Insurance Market Update

Signs of Change for Corporate Insurance Buyers

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Insurance market pricing has been in a state of decline for an unprecedented period of years, leading many to speculate that the traditional cycle is over. In our view insurance pricing will always be subject to cycles due to a combination of losses from claims and investment returns based on the global economy.

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Reality is that the state of the market has been driven by significant competition due to an influx of new capital and a relatively benign claims environment.

However, the claims environment changed dramatically in 2017 as natural catastrophes in the second half of the year, including hurricanes Harvey, Irma, Maria, earthquakes in Mexico, fires in California and string of storm and flood events in Australia and Europe, have resulted in significant losses and a drain on capital in the Property & Casualty insurance market.

> "On the back of a record year of catastrophe losses and losses from class action law suits there are signs of change."

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ANALYSIS

Claims Impact

According to Swiss Re the preliminary estimate for global insured losses from catastrophes is a record breaking US$136 billion, which is more than double the annual average in the previous 10 years of US$58 billion.

Of this figure US$131 billion resulted from natural catastrophes and US$5 billion from man-made disasters.

Swiss Re has indicated that it expects the combined ratio (i.e. Claims and expenses versus premium) in US Property & Casualty insurance for 2017 to rise to 109% from 101% in 2016, with the global reinsurance combined ratio expected to jump to 115% from 92%.

The Financial Services insurance market (which provides insurance for professionals, boards of directors etc.) has also felt the impact of substantial losses in recent years as the growth of Class Action law suits takes a toll.

In Australia alone the estimated cost of Court approved settlements in Class Actions law suits exceeds $4.5 billion, of which Securities Class Actions account for circa $1.3 billion.

In 2016 Securities Class Actions globally hit record highs:

a) a 43% increase in Securities Class Actions from 2015 to 2016
b) a 57% increase in the second half of 2016.
c) 270 Securities Class Action filings is the highest number in a single year for the last 20 years.
d) The average and median settlements in 2015 were $37.9m and $6.1m respectively.

Only last week, ASX-listed QBE agreed to pay $132.5m to settle a shareholder class action led by Maurice Blackburn over a 2013 profit downgrade.

Whilst Securities Class Actions have had a significant impact on Directors & Officers Liability insurance, Class Actions have also had an effect on Professional Indemnity insurance for professional services firms, such as lawyers and accountants.

In addition, global non-life insurance industry profitability declined in 2017, with return on equity (ROE) down to 3% from 6% in 2016. As a result premiums are expected to rise by 6% to 7% in real terms annually over the next two years.

Reinsurance

The January Reinsurance renewal season is a preliminary indicator of what impact the claims environment may have on insurance pricing.

Although 2017 has proven to be the worst year on record for catastrophes, the losses resulted from multiple catastrophes and therefore the impact was spread across a multiplicity of insurers, reinsurers and alternative capital providers.

Traditional reinsurer balance sheets are strong and reports indicate that alternative capital providers remain committed to providing new funds and underwriting platforms. As a result the market remains well capitalised.

Therefore, the availability of capacity maintained a level of competition across all lines of reinsurance ensuring that rate hikes were kept in check.

According to reports out of Lloyd's of London, the reinsurance market conveyed single-digit rate increases at the start of this year after the lows of 2017, and bigger rate rises are expected in the middle of the year on the back of the US renewal season in June and July.

Reports from several sources indicate that commercial property and casualty reinsurance pricing are up by between 5% and 20%. The worst hit being USA catastrophe loss affected accounts where increases ranged from 10% to 20%, whilst increases on loss free accounts were in a range of up to 5%. A flat increase of 5% was the average experience in the UK market.

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CONCLUSION

Whilst there is still significant capacity in the market for some classes of insurance, insurers are beginning to respond to pressure on their margins brought about by losses from claims, increased reinsurance costs and poor investment returns. There is enough evidence to indicate that insurance premiums will increase further notwithstanding an excess of capital.

According to research released by Morgan Stanley Co. in early January 2018 increases of as high as 15% to 25% could also extend to the pricing of property insurance for loss impacted insureds, whilst casualty rates could experience single digit increases.

In Australia particularly, Directors and Officers Liability insurance premiums have jumped by as much as 300% in the last six months due to the increase in the number of class actions launched against Australian companies. The impact is not limited to the initial $10 million or $20 million of cover as due to the amount and size of the litigation going on insurers no longer feel safe at any point of attachment below circa $75 million.

Insurers may also look to reduce their exposure by:
i) limiting the capacity/limits that they are prepared to provide; and
ii) increasing deductibles.

Some insurers, prominent in the Australian market, have already demonstrated a willingness to walk away from long term accounts if they are unable to make the corrections that they are seeking.

With insurer's increasing their focus on underwriting discipline and risk selection, differentiation will be key. In our view, insureds able to demonstrate that they have a strong Risk Management culture; robust Corporate Governance and a history of low claims are likely to be best positioned to obtain optimal outcomes.

Insureds therefore need to be proactive and commence their renewal process early to ensure that their risk is able to be presented in the best light and to allow adequate time to address any surprises or consider strategies which may mitigate premium increases, such as increased deductibles.

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