

NEW ZEALAND

RADAR

FY2022

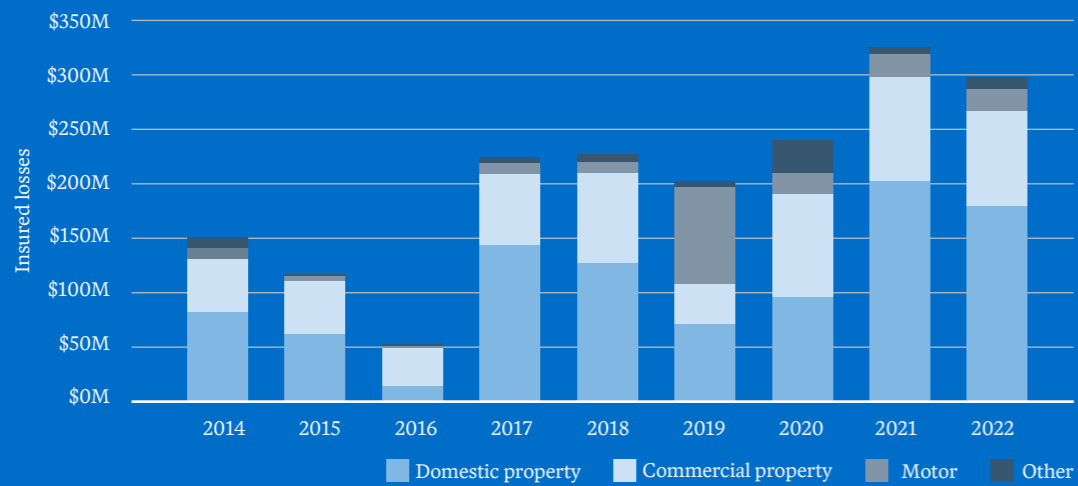
SNAPSHOT

Global events, from rising inflation to climate catastrophe and cyber risk kept insurers at their sharpest in the past year. We look at the trends, local impacts and unique challenges for the local scene and what the industry can do to ensure resilience and sustainability ahead.

General Insurance update 2022

Natural disasters continued to headline concerns for the general insurance industry over the past year. In the year to 30 September 2022, the ICNZ has captured nine separate weather-related events impacting all parts of the motu. By calendar year, total losses to date for 2022 are \$297M, of which \$180M relates to domestic householders, but this figure may rise, as costs from the August Nelson floods are expected to increase. We expect this will result in 2022 having the highest annual gross insurance losses for weather-related events over almost a decade.

Weather-related insurance losses by calendar year



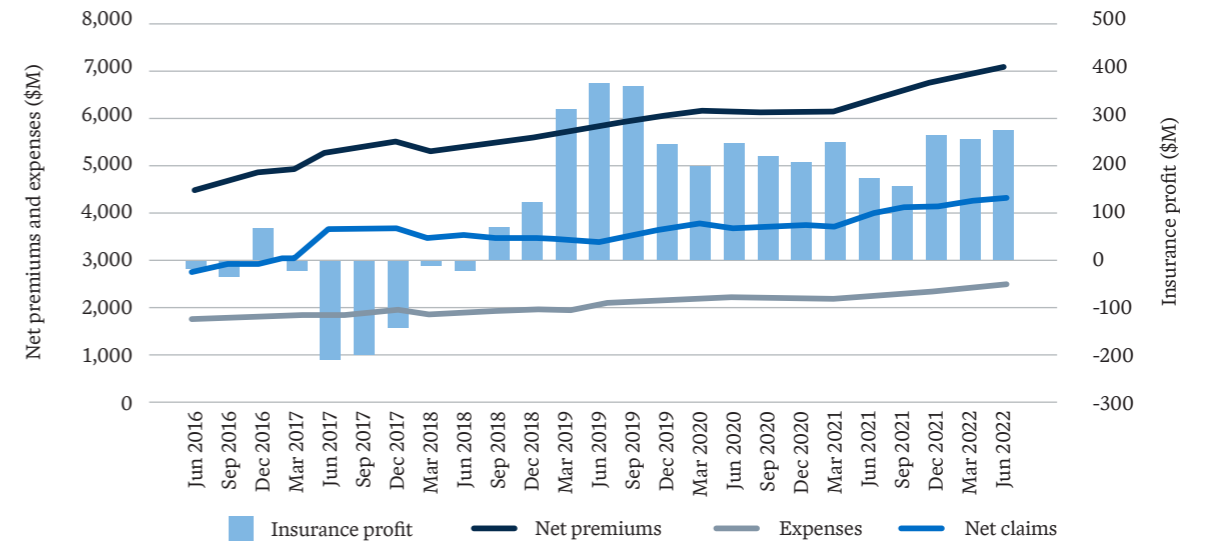
Source: Insurance Council of New Zealand, cost of natural disasters



Profitability holding on for now

Insurers have remained profitable despite the increase in weather-related losses, as shown by quarterly RBNZ data. This is partly due to an increase in premiums, with net premiums increasing by 11% over the year to 30 June 2022. The increase in premiums reflects not just the increase in claims from weather events but increasing costs, as inflation impacts insurer claims and expense costs. In turn, these rising costs may add pressure to insurance availability. With inflationary pressures expected to continue and a recently declared third La Nina weather pattern, it's likely insurance premiums will continue to rise for the next year, with flow-on effects for customer affordability.

Non-life insurance profitability by quarter



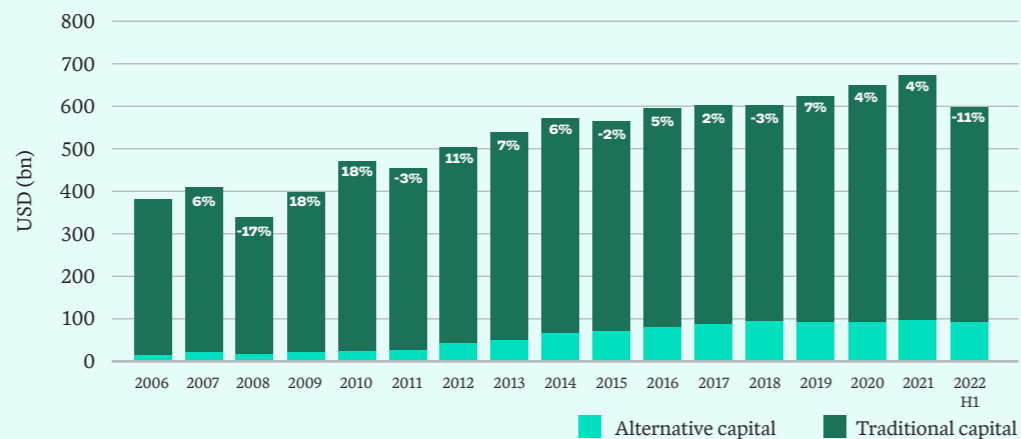
Source: RBNZ Quarterly Insurance Financial Performance

Reinsurers hit by global capital loss and natural disaster distress



Internationally, reinsurance capacity has been impacted by increasing interest rates in response to global inflationary pressures. Unexpected increases in interest rates result in a decrease in bond values. For reinsurers, which hold large amounts of bonds, this results in investment losses that reduce the size of their assets, and therefore reduce their capital values. Global risk management firm Aon estimates reinsurer capital has reduced worldwide by about 11% in the six months to 30 June 2022, substantially affecting the availability of reinsurance cover for direct insurers.

Global reinsurer capital



Source: [Aon, Ultimate Guide to the Reinsurance Renewal – Market Outlook for January 1, 2023](#)

Reinsurers have also been responding to the increasing frequency of natural catastrophes over the past few years, although these are traditionally considered ‘high severity, low frequency’ events.

This increase has been in traditional perils, such as cyclones and floods, but also secondary perils such as small-to-medium-sized events or weather events impacting areas beyond the traditionally affected geographic risk areas. In its recent [global reinsurance market report](#), US credit-rating agency AM Best noted a declining appetite for property natural catastrophe risks. For reinsurers continuing to write property natural catastrophe business, rates are increasing and cover is shifting to higher layers, as reinsurers seek more stable results.

For New Zealand insurers, these trends are likely to result in increasing costs, either through higher reinsurance premiums or higher retained costs due to reinsurers increasing the retention limits for reinsurance cover.

Key considerations for decision-makers

- Increasing costs due to inflation, natural disasters and reinsurance costs need to be monitored and managed to ensure premiums remain sufficient and affordable, while cover is relevant, available and sustainable.
- Reinsurance for natural disasters is likely to be harder to obtain. Insurers should be looking to engage with their reinsurers early, and demonstrate understanding of their exposures and their underwriting actions to manage natural-disaster risk.

EQC cap and seismic model shake up the earthquake landscape

In addition to the market cost pressures we outlined opposite, two local changes will impact future reinsurance costs for New Zealand insurers:

- The first is the introduction of a higher Earthquake Commission (EQC) cap of \$300k, which applies to all domestic house insurance policies written from 1 October 2022. The increase in the cap from \$150k to \$300k should result in insurers needing less reinsurance coverage, as earthquake risks drive the reinsurance requirements for most New Zealand insurers. This reduction in reinsurance cover would not be fully realised until late 2023 once all domestic policies have moved onto the new cap. The impact will also depend on the amount of domestic property insurance written by each insurer.

When the EQC cap change was announced last year, Earthquake Commission Minister David Clark said he expected the increase in the cap would result in a decrease in premiums. In recent years, several insurers have moved to risk-based pricing for earthquake risks. In contrast, EQC levies use a single national rate, which results in low-earthquake-risk regions subsidising high-risk earthquake regions. This means increasing the EQC cap reduces the impact of risk-based pricing and may result in an [increase in premiums for low-earthquake-risk regions](#).

- The second change likely to impact future reinsurance costs for New Zealand insurers is the recent release of an [updated national seismic hazard model](#). The new model shows that the potential severity of shaking from earthquakes is greater than

previously modelled. Seismic models such as this are used by insurers and reinsurers to assess potential insurance losses from earthquakes and set the premiums required to cover these losses.

The new seismic hazard model is yet to be incorporated into insurance models, but once it is, it may result in New Zealand insurers requiring higher levels of reinsurance. The impacts of the new model are likely to be realised over several years, so should not result in an immediate step change in reinsurance requirements.

Key considerations for decision-makers

- It's crucial insurers continue to monitor and improve the understanding of their seismic risks.
- This needs to be balanced with providing affordable insurance, particularly for domestic risks.
- Premiums will respond to opposing forces and insurers will need to be prepared to articulate these. Robust assessment will be vital in clearly outlining any likely reductions to premium from the EQC caps, as well as potential offsets to these reductions due to predicted increase in earthquake severity.

Climate change impacts and adaptation

What's your exposure risk? Mandatory disclosures on the way

The New Zealand Government has announced the introduction of mandatory climate-related disclosures for some businesses and government entities. The requirements of the mandatory disclosures are being developed by the External Reporting Board (XRB).

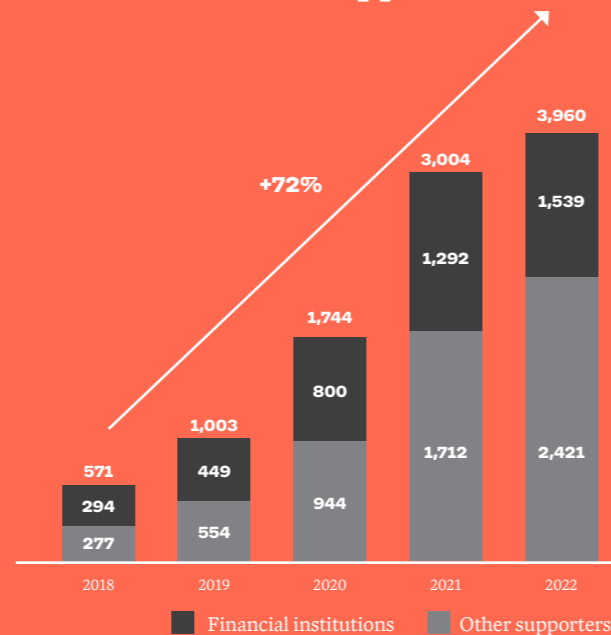
Once the XRB issues its first climate standard, climate-related disclosures are mandatory for:

- Large, listed companies with a market capitalisation of more than \$60 million
- Large-licensed insurers (with greater than \$1 billion in total assets under management or annual gross premium income greater than \$250 million)
- Registered banks, credit unions, building societies and managers of investment schemes with more than \$1 billion in assets and some Crown financial institutions.

The XRB aims to issue its first climate standard in December 2022, which means these entities would be required to make disclosures alongside wider year-end reporting in 2023 at the earliest.

While climate-related disclosures might not be mandatory for smaller insurers and organisations at present – there is growing global momentum toward standardised disclosure of climate-related risks. The Task Force on Climate-related Financial Disclosures (TCFD) issued voluntary guidelines that 2,600 companies around the world endorsed in 2021. Expectations and best practice on climate-related disclosures are evolving rapidly, and thousands of entities have undertaken voluntary TCFD reporting.

Number of TCFD supporters



Source: [TCFD Status Report, 2022](#)

In addition, international efforts are being made towards developing a globally applicable climate-related disclosure standard. The recently created International Sustainability Standards Board has also released draft IFRS on Climate-related Disclosures, which builds on the recommendations of the TCFD.

Over time, investors and regulators expect increasing maturity and quality of disclosures from organisations large and small.



Aiming for net zero – insurer impacts now and in the future

While climate-related disclosures focus on the risk that climate change poses to a business's operations and profitability – companies, investors, regulators and stakeholders are also looking to understand the impact a company's operations and products have on the climate and environment.

Globally, more than 20 leading insurers representing greater than 11% of world premium volume have committed to transition their insurance and reinsurance underwriting portfolios to net-zero emissions by 2050. Further, 39 major insurance companies have adopted policies to no longer insure new coal projects and, in many cases, to phase out their cover for existing coal operations. In a similar way, net-zero commitments are likely to continue to impact underwriting standards in future, particularly for high-emissions industries, such as transport and agriculture.

As economies transition towards lower emissions, opportunities may emerge for industries that can demonstrate more emissions-efficient systems, or even carbon neutrality. Examples already exist of banks and insurers offering better rates to businesses with lower emissions relative to their sector peers – partly because these companies are deemed better risks.

Aotearoa New Zealand's first emissions reduction plan was released in May 2022. The plan could drive future changes in the risk of insured assets and activities across all sectors (including transport, energy and industry, building and construction), which insurers will need to monitor and consider. For example, new technologies and business practices to support net zero could present challenges for insurers – as these risks are unlikely to be manageable based on experience alone. Insurers will likely play a critical role enabling such projects, but ensuring robust underwriting and reasonable risk transfer will be important.

Key considerations for decision-makers

- Climate risk management, adaptation and mitigation will be increasingly critical for insurers, customers and regulators into the future. This is likely to require a forward-looking approach, new capabilities and a broader range of partnerships.
- Larger insurers will need to plan for upcoming mandatory XRB disclosures on their climate-related exposures. Smaller insurers, too, will need to start thinking about their climate-related risks, given the global momentum towards standardised disclosures.

Government signals support for adaptation and home flood insurance

In August, the Government released its first National Adaptation Plan (NAP,) which sets out the long-term adaptation strategy for how New Zealand will adjust to the impacts of climate change. The plan is underpinned by four priorities:

- Enabling better risk-informed decisions
- Driving climate-resilient development in the right places
- Laying the foundations for a range of adaptation options, including managed retreat
- Embedding climate resilience across government policy.

The NAP identifies a series of objectives and critical actions required in New Zealand to adapt to climate change. The NAP contains one critical action that directly relates to insurance – “develop options for home flood insurance”. This action notes that work is underway to determine the impact of risk-based pricing on insurance and explore **options to support access to and affordability of flood insurance**. Possible options range from doing nothing through to some form of government intervention, as in Australia, the UK and other countries.

One example is the recently established government-backed reinsurance pool for cyclone risk in Australia, operated by the Australian Reinsurance Pool Corporation. Similarly, the United Kingdom has introduced a government-backed reinsurance pool model, Flood Re.

The NAP is part of the Government's long-term response to climate change and a signal that it's prepared to intervene and provide support. The first three years of the NAP will be key for collecting data and starting long-term programs. This will feed into a second national climate risk assessment that will be published in 2026, while a second NAP will be developed in 2028. As the NAP evolves over time, it's likely to have more impact on insurers, as details emerge on how adaptation actions, such as managed retreat, will be enabled.

In response to the NAP, IAG NZ has called for more specific, urgent and targeted steps to [reduce the risk of flooding via a three-step plan](#). Its proposed steps are:

- A joint government and private-sector project to build a common understanding of priority flood-prone communities
- Implement a National Policy Statement to cease development in flood-prone locations
- Establish a national program of investment in flood protection.

Cyber risk – perils, crimes and cover

In the commercial space, one area of risk that has been growing in recent years globally – including in New Zealand – is cyber risk. Coinciding with a rapid rise in cybercrimes is the increase in remote working due to COVID-19. Unlike other perils, cybercrime is one risk where New Zealand's geographic isolation does not provide us with any additional protection.

Media headlines show that New Zealand companies can become targets of cyberattacks, with recent strikes on the Waikato District Health Board and Pinnacle Health, highlighting the [risk to New Zealand companies](#). Smaller businesses, too, are not immune from risk, as illustrated by the [attack on NZ Uniforms](#) earlier in the year. In acknowledging this accelerating cyber risk, the Government increased funding for the Government Communications Security Bureau to [combat cyberattacks in the 2022 budget](#).

This recognition doesn't seem to be reflected in cyber insurance uptake in New Zealand, with fewer than 10% of companies having policies. By comparison, across the Tasman organisations are showing relative higher cyber insurance rates – up to 70% for large Australian enterprises and 20% for small. As highlighted in our [recent green paper for the Actuaries Institute](#), cyber insurance is not the first line of defence for a company's cyber security. Rather, it can help to strengthen an organisation's cyber hygiene, as the underwriting process highlights gaps between best practice standards and an organisation's current level of protection.

Key considerations for decision-makers

- Cyber risk is a growing problem. Insurance can assist companies to improve their cyber security, but is not the first line of defence.
- Given no organisation is immune from cyber threats, insurers themselves will also need to focus on their own cyber hygiene and protecting their customer data.
- The low penetration in the New Zealand market makes this a potential growth area for insurers with advanced cyber underwriting expertise.

The last word – challenge and promise ahead

The impact natural perils and climate change will have on Aotearoa as a country will be the main focus for the local insurance industry throughout 2023.

The Government increasingly recognises the role our insurance industry plays in supporting national resilience through initiatives such as the National Adaptation Plan and the climate-related disclosure standards issued by the XRB. In addition, international standards and consumer expectations are likely to lead to increased regulatory and commercial pressure to manage climate-related risk for all companies.

With the industry reliant on global support in the form of reinsurance, it will be closely watching international developments, following a significant drop in global reinsurer capital over the past year. Two key factors affecting reinsurance premiums ahead are the changes in EQC caps and updated seismic hazard model.

The rise in cyber perils and speed at which criminals adapt and innovate also highlight the need for insurers to be agile, responsive and proactive in keeping up to date on emerging trends. Insurers will be looking to grow their cyber insurance offerings while being mindful of protecting their own customer data.

Legislation and regulation – a year of big change

Significant legislative and regulatory shifts are affecting insurers in New Zealand. Key movements over 2022 include:

- Introduction of the International Financial Reporting Standard 17 – Insurance Contracts, which is effective for reporting periods from 1 January 2023 and will require substantial changes to insurer financial reporting processes.
- Introduction of the Financial Markets (Conduct of Institutions) Amendment Bill (CoFI), which requires financial institutions to be licensed by the Financial Markets Authority (FMA) regarding their general conduct. Insurers are required to establish an effective fair conduct program to ensure customers are treated fairly. There will be regulations to ban target-based sales incentives.
- Introduction of the new EQC caps.

- Introduction of Interim Solvency Standards, including a new operational risk charge of 3% of an insurer's gross premium, which will be phased in over the next three years.

Future changes on the horizon include:

- Under CoFI, FMA will start licensing applications from mid-2023 and the Ministry of Business, Innovation and Employment is developing supporting regulations. The full CoFI regime will come into force in early 2025.
- The RBNZ will be undertaking a calibration review of the factors used to calculate an insurer minimum solvency capital over the next year.
- The RBNZ will also continue its review of the *Insurance (Prudential Supervision) Act 2010*. This is expected to result in changes to the Act, including enabling the RBNZ to introduce a tiered approach to supervisory intervention for insurers.

Meet our Authors



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Ross is a general insurance expert with actuarial experience spanning pricing, reserving, strategy and analytics. He develops pricing and natural perils models, undertakes competitor monitoring and helps design new products and insurance offerings. Ross is President of the New Zealand Society of Actuaries and regularly presents on issues affecting insurers and consumers in Australia and New Zealand.

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Ramona is an expert in economic and financial modelling, predictive analytics and risk modelling for government and insurance. She is an active member of the Actuaries Institute's Climate Risk Working Group, and a thought leader on the implications of climate change and shifting population demographics. Ramona regularly presents and writes on how government and businesses can manage these risks.

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Win-Li Toh | Principal

Win-Li leads our general insurance team, harnessing more than 25 years advising insurers, self-insurers and government across the globe. She holds several Appointed Actuary roles and is a member of the Actuaries Institute Australia Council, responsible for the reputation of the profession. Win-Li speaks and facilitates on all aspects of the general insurance landscape, with a focus on cybersecurity. She is a keen advocate for collaboration between industry, government and community.

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We are creative problem solvers – from physicists and engineers to mathematicians and computer scientists. This variety strengthens our advice to meet the needs of our clients and their customers.

Our innovations have led to changes in government policy in Australia and New Zealand, and continue to break new ground, particularly in the social sector. Qantas liked our approaches in analytics so much, it bought a 51% stake in our business in 2015.

Across our offices in Sydney, Melbourne and Wellington, we value our people as individuals, offering a flexible working environment, with limited hierarchy and where everyone shares equally in the rewards.

We are mindful of our effect on the planet and have been carbon neutral since 2006.

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