General Insurance – Property Class rates increases to accelerate near term

In 2016/17 there were average market increases of around 6% across most property classes. The 2016/17 published Australian Prudential Regulation Authority (APRA) statistics show that these rates increases haven't been enough to bring the main property classes into a profitable position.

It's essential for Insurance Advisers to be aware of the factors that are driving increasing premiums. By maintaining a strong grasp of the underlying pricing influencers, we can have meaningful conversations with our clients. These conversations need to occur much earlier than only just a year ago as property rates are rising more quickly than many insurance professionals predicted and capacity also getting tighter as we move through this point in the Insurance Cycle.

What's been reported?

Price increases look set to continue throughout the remainder 2018 and well into 2019, this is certainly going to be the case with property and some motor classes.

Speaking after the release of their FY17 results, Peter Harmer, Managing Director and CEO of IAG, said that the firm expects to see increases continue over the coming year. "I don't want to signal anything too strongly but yes the momentum we closed FY17 with will continue into FY18," Harmer said. "As we closed out the year, we were seeing single digit increases in property classes and commercial motor".

Beyond these comments, the APRA annual insurance performance statistics for June 2017 showed Commercial Motor running at a combined ratio of 103%, only a 3 point improvement on 2016 and Fire/ISR (Property) running at 113%, which was only a 2 point improvement on 2016. Private Motor results were 101%, up from 98% in 2016. It's significant to note when ratios are above 100% this indicates a portfolio is running at a loss from an underwriting point of view.

Of course there are other market forces also at play (some outlined below). Collectively, they mean there can be little doubt general insurance rates will continue in an upward direction.

Low Interest Rates

A sustained period of low interest rates has had a significant impact in insurers results for 2 primary reasons:

1. Insurers are required to maintain reserves for long-tail claims (e.g. liability). When interest rates are falling these reserves need to be 'topped up' as predicted investment returns have been impacted by lower than expected investment returns.

2. Historically investment returns used to make up to 66% of insurers' annual profits. This percentage has decreased to approximately 33% over the last few years. Last year investment returns reduced from 4.3% to 3.6%.

AU$

The AU $ has not fluctuated much over the last 12 months and it is now hovering around 0.77c – 0.80c to 1 $US. This has seen the continuation of claims cost inflation being higher than the general rate of inflation we see across the rest of the Australian economy. This impact has been particularly noticeable in repair costs of motor vehicles that rely on replacement parts which are imported from overseas and for that matter on any building materials or equipment that is imported as part of a claim settlement.

Insurance Company Net Retentions

In the past decade or so the amount of losses held locally by insurance companies has increased. Previously event or individual losses over a set amount were picked up by their reinsurance arrangements, but today the threshold amounts before seeing reinsurance pick up losses have risen markedly. This means many smaller weather events, for example, aren't falling into reinsurance treaties – and the local companies are picking up the losses to their net account. Not surprisingly this is having an adverse impact on local net loss ratios.

LOOKING TO THE FUTURE

After weighing up all the factors I believe we are seeing a period where some property risk types will find it difficult to find underwriters to either underwrite that risk or reduce their capacity. Those risks that are written will definitely experience stronger rate rises than were previously predicted and well up on the prior year of circa 5% - 7%. The insurance industry, I believe is hovering around 8 to 10 O'clock on the Insurance Clock pictured below, and property class (Property/ISR, Home, Commercial and Private Motor) rates will continue to rise to varying degrees depending on the risk type, claims history and your clients ability to manage risk. In simple terms, motor (Private and Commercial) repair costs are marching well ahead of inflation due to the increased automation of vehicles, which whilst adding significantly to vehicle safety, it does come at a significant cost when repairs are done following accidents, minor or otherwise.

Property class loss ratios are unsustainable and there is potential for significant rate increases or reduced capacity to be felt by more and clients in the next few years. Over the last few months we have all seen examples of reducing capacity or even you may have found it difficult to even get terms. There are many emerging risks that will have to be factored into this class, a major one to note is Aluminium Cladding as it has been used on many buildings over the last 20 years and its highly flammable nature will see a higher level of scrutiny been applied to risks that contain this cladding, whether the cladding is fire rated or not!

Structural change and cost cycles are part of every industry and Insurance is no different. The insurance clock, below, a useful tool to represent where the insurance rates are. Above all, it's crucial we work together to maintain policy terms and conditions even though prices are on the increase. After all, as we all know, price is ultimately forgotten when an insurable loss happens.

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