL market is proving to be unpredictable as it moves into its next phase.



CONTACT

Ben Rolfe

Managing Director, Broking & Chief Broking Officer

+61 2 9253 7452

ben.rolfe@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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