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Business Insurance Market Conditions

2023 Outlook

Australia
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Expert insight into the current market conditions in business insurance classes and the factors affecting availability.

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INTRODUCTION

Welcome to the Business Insurance Market Conditions Report, providing a 2023 outlook into the current market conditions across some key business insurance classes, the factors affecting the availability of insurance and the strategies we can help you deploy in order to navigate these challenges.

Partnering with experts

Here at Gallagher, we are managing our clients through this hard market day in, day out, and we understand how to secure the optimum outcomes for business risks of all shapes and sizes, across all industries.

Thanks to our extensive network of local and global insurance markets we are very well equipped and have considerable expertise in supporting businesses with insurance and risk solutions.

Please do get in touch – remember, we are here to help.

GENERAL OVERVIEW

Mark Oatway
Managing Director
Placement

Where we've been

Over the past two years the insurance market has been very challenging, with pricing increases and capacity restrictions commonplace due to:

- insurers failing to achieve rate increases that could keep pace with what they paid out in losses
- additional challenges that drove up claim costs, including social inflation, increased catastrophe activity and concern over pandemic-related losses
- an inability of insurers to offset weak underwriting results through investment income due to low interest rates.

Where we are now

In good news for insurance buyers some relief is now at hand with evidence that the rate of premium price increases is levelling out, although they are not yet falling. The impetus for this change includes:

- improved risk management has made insurers more comfortable with the risks they are accepting
- after three years of substantial rate increases, insurers have remediated their books of business and have returned to profitability as the market has moved towards rate adequacy.

High-hazard occupations remain in focus for insurers; however, pricing increases aren't as great as in recent years.

There are a number of complicating factors that are continuing to impact the overall market, including:

- social inflation
- general economic inflation
- geopolitical threats (Russia/Ukraine war)
- catastrophe losses, and
- a more litigious legal environment.

Premium rates – spotlight on commercial lines

Premium rates across commercial lines of insurance have continued to increase, however, the rate of increase in premiums is moderating in most classes and showing signs of stabilising. Insights on each commercial line can be found within the contents of the report, providing a deeper analysis of the market conditions.

Renewal data for 12 months to September 2022 for commercial and corporate businesses (excludes micro and small businesses)

	Premium rate % change (median) rolling 12 months	**Premium rate variations** (median) QoQ over 12 months	**Rising Premiums indicator**
Property – commercial	⬆ 8%	⬆ 7% to 10%	Stable
Liability – general products and public liability	⬆ 10%	⬆ 10% to 11%	Stable
Professional and financial lines	⬆ 14%	⬆ 12% to 15%	Relatively stable
Workers compensation	⬆ 6%	⬆ 4% to 8%	Moderate upward pressure

Source: Gallagher Drive AU Client Data, Q4-2021 to Q3-2022. The median is the value separating the upper half from the lower half data sample (or the middle value). Policy level rate movements may vary based on the specific account characteristics and claims experience.

Where we are headed

Following on from the difficult insurance markets in recent years many businesses are now seeking alternatives to traditional insurance, with:

- for risks that require multiple carriers, renewal meetings often including discussions about alternative risk transfer mechanisms such as captives and protected cell companies
- businesses are looking for more control over the volatility of insurance pricing and a better breadth of coverage.

A level of uncertainty also remains in the insurance markets, with several factors having upwards pressure on insurance pricing including:

- rising inflation
- ongoing supply chain difficulties, and
- continuing labour shortages.

Critical factors affecting the current price and availability of insurance cover

There are several factors having an effect, either positive or negative, on the current insurance market, including:

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- the increasing prevalence of extreme weather events
- increased inflation, supply chain issues and labour shortages

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- improved risk awareness, risk management and mitigation from businesses
- a return to profitability for many insurers, and
- new capacity entering the market both locally and overseas.

Risk Alert! Property Sums Insured

Have you updated your property valuations?

High inflation and supply chain disruptions have sent building costs soaring so if your property is damaged the cost of repair or rebuild will be far greater than you expect. In the event of a claim, this means you could be forced to cover the shortfall between your payout and the actual repair or rebuild cost, which may be substantial.

If you haven't done so in the last two years, it's time to conduct a professional asset valuation, review your sums insured and make sure you have adequate insurance cover.

We're here to help.
Talk to your Gallagher broker.

Key facts:

7.3%
Annual CPI inflation to September 2022[1]

25%
Increase in construction costs over last 5 years[3]

11%
Residential construction cost increase to September 2022[2]

2/3
Estimated proportion of Australian businesses which are underinsured

Sources:
[1] ABS: Consumer Price Index, Australia
[2] CoreLogic's Cordell Construction Cost Index (CCCI) for Q3 2022
[3] Property Council 'Construction costs set to peak this year as Australia records fourth highest cost of labour in the world'

PROPERTY

Reflective of the broader market, the extent of pricing increases is continuing to reduce for most property risks, however, insurers are increasingly focused on the potential for losses related to floods and natural catastrophes in general.

KEY TRENDS:

- Premiums are still increasing but the magnitude of increases is reducing
- Natural catastrophe exposed and high-risk property types remain difficult
- Insurers are concerned about the impact of additional flooding
- Businesses are willing to look at alternatives like captives, protected cell companies and parametric covers.

With a third successive La Niña event recently announced for Australia, increasing the likelihood of above-average rainfall for northern and eastern Australia during spring and summer, the impact of recent and any future flooding will continue to be felt with both flood-affected and flood-prone areas likely to experience capacity restrictions.

Other high-risk property types that continue to experience challenges include:

- food and beverage producers with a large footprint of expanded polystyrene (EPS)
- high fire load manufacturing accounts with inadequate fire protection
- buildings with aluminium composite panel (ACP) cladding
- timber constructed hotels and pubs
- recycling operations, and
- timber mills.

As a result alternative risk transfer solutions, such as the use of captives and protected cell companies, are now commonplace considerations when conducting renewal discussions.

Previously the domain of large corporates, alternative risk transfer solutions are now being considered by mid-market companies with risks that continue to be hard to place at affordable pricing and with an adequate level of protection.

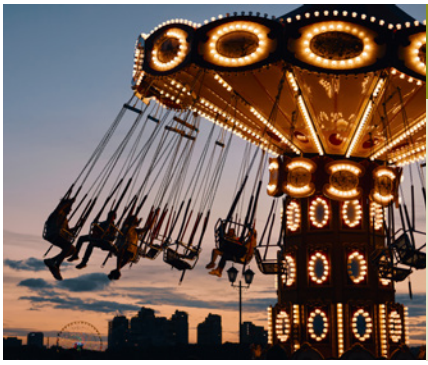
Other alternative forms of insurance, such as parametric covers, are also increasingly on the table for catastrophe-exposed businesses looking for flood or cyclone cover that isn't available in the general market.

Updated valuations essential

Rising inflation is also playing a role in property insurance placement, with insurers requesting updated building valuations to ensure that sums insured are adequate as the cost of property rebuild or repair work is blowing out in some cases, affecting claims ratios.

LIABILITY

In general, conditions in liability markets have eased considerably, with pricing for good risks recording only moderate increases in line with inflationary pressures.



KEY TRENDS:

- Premiums for good risks are recording only moderate increases
- Loss-affected and higher hazard liability risks remain difficult
- Top-up cover continues to come at an increased price, as insurers set minimum premiums
- Social inflation is affecting long-tail claims costs.

However, premiums for loss-affected and higher hazard liability risks are recording larger increases and still remain challenging to place, including businesses with:

- high bushfire exposure
- high worker to worker exposure
- amusement rides that 'lift and spin'
- trampoline and inflatables entertainment centres, and
- thermal coal risks and tailing dams.

In instances where businesses request additional cover this is also continuing to be provided at an increased price, with more insurers instigating minimum premiums for top-up covers.

Issues surrounding worker to worker and labour hire risks remain problematic, with workers' compensation insurers looking to reclaim costs by suing other insurers under their liability policy on the basis that a safe place to work wasn't provided.

More exclusions are also beginning to appear related to the use of PFOS and PFAS chemicals as the health concerns surrounding these substances continues to build momentum.

In general, insurers remain alert to the potential for loss developments on long-tail liability risks with the impact of social inflation on claims costs increasing.

Social inflation explained

Social inflation describes the contribution that social factors, such as changing views in society about the role of insurance and what it is designed to cover, have on liability claims costs. Some of the factors that contribute to social inflation include:

- increasing claims volumes
- broader definitions of liability, and
- higher compensation awards.

PROFESSIONAL AND FINANCIAL LINES

After a few years of fairly steep premium increases, the pendulum for professional and financial lines insurance has begun to swing back in the favour of businesses, rather than insurers.

KEY TRENDS:

- Premium price increases are levelling out
- Insurer appetite is returning to the market due to new competition, improved underwriting results and businesses buying less cover
- Challenging risks can still be hard to place
- Excellent corporate governance and risk management are key.

Businesses that saw sharp increases in their directors and officers' and professional indemnity insurance may now be seeing premium increases level out as insurer appetite returns to the market.

The fast upward movement of premiums over the last few years caused a number of corporates to review their buying patterns, often only buying limits up to their budgets, and as a result there were parts of programs or certain risks that they chose not to transfer to the insurance market because of what they saw as uncommercial pricing.

That has taken a significant amount of premium out of the market and, along with new competition, insurers are now looking for ways to recoup that premium with a focus on the adequacy of the premium, achieved relative to the risk, rather than a need to keep pushing for higher premiums.

Buoyed by improved underwriting results since 2020 as well as in the first half of this year, insurers are growing in confidence and are more willing to look at risks now than they were a year ago, however, the market is still patchy.

Businesses with excellent corporate governance and risk management that have types of risks that are attractive to insurers are benefiting from this changed environment, but more challenging risks can still be hard to place as the underwriting rules and coverage restrictions introduced as the market hardened have not changed.

Some of the more challenging placements involve:

- global financial institutions
- complex construction, and
- global technology or carbon-intense industries.

The environment is not uniform across Australia but, while on the whole the professional and financial lines market seems to have taken a breath, given the backdrop against which they are operating, global insurance markets remain fragile in regard to natural catastrophe risk, geopolitical events, inflation and global volatility: all factors that could erode the confidence that insurers are starting to feel.

CYBER

There are positive signs that global cyber insurance markets have adjusted to an increased threat environment in recent years as we now start to see some easing of the dramatic price increases that so many companies have experienced. New cyber insurance capacity is now available for Australian businesses, which is a welcome development.

KEY TRENDS:

- Premium pricing is increasing in Cyber but less steeply, as new capacity enters the market
- Cyber is now considered a key part of enterprise risk management at board level and is no longer thought of as an IT problem
- Hard to place risks can still be challenging so having best practice corporate governance and a good story to tell are key
- Data retention and destruction is the subject of sharp focus.

The key driver behind the positive trading conditions is improved risk management and business investment in security controls that can be demonstrated to reduce overall claims activity. However, it needs to be understood that the best outcomes are only available for businesses that can show measurable best practice controls throughout their organisation.

With new technologies and the ability to improve security constantly changing, cyber security needs to continue to be addressed at board level, or elevated to board level, and should be a focus of audit and risk committee agendas.

Since the market remains selective having the right risk management story to tell is key, as the cyber market remains a challenging place to navigate. Underwriter scrutiny is firmly focused on best practice controls.

There has been positive momentum in the understanding of cyber security as an enterprise risk in executive thinking. Companies that have had audits, identified gaps and have a clear strategy for improvement will have greater access to competitive cyber insurance. Timelines for these remedial actions need to be as short as possible or restrictive policy conditions may continue to be applied.

This need for urgency is mirrored by changes in July 2022 to the *Security of Critical Infrastructure Act* which requires the providers of key public services to register their critical infrastructure assets and risk management and continuity plans for protecting them, or risk governmental intervention under extraordinary powers. Suppliers to these businesses may also be impacted by this legislation without knowing about this obligation.

Data storage and disposal – risk spotlight

The issue of data destruction is now the subject of sharp focus. Underwriters and regulators are asking for detailed information about the security controls a company has in place to protect customer or other sensitive data, whether the information is privately identifiable data and how they deal with the purging of that data.

Companies need to be able to demonstrate that they fully understand their risk, and that they know where their critical data is, who can access it and how they are protecting it.

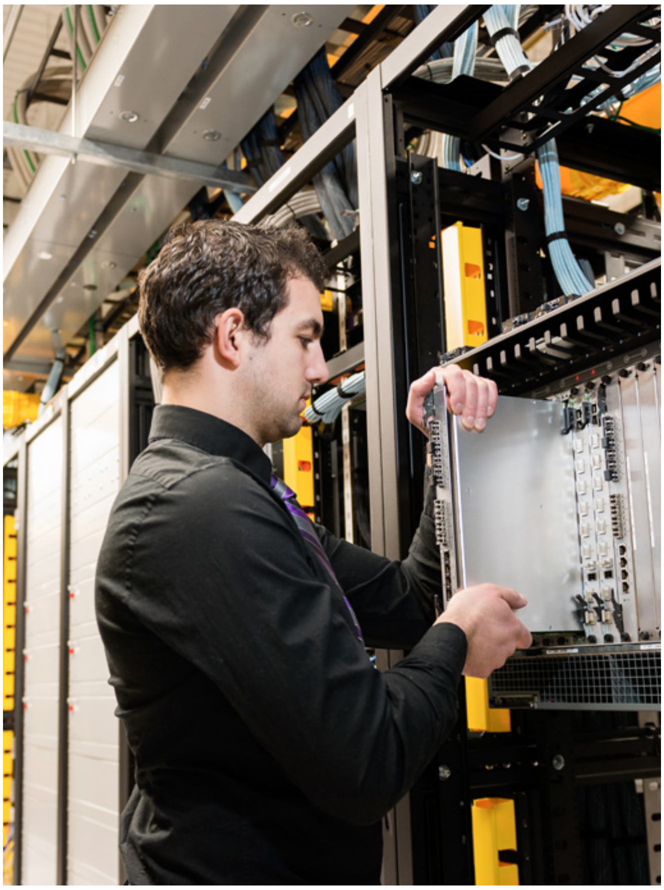
While ransomware attacks remain a problem, we have noted a definite increase in business email compromise, with targeted attacks by hackers accessing vulnerable systems and diverting funds: a type of attack that can affect a business of any size.

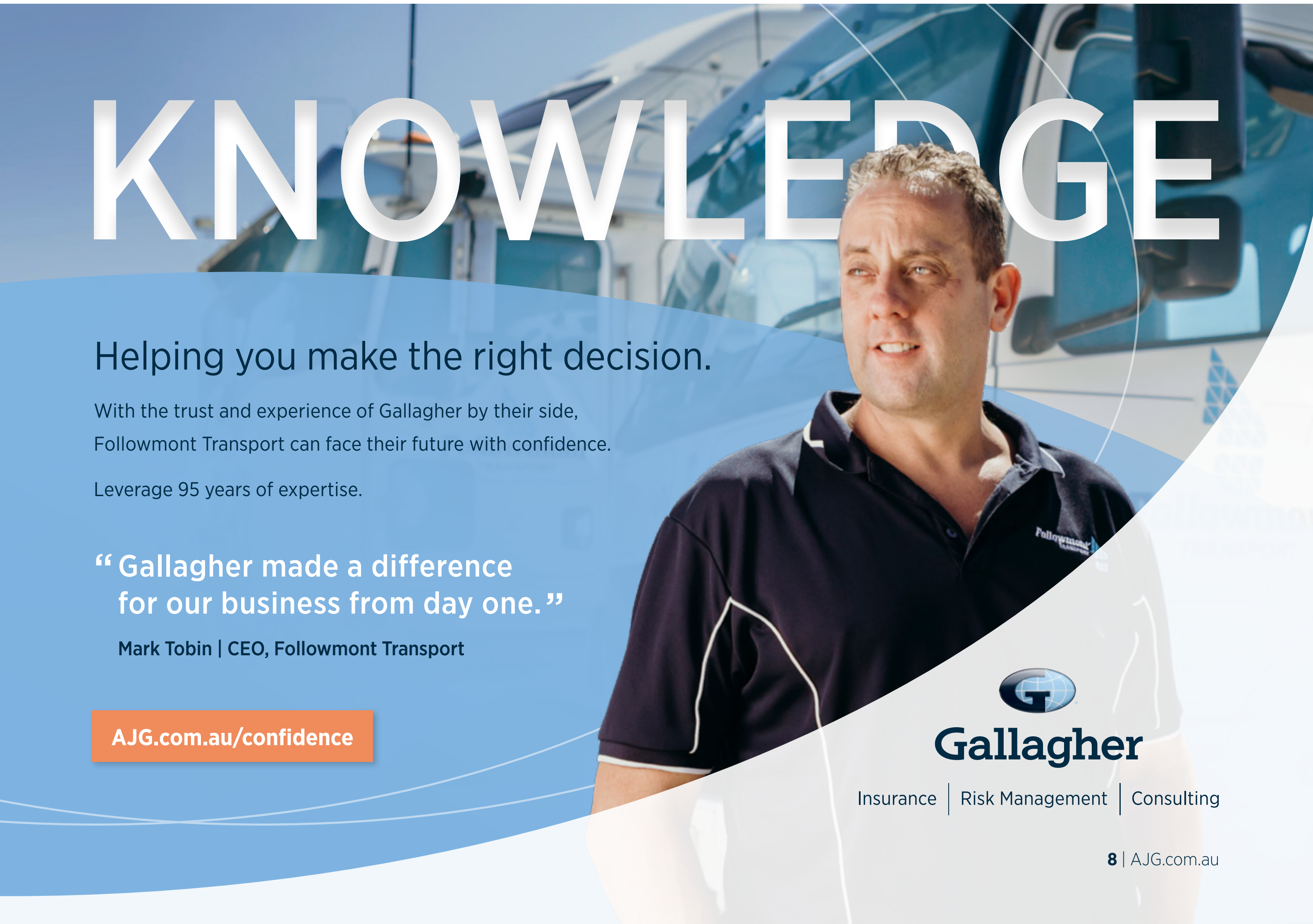
Reports of malicious links and suspicious language detected in emails have increased significantly. Cybercriminals ramp up efforts on attacks that work, and phishing attempts are becoming more sophisticated. This flags the importance of businesses undertaking security awareness training, deploying phishing simulations and utilising an inbox protection tool.

Looking forward, it is possible the new market capacity may lead to increased competition, but underwriters are likely to remain reactionary to risks as they emerge.

Insurance has always been designed to protect against only unforeseeable events. If businesses know they have vulnerabilities they should quickly address these issues before seeking cyber cover or be able to provide a commitment to these improvements.

Insurers need to see that a business fully understands their risks and have processes in place to prepare, respond and recover from any cyber attack.



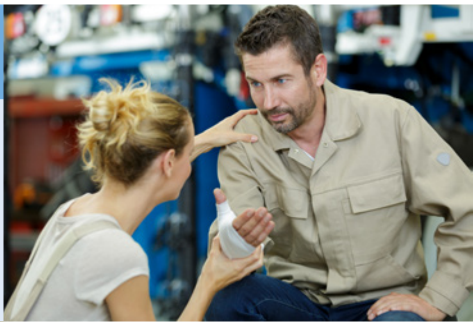


WORKERS' COMPENSATION

Workers' compensation premiums typically represent an employer's highest insurance cost and in this market premiums are rising in many jurisdictions, adding to the cost burden already faced by businesses due to rising inflation.

KEY TRENDS:

- Premiums are increasing at a moderate rate
- Insurers are less willing to underwrite sub-standard risks to win market share
- Mental health claims are beginning to have a material impact on the market
- Now is the time to address psychological health hazards in the workplace.



In the managed funds states of NSW, Victoria, Queensland and SA where the government sets the workers' compensation rates, all except Queensland have moved to a hard market, with costs being passed on to businesses. In Victoria premiums are expected to remain fairly stable until the state election late in 2022, but come 2023 increases are likely to flow through due to the scheme's negative funding position.

In the privately underwritten jurisdictions of WA, the NT and Tasmania premiums are also increasing, or are likely to do so, while they are decreasing in the ACT.

The workers' compensation market in WA is hardening, but companies with a sound risk management approach will continue to see competitively priced cover.

Changes to the *Return to Work Act 2020* in the NT, which saw a reinstatement of coverage for most journey claims, have not had a measurable impact on the scheme. But despite this the NT typically moves in step with WA, so rate increases are expected there.

In Tasmania premiums for the current financial year are likely to be flat or only involve small increases, while in the ACT the average premium rate has fallen, led mainly by a decrease in claims costs and a reduction in claims frequency. That said, access to uncapped common law awards still presents an issue for the scheme's profitability and average rates in the ACT are likely to remain the highest in the country.

In privately underwritten states where premiums are rising it's important to have a strong broker advocate, such as Gallagher, to sell your risk management story to secure premium relief.

Mental health claims are also beginning to have an impact on workers' compensation schemes as the strain that COVID-19 put on workers has increased the numbers. Governments are starting to respond by issuing either codes of practice or regulation in this area and over the next two to five years the cost of psychological health claims will have an impact on all schemes in both managed fund and privately underwritten states.

Businesses that are already thinking about the psychological health hazards and investing proactively to address these are going to benefit, while those that ignore them are going to see additional costs, not just from compliance and increased workers' compensation premiums but also due to absenteeism and employee turnover.

PARTNERSHIP

Navigating business insurance market conditions with expertise at your side

At Gallagher we are managing these hard market conditions for clients every day.

Our constant management of insurance market solutions for clients involves understanding and adapting to the risk market influences and how to secure optimal outcomes for business risks of all shapes, sizes and industries. Combined with our extensive network of local and global insurance markets, we are strongly equipped to provide considerable expertise to support businesses with risk and insurance solutions.

Gaining optimal risk solutions for clients in hard market conditions requires the combined expertise and capability Gallagher can provide through:

- a partnership approach between the organisation, Gallagher brokers and the insurers
- detailed risk management information
- global expertise in accessing insurance markets in order to offset local market constraints.

As an experienced broker and risk advisor we work to explore all the options available to your business, discuss a range of pricing and funding options and ensure that you are appropriately protected against all insurable risks.

We work with a large variety of businesses, each exposed to unique risks and all dealing with individual business challenges and circumstances. As one of the leaders in risk management, we remain fully committed to supporting businesses through these uncertain times.

As a guide to working on effective risk outcomes for business these key steps remain a focus.

1 Building strong relationships ahead of renewal

Your relationship with your insurance broker and their relationship with providers in the insurance market are of critical importance. It's imperative that your broker understands your organisation and knows the individual risk exposures associated with your business. This enables them to design a fit for purpose insurance and risk program, ensuring you get value for money with the correct coverage in place.

2 Starting renewal preparations early

The more time your broker and you and your business team have to work on the renewal of your insurance program, the more likely you will gain an effective result in this challenging insurance market. That demands putting in the time to gather the relevant and comprehensive information so that it can be presented to potential insurers well before the renewal date.

Building in a longer lead time enables your broker to properly market your insurance program to and negotiate with potential insurers, presenting your business in the best possible light.

3 Provide detailed information that represents your risk profile in positive terms

Be prepared to document and detail your risk management protocols. In the current market conditions insurers will require more underwriting information. Collect and collate accurate, up-to-date building valuations and risk surveys. Insurers will also want to see your business's risk control processes, supply chain management and your risk management program.

Work with your broker so that they can present your insurance needs to potential insurers in a tangible manner that will resonate and be attractive.

4 Being open to flexible, innovative ways of structuring your insurance program

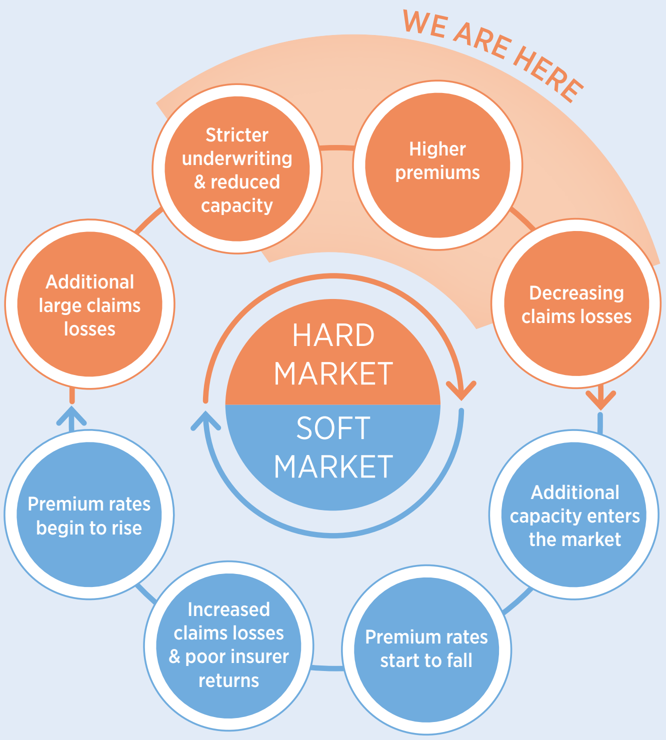
The insurance market isn't static but in fact highly responsive to claims impacts and events that alter the perspective on risk. Be open to working with your broker around changes to pricing, deductibles and coverage.

Your insurance broker may be able to offer creative solutions for high risk businesses where the insurance market may be unwilling to deploy their capital. If you're willing to take more risk on your balance sheet, let your broker know.

INSURANCE MARKET CYCLE

Prices rise and insurers' reduce coverage. Loss events, dipping underwriter profits and capital retreat signal to the insurance market that prices have risen in order for insurance businesses to remain profitable.

Premium prices and insurer profits start to react to negative pressure. As claims losses rise, the market starts to tighten.



Premiums are higher and cover is more difficult to find. Underwriters may step away from certain markets as they look to rebalance the profitability of their books.

Prices begin to drop, cover becomes more accessible in the absence of major losses or with more capital entering markets, underwriters are more willing to place business.

ABOUT GALLAGHER

Building business confidence for more than 90 years

We are Gallagher, a global leader in insurance, risk management and consulting services. Since 1927, we've been working together with our clients to find effective solutions to their challenges, and helping them face their future with confidence.

Much more than simply an insurance broker, we provide cost-effective, client-centric and expertise-driven risk management solutions. Our leadership team fosters a dynamic, entrepreneurial culture that has made us an innovator in creating new products and services for our clients.

Wherever you are in the world and whatever your industry might be, we create and uphold a passionate culture based on strong values, collaboration, and professional excellence.

With over 35,000 experts globally, and 130,000 clients in Australia and with 30+ regional and metropolitan branches nationally, we understand local business communities because we're part of them ourselves. Keeping our focus where it's always been – helping you and your business through every challenge you face. Building confidence, together.

The **Gallagher** Difference

A client-led approach

We don't just claim a "client-first" focus, it's embedded into our strategy and structure. It's what ensures we always act in your best interests to achieve the best outcomes.

A values-led culture

The people who started our business back in 1927 lived and breathed a very particular set of values, and it still stands today. We call it The Gallagher Way – it puts people first, no matter what.

We'll fight for what's right

We hope you'll never have to make a claim, but if you do, we'll stand with you. Because insurance is essentially a promise – and you need people who will keep theirs.

Creating tomorrow's solutions, today

You only get to stay around for the long haul if you know how to evolve and adapt.

Our commitment: the Gallagher Way

Our pledge as your trusted advisor is to hold ourselves to the highest ethical standards in all our dealings with you, and your business. For nine consecutive years, we have been the only insurance broker in the world to be named one of the world's most ethical businesses by the Ethisphere Institute and we take that commitment seriously.

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Get in touch

For more information on obtaining the cover you need in a hard insurance market, please contact Gallagher for a friendly and informal discussion on your insurance program.

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