CROMBIE LOCKWOOD INSURANCE MARKET UPDATE | AUGUST 2023

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IN THIS ISSUE

In our August market update, we examine the impact of hard market conditions, rising reinsurance costs and extreme weather events on insurance rates.

We also highlight the importance of understanding an insurer's definition of a flood and take a look at the Directors & Officers Liability insurance market, where risk management is now as important as a company's financial position for insurers.

Market continues to harden

- *Rate increases for some policies accelerate during 2023*
- *Increase driven by climate change concerns, global uncertainty and higher reinsurance costs*
- *Trend likely to continue for the next renewal cycle and beyond*

As discussed in our March market update, the insurance market remains in a 'hard' phase, during which insurers increase premiums, reduce insurance capacity and offer more restrictive terms and conditions. These conditions are caused by mounting concerns about climate change as evidenced by the rise in volume and severity of extreme weather events and natural disasters, both here and overseas, as well as by unstable global financial conditions.

Insurance rates trend upwards

To better understand what the recent rise in the cost of insurance means for our clients, we analysed data for the insurance renewals of a large section of our commercial client base. These clients have Material Damage and Business Interruption policies and represent a good spread of occupation type and location.

The data illustrates a rising trend in average rate increases broken down by earthquake perils and non earthquake perils as follows. (Insurers use a rate to calculate the premium based on the sum insured.)

Commercial portfolio: Average rate increase		
Time period	**Non-earthquake perils**	**Earthquake perils**
12 months to 31 Dec 2022	4.93%	6.96%
1 Jan – 31 March 2023	7.62%	15.0%
1 Jan – 31 May 2023	20.66%	13.46%

The figures show that if a sum insured was unchanged at renewal during 2022, the premium increased by a relatively modest amount. By the end of the first quarter of 2023 (before the financial impacts of the two flooding events were fully understood), rates had risen substantially, particularly for earthquake perils. By the end of May 2023, the rate rises were even more dramatic, predominantly for non-earthquake perils.

When analysing this data for the three main metropolitan areas, the recent rate increase for non-earthquake perils for Auckland and Christchurch averages around 25% as below.

Rate increase for policies renewing between 1 January 2023 to 31 May 2023			
	Auckland	**Wellington**	**Christchurch**
Non-earthquake perils	25.4%	20.39%	24.48%
Earthquake perils	9.4%	14.93%	13.5%

For many clients, these rate increases are compounded by increased sums insured to reflect the impact of strong inflation, which means actual premium increases may well be higher.

Past and future concerns both playing a role

It is not only past events that are driving rate increases; the growing risks of climate change, with a forecasted rise in the number of extreme weather events, are also troubling insurers.

In a recent interview, Swiss Re's lead underwriter for Australia and New Zealand, David Sinai, commented, "More frequent and larger claims will require higher insurance premiums to service those claims. Insurers need to stay ahead of loss trends to ensure the premiums collected are adequate to cover their obligations to policy holders and protect their shareholders' interests.

"The 2023 events not only remind us of the large-loss potential of weather-related events – $4 billion in claims and counting – but should also reframe our perspective of overall risk drivers in New Zealand. The increase in frequency and severity of weather claims would suggest that weather losses are closing the gap to earthquake risk."

What this means for our clients

Hard market conditions and rising reinsurance costs continue to push up insurance rates on Material Damage and Business Interruption policies. We expect that this trend will persist through the next annual renewal cycle at the very least, as individual policies are reviewed and renewed.

We continue to advise our clients that the most effective way to navigate the hard market conditions is to engage early with your broker and prepare a detailed submission for insurers. This will provide your broker with the maximum amount of time available in which to negotiate terms.

Flood insurance presents challenges

- ***Flood insurance availability is a growing concern***
- ***Insurers consider risk-based pricing for commercial businesses***
- ***Different insurer flood definitions may impact clients***

The availability of insurance to cover flooding is a growing concern. The Government and local councils have recently introduced land zoning for areas affected by the 2023 flooding events, with significant implications for homeowners in flood-prone zones. Most insurers are now refusing to consider new cover for homeowners located in the highest risk categories. While insurers may look at renewing existing policies, these customers can expect more stringent underwriting and restrictive policy terms and conditions.

Insurers are also considering risk-based pricing for commercial businesses. This means that an insurer will examine each risk on its own merit and consider factors such as past loss experience and susceptibility to future floods.

> *"Customers in flood-prone zones can expect more stringent underwriting and restrictive policy terms and conditions."*

Varying flood definitions

For those with higher flood risks, insurers are imposing special terms on Material Damage and Business Interruption policies. These generally relate to:

- A higher excess for flood claims
- A sub-limit for the amount of flood cover available
- A blanket exclusion for flood cover.

There are generally two main types of flood: pluvial, where flooding results from an accumulation or run-off of surface water from rain and fluvial, where flooding results from water escaping from a river, lake, reservoir or other natural watercourse.

There is currently no standard definition of Flood across insurers in New Zealand. Some insurers refer only to fluvial, some to both fluvial and pluvial and we have seen some examples where sea surge and/or escape from drainage systems are included in the definition.

What this means for our clients

If special conditions are included for flood in a policy, it is important to understand the implications of the flood definition/s that apply. The Insurance Council of New Zealand is understood to be working with insurers to develop a consistent definition. In the meantime, your broker is best placed to explain the implications of any special terms that may apply to your policy.

Directors & Officers Liability Insurance (D&O) update

- ***D&O rates stabilise for most corporate clients as market softens***
- ***Commercial and SME clients face inflationary premium increases***
- ***Insurers sharpen their focus on corporate risk management***

It is encouraging to note that D&O Liability rates have stabilised for most corporate clients as the hard market conditions continue to ease. Recent legislative changes in Australia and an influx of capacity into the London D&O insurance market have contributed to the softer market, which has put pressure on the New Zealand market to reduce pricing. This is particularly the case in excess layer placements or 'top up' cover.

However commercial and SME clients are likely to face inflationary premium increases.

While the D&O market has softened somewhat, the global economic and geopolitical landscapes continue to remain challenging, with higher global interest rates, inflationary pressures, the impact of the Ukraine conflict and supply chain interruptions.

The combination of these factors, together with the protracted nature of D&O Liability and other financial lines claims and the anticipated legislative changes following the conclusion of the Law Commission's investigation into Class Actions and Litigation funds, could all negatively impact the market and pricing going forward.

What this means for our clients

The hard markets of 2020/2021 are firmly behind us for most D&O Liability risks. However clients should continue to demonstrate their financial viability to insurers and importantly, show how they are addressing cyber and data security, environmental, social and governance (ESG), supply chain and business continuity.

The uplift in event-driven D&O claims globally (including data breaches and greenwashing) means insurers now expect more from directors' risk management approach as part of their company's overall operational resilience. Insurers are also showing a heightened awareness of these risks.

Risk management is now as important as a company's financial position when it comes to underwriting criteria, which had not previously been the case.

For more information

If you have any questions or want to understand the impact of these changes on your specific situation, please contact your Crombie Lockwood broker.

About Crombie Lockwood

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