



Our class-by-class insights for insurers

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welcome


How does the past year stack up in RADAR, Taylor Fry's annual roundup of Australia's insurance landscape, and what does it mean for insurers? Among the hottest topics, we investigate nuanced affordability issues, promising mitigation efforts, the rapid rise of artificial intelligence, why cyber is top of mind, and navigating the age of customer centricity at a time of intense regulatory scrutiny.

Drawing on the latest data released by the Australian Prudential Regulatory Authority (APRA), combined with deep industry know-how and experience, we unpick each major line of business across three years of results to help insurers benchmark their performance, and assess their strategies and goals.

Find out what's driving performance in each class, and how this is impacting business, government and community. We also cover the latest news and trends, as well as what insurers need to do to prepare for the next 12 months and beyond.

This year, you'll find two new sections – for a future-focused quick view of the major classes, jump straight into 'Looking ahead' on page 6, then check out 'Profitability' on page 8, looking behind the scenes for the five things you need to know about FY23 industry profits.

Lastly, we cast our 'Spotlight on AI', exploring the 'friend or foe' themes on new technologies for decisionmakers on page 32, plus a compelling 'Spotlight on inflation', on page 34, where we assess skyrocketing inflationary pressures and offer insight behind the headlines.

We hope you find clarity and support on the following pages to help you move forward with confidence in this turbulent but opportunity-charged landscape. 

Win-Li Toh
Principal

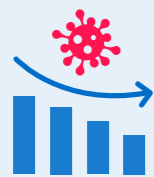
Looking ahead

DOMESTIC MOTOR



- Cost of living** pressures driving greater focus on prices
- Customer loyalty** not guaranteed
- Changing claims** mix post-pandemic
- Care needed** to reflect in future rate setting

COMPULSORY THIRD PARTY



CTP claim frequency remaining **lower** than pre-COVID-19 levels

- Average premium per vehicle **reduced** in real terms
- Profitability more **nuanced** under the surface

WORKERS COMPENSATION

Mental injury Proposed reforms to limit **mental injury** cover (Victoria) > May trigger recharacterisation of some claims to ensure coverage, but lead to poorer claimant outcomes

Investment in AI presenting challenge to maintain 'human touch' > Careful governance to ensure positive claimant and scheme experience



HOUSEHOLDERS

Affordability and availability pressure on consumers

Critical need for **multifaceted, collaborative** approach

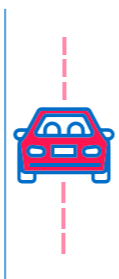
Understanding the impact of mitigation activities on **risk**

Priority for **insurers** wanting to thrive over the next decade

COMMERCIAL MOTOR

Increasing premiums to offset cost pressures

Challenges ahead as economy tightens



Risk of fraud on the rise

Do existing processes and infrastructure provide adequate defence?

COMMERCIAL PROPERTY

- More employees **working from home** reducing leased space
- Potential reduced **revenues**
- High **inflationary** environment
- Underinsurance may **negatively impact profitability**

TRAVEL



1 in 10

Affordability challenge, with 1 in 10 Australians **potentially ditching travel insurance**

- Class most prone to customer complaints
- Conduct risk and compliance top of the agenda

Communicating value to customers is key

PROFESSIONAL INDEMNITY & DIRECTORS AND OFFICERS

Higher inflation & relaxation of litigation funding restriction } Potential **class action** activity

Growing risk of cyberattacks } **Impacting costs** and availability of cover, particularly professionals working with sensitive personal data



LENDERS MORTGAGE INSURANCE

Interest rates expected to peak in 2024

Falls in rates likely to ease loan default pressures and prompt growth in lending volumes



PUBLIC & PRODUCTS LIABILITY

Flexible employment practices

Troubling **severity** of worker-to-worker bodily injury claims

Affordability concerns present reputational risks

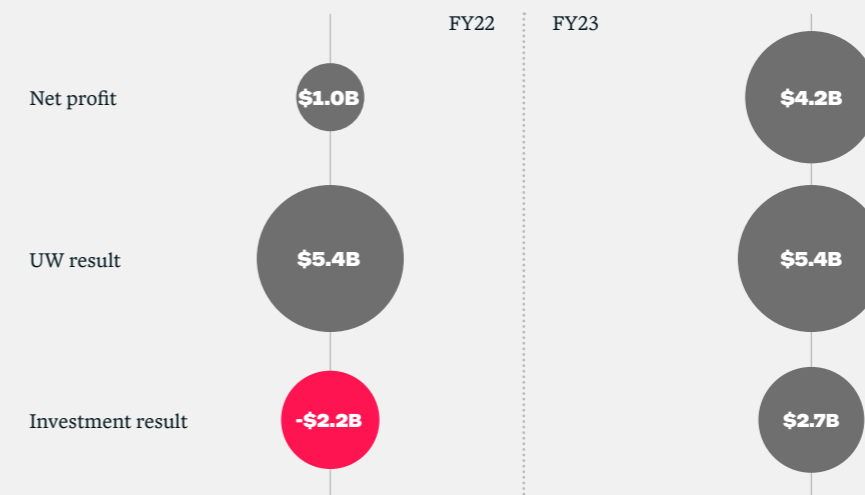
Risk management & mitigation essential to obtain cover

Profitability

The general insurance industry recorded a profit of \$4.6 billion over the year to 30 June 2023, the best result for the industry since 2014. The latest result is a turnaround from the \$0.9 billion profit recorded in each of the last three years.

What do these results say about the industry? We outline 5 things you need to know ...

How direct insurers are faring – FY22 vs FY23



1. Direct insurers recorded a \$4.2 billion profit after tax, the highest profit since 2014, up from \$1.0 billion in 2022.

The underwriting result was a profit of \$5.4 billion, in line with last year, as premium increases and reserve releases largely offset higher claims.

Investment income over the year was \$2.7 billion, which was a significant improvement on the \$2.2 billion investment loss experienced in 2022.

Return on capital increased from 4% in 2022 to 15% in 2023.

2. Highlights of the underwriting result – three classes stand out

Householders was the only class recording an underwriting loss – \$0.2 billion for the year. This was driven by an increase in catastrophic losses combined with high claims inflation.

While premiums rose sharply over 2022/23, this was not enough to overcome increases in claims.

Commercial property recorded an underwriting profit of \$2.05 billion as increases in average claim size were largely offset by premium growth and insurers releasing remaining reserves set aside for business interruption losses due to COVID-19. Although recent results have been satisfactory, commercial property has delivered poor returns over the long term, with negative margins over the past seven years.

Lenders mortgage insurance recorded an underwriting profit of \$0.8 billion – the highest profit in 10 years – as benign claims experience during 2022/23 prompted insurers to release reserves, resulting in negative loss ratios and strong returns on equity. However, gross written premium was down as banks tightened lending standards and loan volumes declined.



3. Reinsurers recorded an after-tax profit of \$0.4 billion, an improvement on the \$0.1 billion loss recorded in 2022.

The underwriting profit was \$0.3 billion, which is below the \$0.7 billion profit recorded in 2022. Net premium reduced by \$0.5 billion as reinsurers became more selective about the risks covered, while net incurred claims remained steady at \$2.7 billion.

Investment income over the year was \$0.3 billion, a significant recovery from the \$0.6 billion loss recorded in 2022.

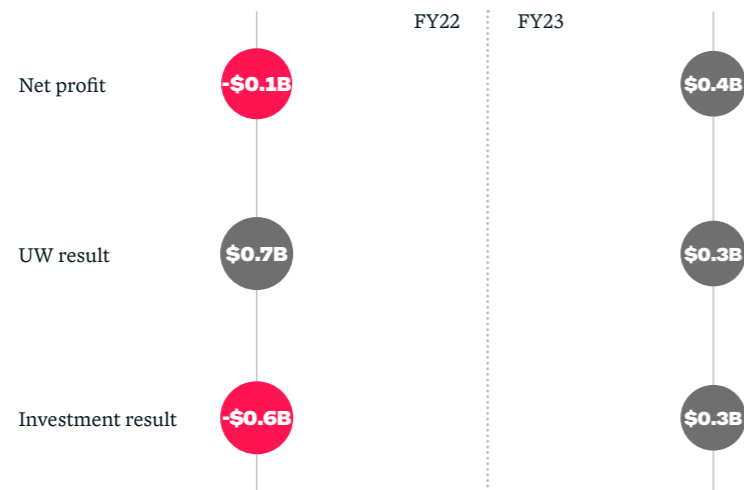
Return on capital increased from -1% in 2022 to 9% in 2023, largely due to the sharp improvement in investment returns.

Given reinsurers bore the brunt of losses last year, this year's result offers them some relief, and may assist insurers at their next reinsurance renewal.

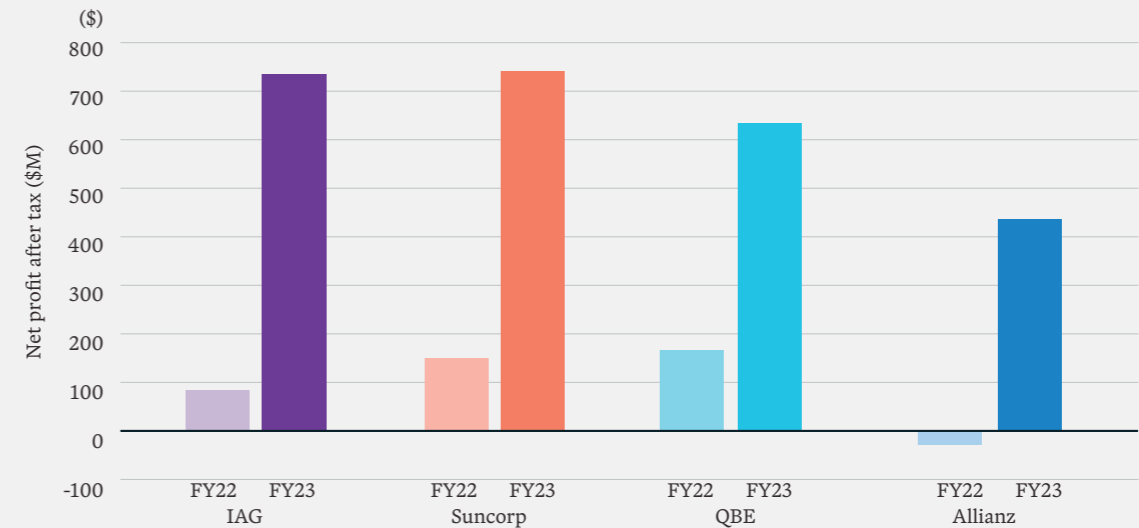
4. The industry continues to be adequately capitalised.

Measured with reference to APRA's Prudential Capital Amount, for direct insurers, the coverage ratio increased from 164% to 172%. For reinsurers, the coverage ratio reduced slightly from 186% to 185%.

How reinsurers are faring – FY22 vs FY23



How the top 4 insurers are faring – FY22 vs FY23



Source: 30 June 2023 APRA Quarterly General Insurance Performance Statistics

Profitability has increased over 2023 across the top four Australian insurance groups, averaging more than \$0.6 billion over the year. Insurers cited revenue growth due to premium rate increases and a turn around in investment income as key drivers for improved performance.

5. In our view, some of the key determinants to industry performance over the next year will be:

Inflation – This is likely to remain high, driving up repair and replacement costs and increasing the risk of underinsurance. However, insurers are flagging premium increases in property classes, which may offset the higher claims costs.

Investment returns – Insurers will continue to enjoy strong investment returns, with interest rates remaining high and likely to peak during 2024. This is particularly important for insurers of longer tailed classes of business, where insurers are holding significant claim reserves.

Catastrophe activity – While the likely onset of El Niño should reduce the risk of severe rainfall events, it may increase the risk of bushfire losses, particularly for householders, when an expected dry summer combines with dense vegetation following years of above-average rainfall. [®]



Domestic Motor

The convergence of claims mix changes, claims inflation and cost-of-living pressures is creating an environment where insurers and customers are directing their gaze back to prices. Insurers will need to balance customer retention and long-term value against the need to maintain short-term profitability. Disentangling the drivers of changing claims experience and understanding changing consumer elasticity will be key to setting rates going forward.

Insurers are increasingly investing in the use of machine learning and artificial intelligence in areas including pricing and claims management. While this presents opportunities for insurers to establish a competitive advantage, a changing regulatory environment coupled with recent failures to meet pricing promises highlight the need for stronger governance of these systems. Transparency and fairness will also need to be front of mind to ensure regulatory, legislative and community standards continue to be met.


Changes in claims mix

add complexity to pricing, as relying on past experience may not be appropriate for setting future rates. Changes in driving behaviour following the pandemic have contributed to a reduction in the frequency of minor collisions and a consequential increase in average severity. With uncertainty as to where driving behaviours will ultimately land, insurers will need to take care when rate setting to ensure frequency and severity trends in the data are reflective of future experience.

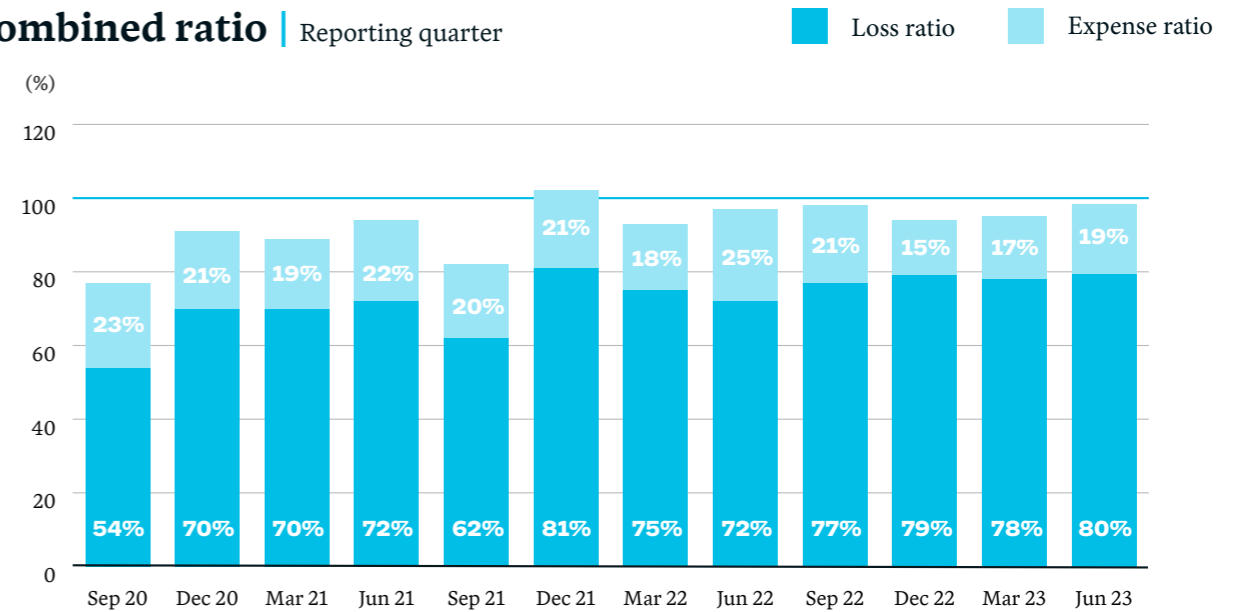
Claims inflation has had similar volatility over recent years

, though repair costs and after-market vehicle values are now reducing from their peak, due to the easing of global supply chain bottlenecks. This is affecting pricing decisions in terms of risk relativities and the overall price, as insurers seek to understand the drivers of recent movements.

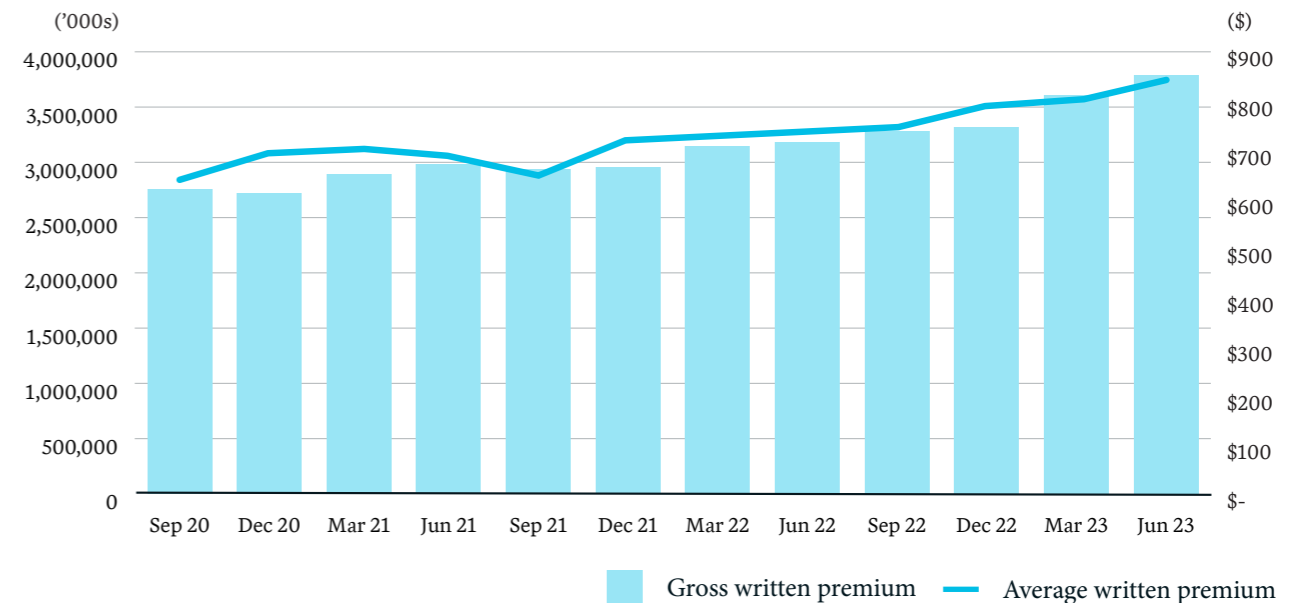
Cost-of-living pressures may drive increased churn

in the coming year. While premiums grew by 14% during FY23, the tightening of the economy is creating a market where customers may be turning their attention back to prices and historically loyal customer segments may prove to be less so in the face of tighter household budgets. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

We expect use of analytics and artificial intelligence will lead to improved risk selection and pricing as well as expenses, as claims processes become more streamlined and processing times are reduced. This trend is also starting to create a capability divide among insurers, providing an opportunity for early investors to differentiate themselves from competitors through improvements in pricing and claims management.

Increasing complexity in processes such as pricing and claims management also has implications for insurers'

ability to meet customer promises and comply with legislative, regulatory and community standards. A recent report from the Australian Securities and Investments Commission, *When the price is not right: Making good on insurance pricing promises*, has put the spotlight on shortcomings in pricing practices and highlighted the need for stronger governance of systems affecting customer outcomes. Providing the required oversight of these systems will require transparency and fairness to be a core part of their design and governance, rather than an afterthought.

Householders insurance is in crisis! The perfect storm of more frequent and costly natural disasters, building materials inflation and ongoing supply chain pressures is generating losses for insurers and leading to affordability and availability pressures for consumers.

A 13% increase in average premiums over 2022/23 was not enough to cover the increased cost of claims, with the industry recording a combined ratio of 102%. Trans-Tasman insurance giant IAG has flagged it expects to increase rates by up to a further 20% over the next year, in an effort to restore profitability. We expect other insurers to follow suit.

What's the solution to increasing losses, rising premiums and the affordability and availability crunch?

There's no quick fix. The proposals in the Actuaries Institute report *Funding for Flood Costs: Affordability, Availability and Public Policy Options* are highly relevant – particularly with more frequent and extreme weather events due to climate change. A multifaceted solution is needed, including: replacing insurance taxes with a property-based levy; means-tested subsidies for high-risk properties; improving the resilience for existing properties and buying back properties where the risk is extreme; future-proofing building standards; and better land-use planning.


Steps are actively being taken to address some of these issues, but more work is required – and fast!

Householders

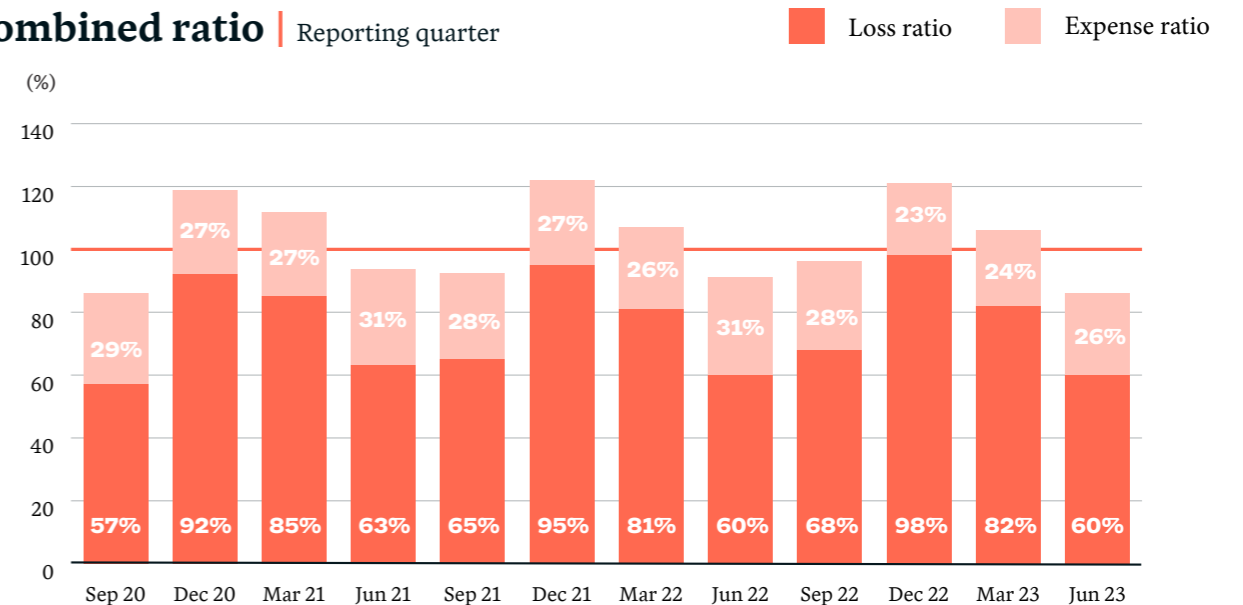
Insurer practices will be scrutinised, as the parliamentary inquiry into insurer responses to the 2022 floods examines policyholder experiences, claims-handling practices, communication between insurers and policyholders, and internal dispute resolution processes. We expect affordability and availability to be centre stage. A recent report commissioned by consumer advocacy group Choice identified several barriers for consumers. These included complex product design, inaccessible information on natural hazard risk, and a weak link between mitigation measures and premium discounts.

Future disaster resilience and risk reduction initiatives are being partly funded through the Disaster Ready Fund, providing up to \$1 billion over the next five years. Projects in Round One cover building flood levees, seawalls, firebreaks and improving digital connectivity

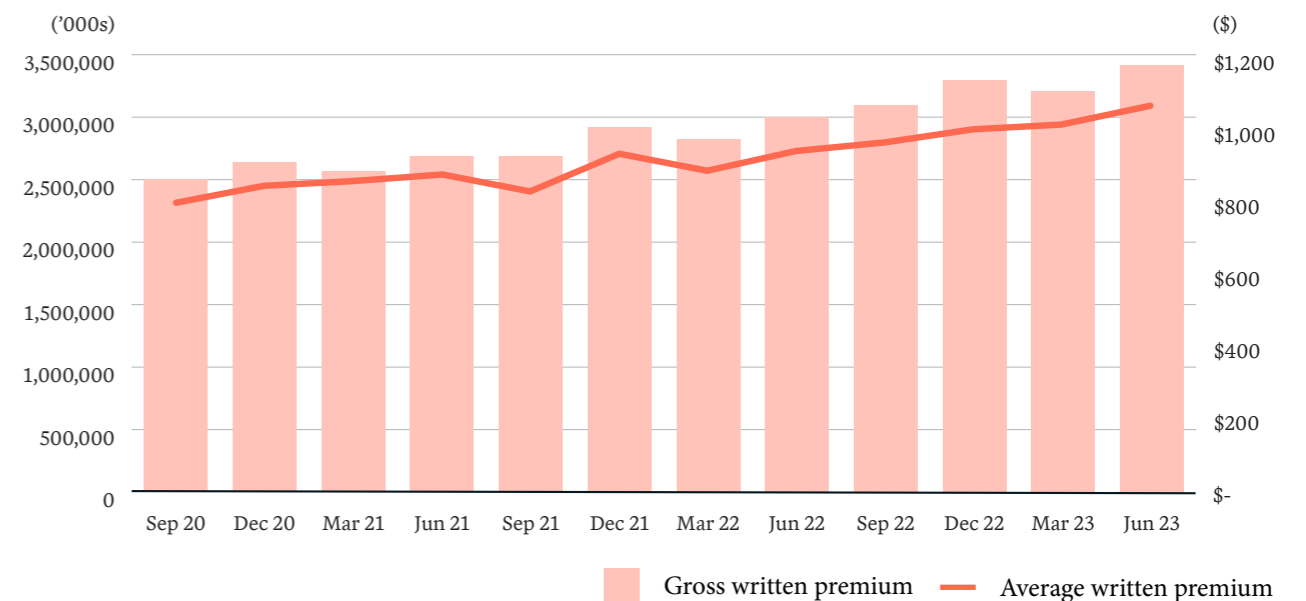
during natural disasters. The National Emergency Management Agency estimates for every dollar spent on disaster risk reduction, there's an estimated \$9.60 return on investment. The Disaster Ready Fund may be a step in the right direction, but it will take years for the benefits to materialise. Larger insurers are required to reinsure cyclone risk with the Australian Reinsurance Pool Corporation before the end of 2023. This is anticipated to lower reinsurance costs and alleviate rate pressures for householders in Northern Australia.

Rising building and labour costs along with supply chain issues and disaster-related demand surges are increasing claims costs. In the past two years, construction costs have increased by almost 20% across Australia, with the impact more severe in regions affected by natural disasters. While the inflationary peak may have passed, we expect above-average claims inflation to persist next year. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

Understanding and accurately pricing risk has always been key. But current heightened price pressure demands greater understanding of impacted consumers and affordability, and integration of these into thinking on price setting and risk mitigation. Insurers now need a detailed understanding of risk at an address level. Longer term, they'll need to understand impacts of mitigation measures on risk and implications for premium. A good example is changes in risk for properties eligible for the Queensland Government's Home Raising program. Insurers who improve their understanding will be well placed to thrive over the next decade.





Compulsory Third Party


On the surface, APRA data indicates that the privately underwritten CTP schemes have continued to deliver strong insurer profitability and that premium rates have changed little over recent years. Beneath the surface, the story is more revealing, including:

- Clawback of insurer profits in New South Wales, which is expected to continue
- An insurer withdrawal from the Queensland market due to poor profitability
- Large changes in market share in the South Australian scheme.

In addition, CTP claim frequency in all jurisdictions remains lower than pre-COVID-19 levels, partly reflecting traffic volumes that have not yet fully recovered.

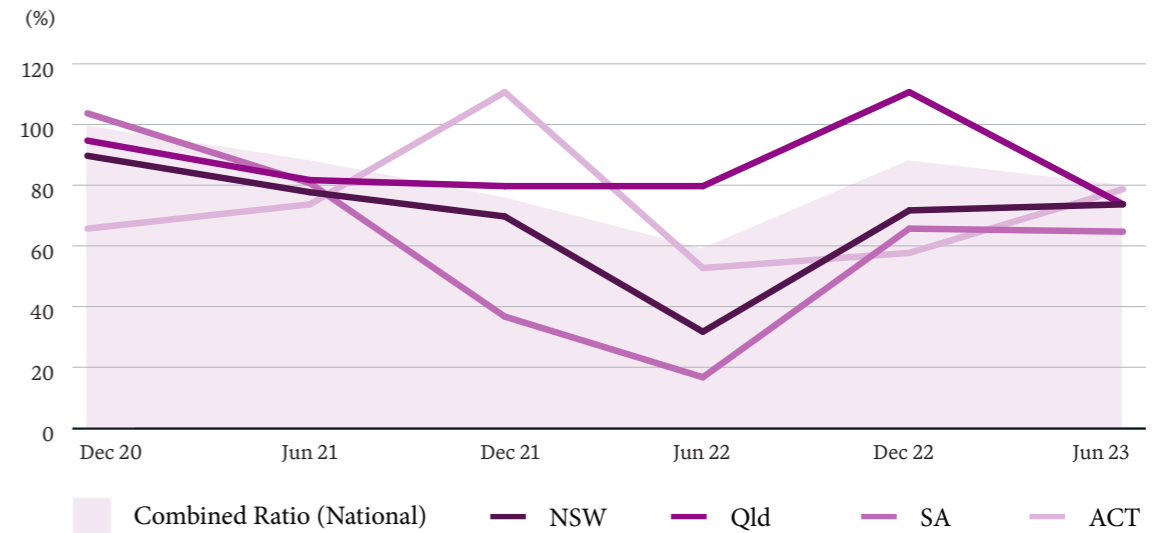
New South Wales scheme regulator the State Insurance Regulatory Authority looks poised to claw back further excess profit from insurers, having recently started the second stage of its annual assessment of transitional excess profits and losses. About \$269 million has been recouped to date, with the actual cost of claims from the scheme being significantly lower than was anticipated in setting the premiums. The recouped excess profits have served to subsidise the CTP premium levies paid by consumers. Over time, the gap between the pricing basis and actual experience will close, reducing this level of subsidy and placing future upward pressure on Green Slip levies.

In Queensland, overall scheme profitability was not shared equally by all, with insurer RACQ announcing its withdrawal from the market following 'significant losses', stating its 'risk profile has worsened'. RACQ will cease providing insurance from 1 October 2023, with its customer base (approximately 25% of the market) to be redistributed to other insurers. Findings from the 2023 Scheme Review undertaken by scheme regulator the Motor Accident Insurance Commission are due later this year.

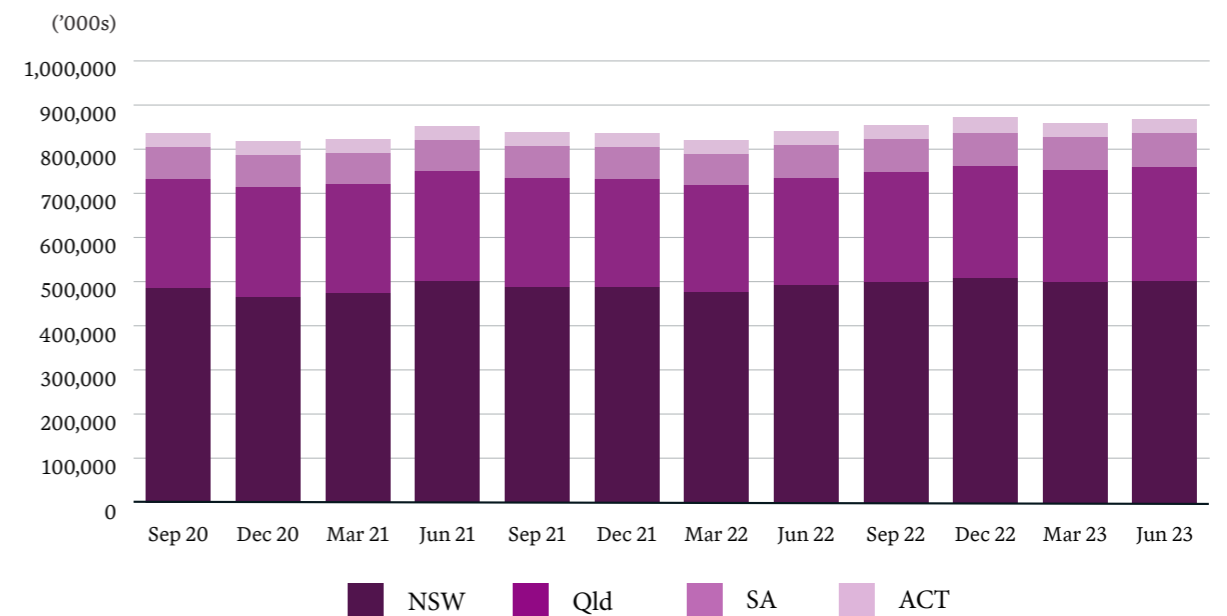
Recent entrant in South Australia Youi has established a 5% share of the market in its first year, while QBE (which provides \$25 gift cards for new and renewing 12-month passenger and goods vehicle policies) has almost doubled its market share to 36%, largely at the expense of AAMI and NRMA. Traffic volumes in SA remain lower than pre-COVID-19 levels and the overall number of CTP claims per policy (frequency) has been lower than expected, particularly for lower severity claims. As a result, our estimation of the risk premium has reduced by almost 15%. 

RADAR

Gross loss ratios | Reporting half year



Gross earned premium (\$) | Reporting quarter



Impacts and trends at a glance

Growth in gross written premium in the privately underwritten CTP schemes averages about 2% p.a. over the past two years, which mostly reflects increases in the number of vehicles on the road. In real terms, average premium per vehicle has reduced.

Combined ratios indicate the schemes continue to provide greater-than-expected profitability for insurers, although the reported APRA statistics over-represent this profitability, as the excess profits recouped by the regulator in NSW are not reflected. For this reason, care should be taken in interpretation of the APRA data for NSW and at the overall level.

Workers Compensation

Insurers recorded a healthy underwriting result of \$236 million for FY23, following last year's record of \$489 million. The reserve releases contributing to the FY22 result have all but dried up. Gross written premium grew by 13% over the year, as the industry recorded a 77% loss ratio and a 13% expense ratio.

Workers compensation insurers and publicly underwritten schemes are grappling with increasing mental health claims, and are beginning to explore how emerging technology can be used to improve their operations and claims handling. In Western Australia, insurers need to prepare for the proposed reforms now before parliament.

While APRA data comprises the privately underwritten schemes covering workers in Western Australia, Tasmania, Northern Territory and the Australian Capital Territory, we have also considered publicly underwritten scheme experience to inform our insights into emerging workers compensation issues.

Mental-health injuries continue to test all workers compensation schemes –

For WorkSafe Victoria, mental injury claims represent 16% of new claims. Proposed reforms to this scheme look to cut weekly payments to workers with stress and burnout claims. Instead, these workers will be entitled to provisional payments for 13 weeks to cover medical treatment and psychosocial support.

If stress and burnout claims are excluded, we expect to see a push to recharacterise some of these as the types of mental injuries

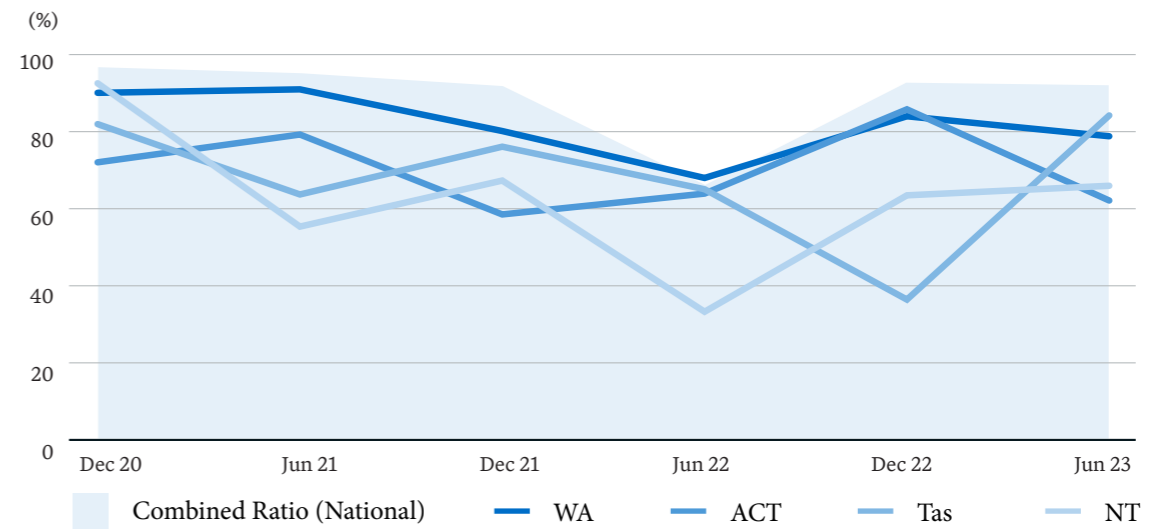
still covered by the scheme – for example, bullying and harassment claims. Return-to-work outcomes for bullying and harassment claims tend to be poorer, due to difficulties in returning the worker directly to their pre-injury duties and team. The recharacterisation of some stress and burnout claims may lead to poorer outcomes for the claimants.

This is the first scheme we've seen take a step to limit coverage for mental injury. Other schemes will be watching closely, as they try to balance financial sustainability and premium rate increases.

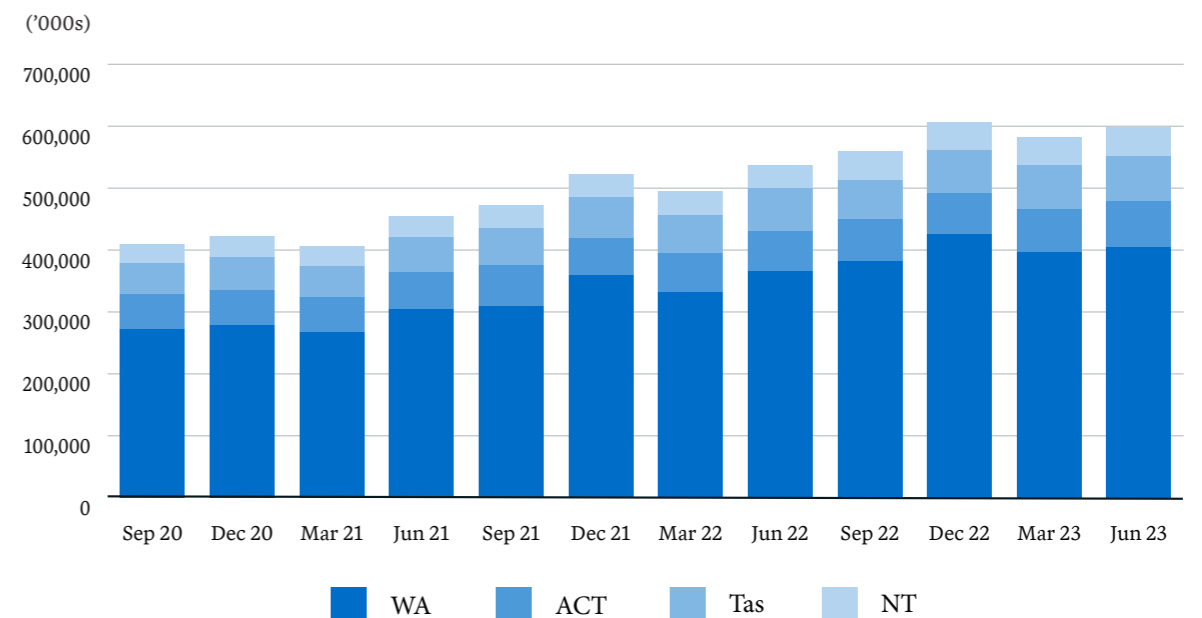
The Western Australian Workers Compensation and Injury Management Bill 2023 is before parliament –

The Bill proposes several changes to entitlements and the operations of the scheme across income compensation, catastrophic injuries, flexibility for gig-economy workers and provisional payments relating to liability decisions. While the Bill is yet to gain assent, insurers are well advised to start assessing the potential impact on claims costs, premiums and their operations. [®]

Gross loss ratios | Reporting half year



Gross earned premium (\$) | Reporting quarter



Impacts and trends at a glance

A shortage of experienced claims managers combined with high caseloads is leading insurers to ask, how can we use data and artificial intelligence to do things better without losing the 'human touch'? Like all AI tools, it will be crucial for insurers to apply these tools with appropriate governance to ensure they result in positive and fair outcomes for claimants.

We're seeing insurers prioritise investments that reduce the administrative burdens on claims managers, unlocking more time for high-value activities – notably, interacting with claimants! This is particularly important, given the increasing prevalence and focus on primary and secondary mental health claims, which can be more challenging for case managers.

We'll be keeping a close eye on how these new technologies translate into improved claim outcomes, insurer profits and scheme performance.


After more than three years of consistent profits, insurers are expected to face headwinds, as elevated inflation and a weakening economy combine to make future profitability more uncertain. While commercial motor insurers were able to offset cost pressures by increasing premiums, we expect this to be more challenging in the year ahead as the economy tightens.

Insurance pricing and customer retention are key focus areas for insurers in this environment, as they balance cost pressures with the need to remain competitive. Insurers also need to be increasingly wary of the risk of fraud in the commercial motor space, and consider whether existing processes and infrastructure are providing adequate defence.

Commercial Motor

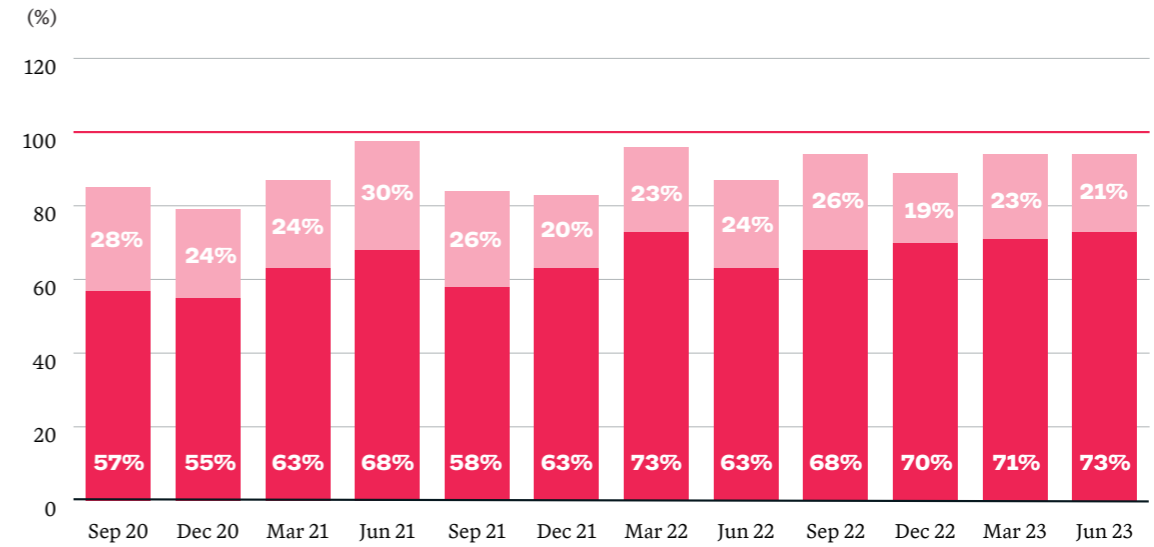
Fraud is on the rise as the economy weakens, but artificial intelligence is helping combat this. While the personal motor space has long been a prominent area of insurance fraud, criminals are increasingly turning to commercial targets, which by comparison is less developed. In addressing the issue, Allianz Commercial UK reported an 11.2% increase in fraud savings in 2022, with some of that growth attributable to improved use of analytics and machine learning techniques to detect fraud at the underwriting and claim stages. As patterns of fraud continue to evolve, use of machine learning and analytical techniques to detect and prevent it will become increasingly important.

The 17% premium volume growth was driven by an 11% increase in the average premiums and a 6% increase in the number of risks written. As the economy weakens, businesses are tightening their belts and making it more difficult for insurers to maintain the same level of premium rate increases in the year ahead. This means insurers will need to balance customer retention and long-term value against the need to maintain short-term profitability.

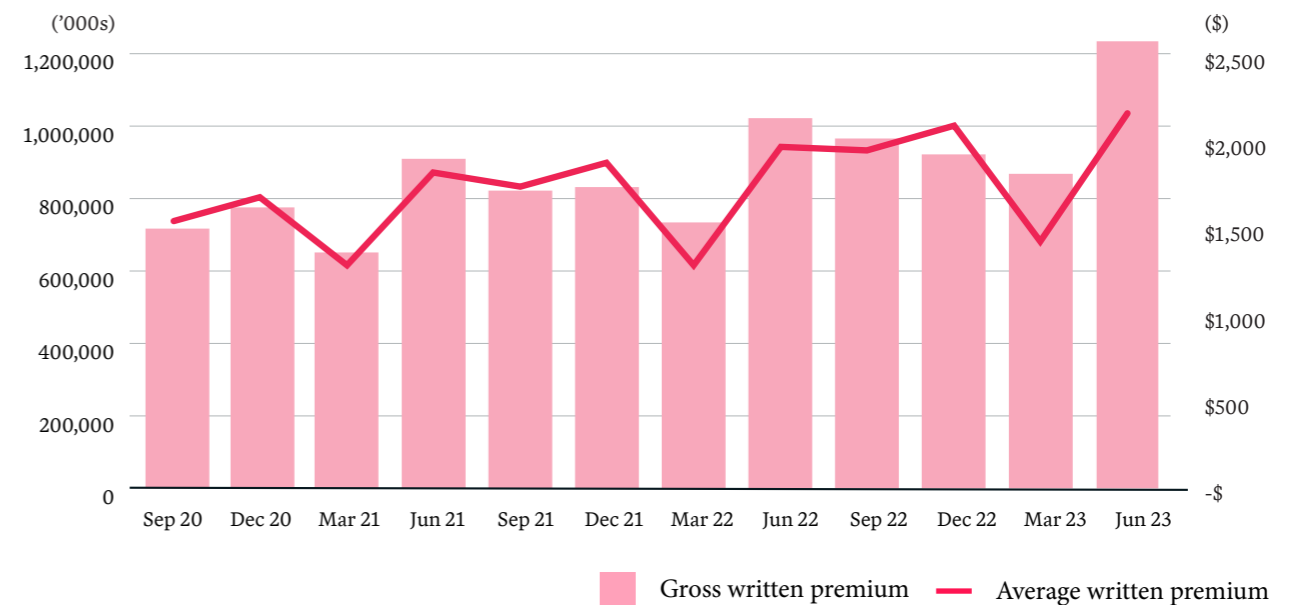
Combined ratios have returned to pre-pandemic levels, following three years of favourable experience. Insurers have managed to curb expenses, but loss ratios have crept up due to persistent claims inflation. Supply disruptions, labour shortages and increased use of technology have contributed to the cost pressures. Looking forward, although the supply of replacement cars and car parts has improved, labour shortages persist, threatening a prolonged period of high costs. 

Combined ratio | Reporting quarter

Loss ratio Expense ratio



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

With profitability expected to be more challenging in the year ahead due to inflationary pressures and a weakening economy, insurers are looking for ways to cut operational costs. Some insurers are investing in AI solutions to generate more transparent repair quotes and streamline condition assessments, maintenance and repair of commercial motor fleets.

The use of AI in claims and the smash repair industry has garnered some attention in the recently published independent review for the Motor Vehicle Insurance and Repair Industry Code Administration Committee. Among the 15 recommendations in the review, one recommendation suggested AI-related issues be included in the Code, with the aim of providing clear guidelines on the disclosure of algorithms and dispute resolution processes related to AI-generated assessments.

Despite economic challenges, rising natural peril costs and supply chain disruptions, commercial property has shown strong performance this financial year. High inflation put upward pressure on repair and replacement costs and consequently led to increases in average claim size, but this was largely offset by robust premium growth. Average premiums rose by 15% over the year, as the market continued to harden.


Overall profitability showed improvement, with combined ratios remaining well below 100%, as claims stabilised following the impact of floods in South East Queensland/New South Wales in the previous year. Over a longer historical period, commercial property has been a poor performer, having delivered negative insurance margins and average combined ratios of more than 100% over the past seven years.

Looking ahead, the Australian Reinsurance Pool Corporation (ARPC) is expected to lower reinsurance costs for SMEs and strata cover in high-risk cyclone areas, which may in turn allow direct insurers to constrain rate increases and improve affordability in affected regions.

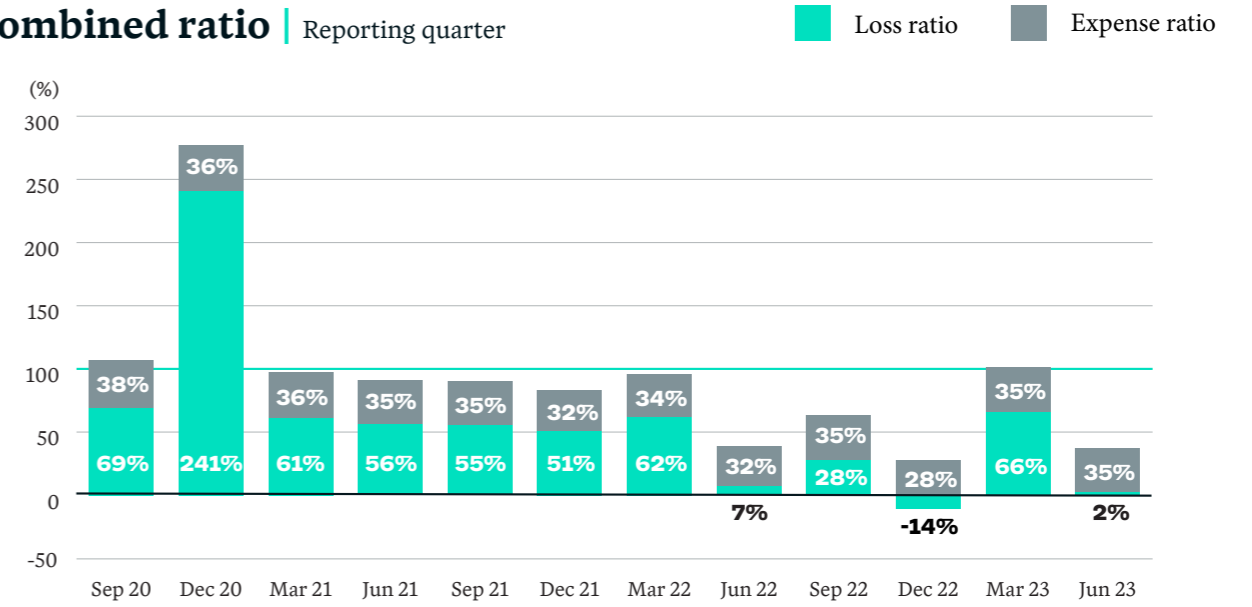
Commercial Property

Inflation is driving up repair and replacement costs – The elevated level of inflation can be traced back to geopolitical risks, which are creating economic instability, disrupting supply chains and resulting in shortages of skills and materials. Many businesses have not increased sums insured in line with high inflation, resulting in insured property values that no longer accurately reflect actual replacement costs. This in turn increases the risk of underinsurance.

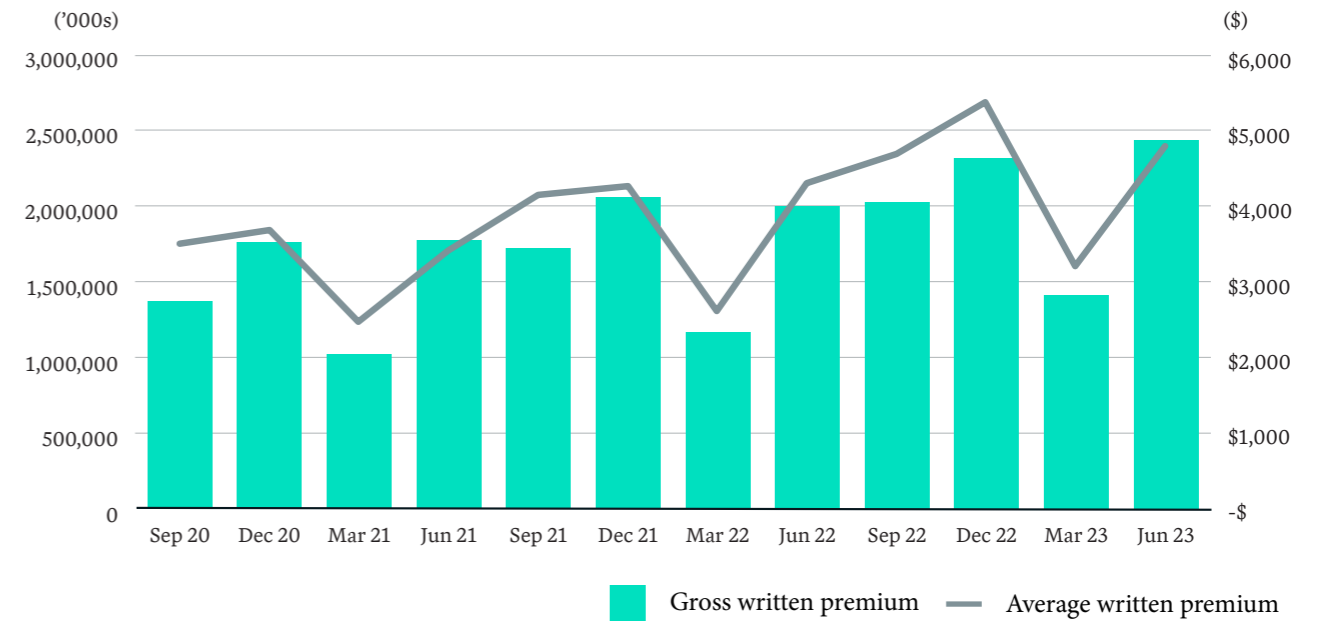
Rising natural peril costs – While these costs were relatively favourable in the past year, climate change is pushing them up over the long term. A feature of this experience is an escalation in property damage and interruptions to business operations due to heightened risks from natural disasters such as floods, storms and bushfire.

Delays resulting in higher cash settlements and indemnity period worries – In addition to creating inflationary conditions and putting upward pressure on average claim size, supply chain disruptions are also causing blowouts in average claims processing times. As a result, businesses might be tempted to consider cash settlements, despite the risk these may not adequately cover replacement costs. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

An increase in the proportion of employees working from home is leading to some companies reducing their leased space, which may in turn put downward pressure on commercial property insurance revenues for the relevant market sector.

In the short term, likely premium increases – as the market continues to harden in response to ongoing high inflation and rising natural peril costs – will benefit insurer profitability. Longer term,

the high inflationary environment may negatively impact profitability due to underinsurance, unless corrective action is taken.

ARPC is expected to improve affordability of SME and strata cover in cyclone-prone areas, with major insurers required to reinsure cyclone risk with the pool by the end of 2023.

Travel

More than two years since Australian borders reopened, monthly outbound travel volumes are nearing pre-pandemic levels. Quarterly gross written premium is now the highest on record at \$329 million, reflecting this rapid recovery. Key to the upswing is: a reduction of competition from withdrawal of capacity due to COVID-19 (but signs of returning capacity, with new operators such as PassportCard and Freely); inclusion of COVID-19 cover; inflation of travel costs; and a general hardening of the (re)insurance market.

Loss ratios are also broadly tracking at pre-pandemic levels, suggesting higher average premiums reflect a post-pandemic environment of elevated claims.

In FY23, the regulatory environment shifted, increasing pressure on insurers for customer conduct issues (e.g. regulator enforcement actions on pricing promises against RACQ and IAG). The *Financial Accountability Regime Bill 2023* will further increase conduct and accountability rules for insurers, their directors and executives.

Profitability and premium rate increases

– Travel insurance has very much returned to profitability, with record gross written premium increases. These increases reflect the expansion of policies to include COVID-19 cover (now standard in some cases), as well as increased claims payouts due to escalating costs associated with travel, such as accommodation and airfares.

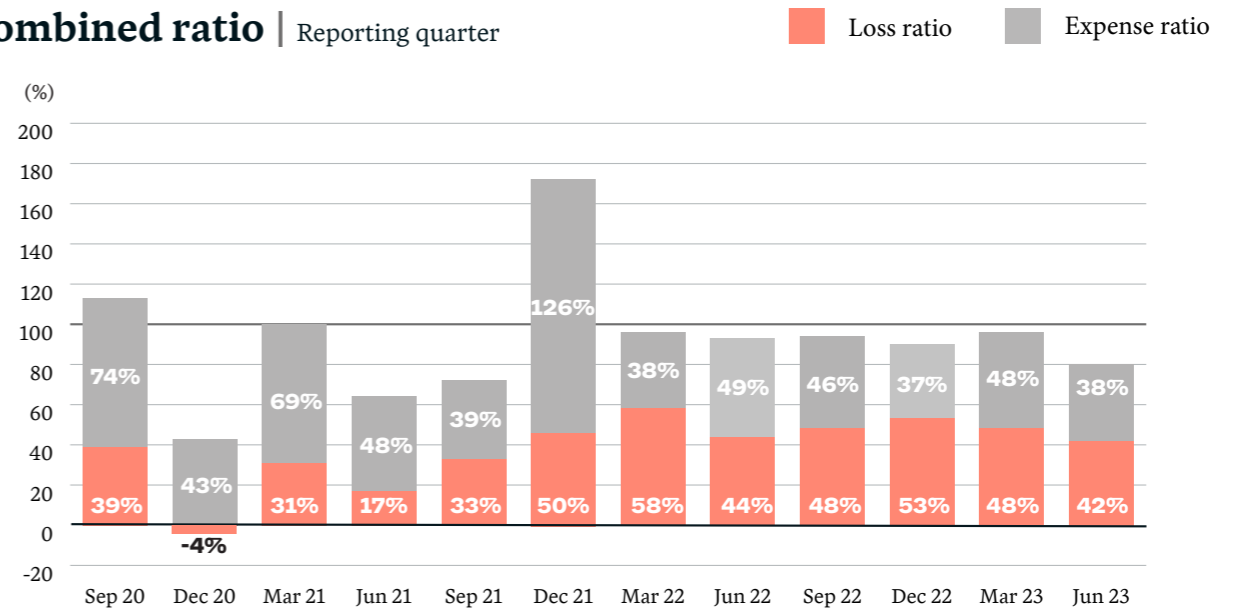
Regulatory/conduct risk

– Across the industry, regulators have greater expectations of insurer conduct and are prepared to enforce them, particularly for insurers selling direct to the public. During the year, the Australian Securities and Investments Commission issued several design and distribution obligation interim stop orders to protect consumers from “acquiring products that may not be consistent with their objectives, financial situation or needs”.

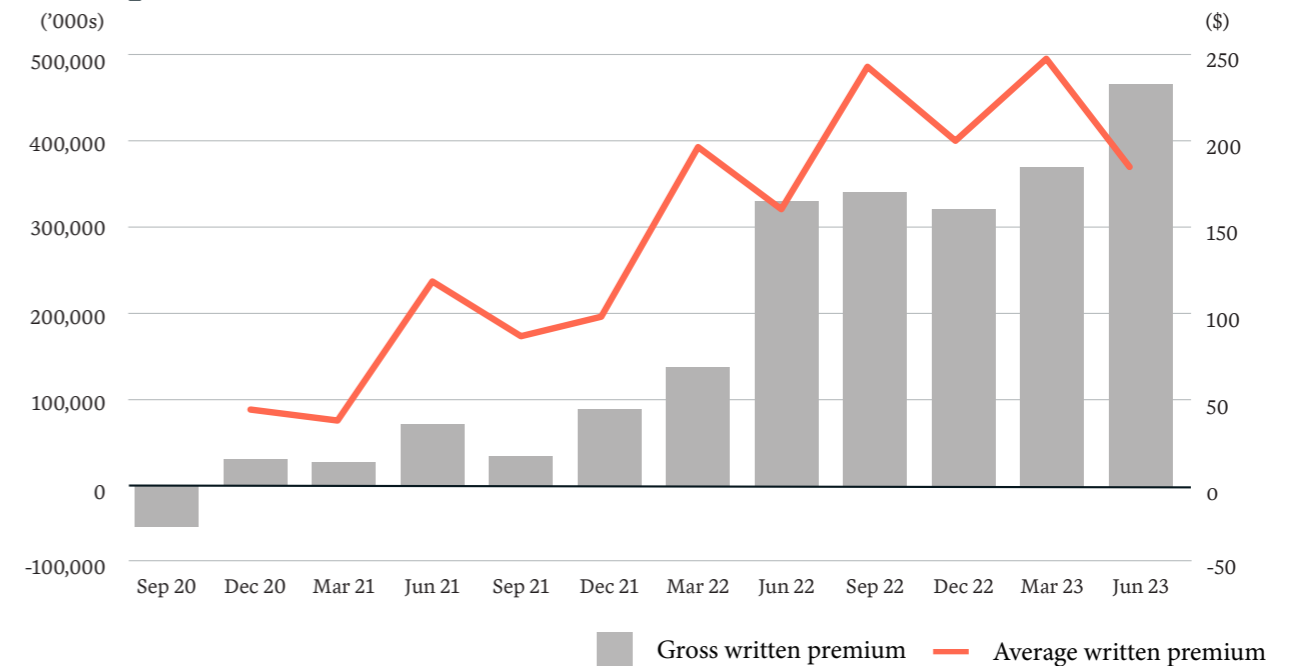
Unfair contract terms

– The testing of unfair contract-term provisions on insurance contracts is particularly important for travel insurers in considering to what extent changes need to be made to their pre-existing condition exclusions. [Ⓜ]

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

The industry has adapted well to the post-pandemic environment, building in COVID-19 cover while maintaining underwriting profit. Further potential for growth exists, as international travel and airline capacity approach pre-pandemic levels. Insurers can take advantage of this opportunity for growth by investing in areas such as improving cover choice and flexibility, and streamlining policy and claims administration.

As travel insurance is traditionally the class most prone to customer complaints, conduct risk and

compliance should also be top of the agenda.

On affordability, a challenge will be to emphasise the value of travel insurance to customers, including communicating the risks of being stuck overseas with illness and escalating medical costs. This follows research by Southern Cross Travel Insurance, finding that 1 in 10 Australians could ditch travel insurance due to increasing costs.

With regulators sharply focused on customer experience, insurers must take great care to apply a customer-centric mindset across product lifecycles.

Public & Products Liability

Insurers experienced a 96% combined ratio for FY23, 86% for current year exposures and an additional 10% for prior reserve strengthening.

Increases in claim sizes and large claim frequency continue to drive insurers to harden rates for select industries. In response, there has been an increased uptake of higher excesses to mitigate the impact of the rising premiums. Affordability and availability are top of mind as the industry notes potential deficiencies in the existing system, working with the Insurance Council of Australia (ICA) and other industry bodies to develop solutions.

In broader industry news, the number of claims received by the National Redress Scheme continues to accelerate. More than 11,000 claims were received over the year to June 2023 compared to 5,600 claims received for the year to June 2022. Abuse claims continue to present challenges for the industry, with ongoing latent reporting and reducing insurer capacity.


Overall premium growth for the year was 12%,

with 14% increase in average premiums, offset by a 2% decrease in the number of risks underwritten. Escalation in claims costs and accompanying rate increases have not been felt equally across the industry. Most affected by affordability challenges are leisure and entertainment, some professional segments, as well as sectors with significant labour hire.

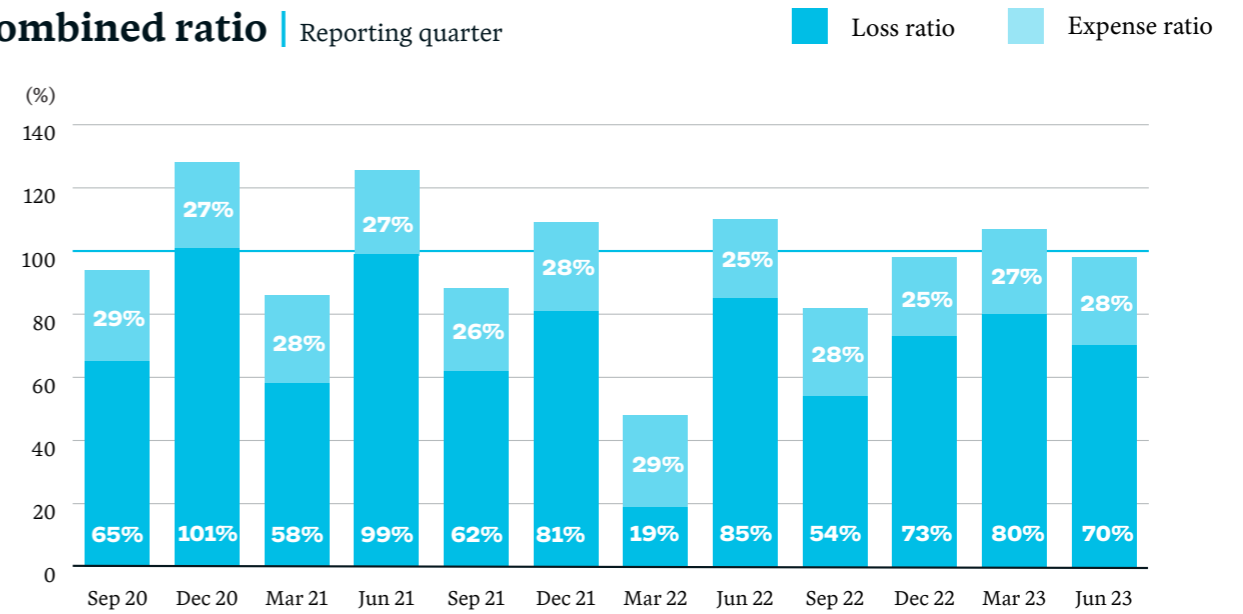
The construction industry continues to face deteriorating claim development

patterns for bodily injuries (both increased frequency and size) and higher claims costs for property damage. Additionally, flexible employment practices are resulting in a higher proportion of worker-to-worker claims whose average size is more than double other bodily injury claims.

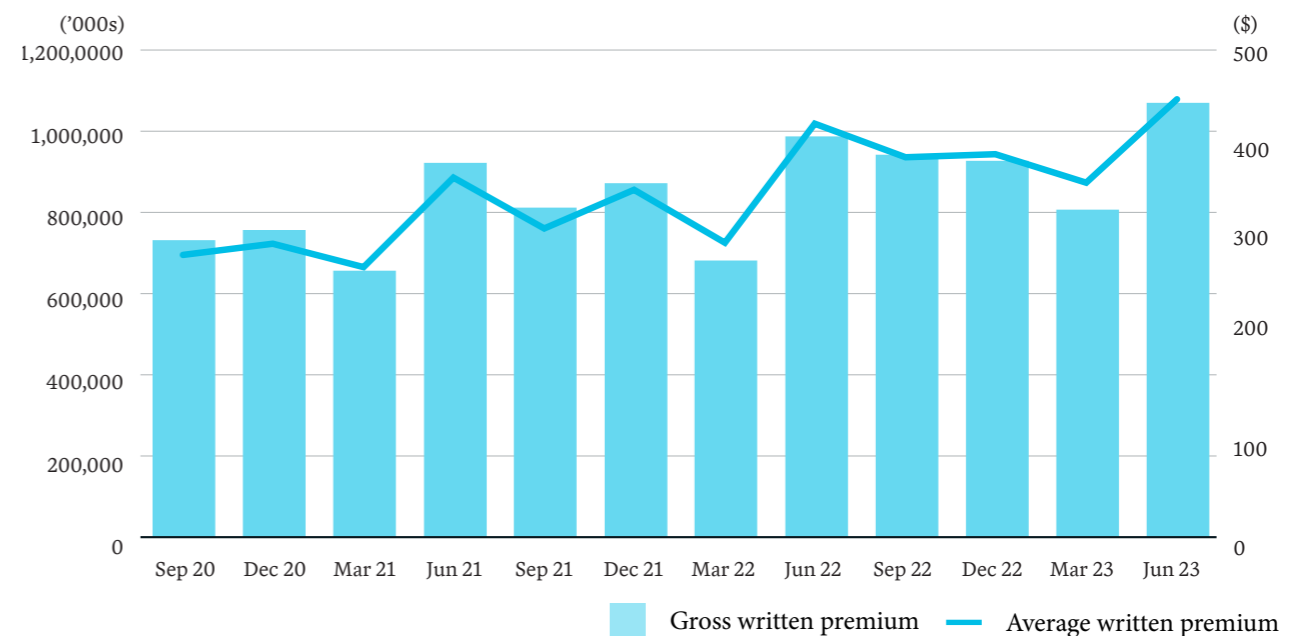
Insurers remain concerned about social inflation

and its impact on liability costs, such as media scrutiny on abuse claims, legal expenses and rising medical bills. Another social inflation driver is the increasing proportion of psychological claims reported for public liability and other liability-type classes, such as workers compensation and CTP. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

Affordability concerns present reputational risks to insurers and the industry. Insurers need to be aware that claims experience is mixed among occupations, even within the same industry, and to balance this against rising litigation costs to minimise the number of ill-affected policyholders.

The ICA, in conjunction with other industry bodies, has developed a program to assist business operators to better understand the risk management and mitigation required to obtain public liability insurance in current market conditions.



Concerns remain with certain occupations and industry groupings, notably professionals in financial occupations and the building industry. Class action activity is also rising, including the first ever consumer class actions brought by people impacted by data breach incidents. Upcoming changes to the Privacy Act may make it easier for similar claims to be brought. Several high-profile class actions underway from data breaches have the potential to establish precedent.


Insurers are anticipating potentially more class actions, following the commencement of the *Corporations Amendment (Litigation Funding) Regulations 2022* in December last year. With this legislation, the Albanese government indicates a desire to reverse litigation funding reform introduced by the previous Coalition government.

The long-awaited *Financial Accountability Regime Bill 2023 (FAR)* was passed by Parliament on 5 September 2023, presenting significant change for insurers.

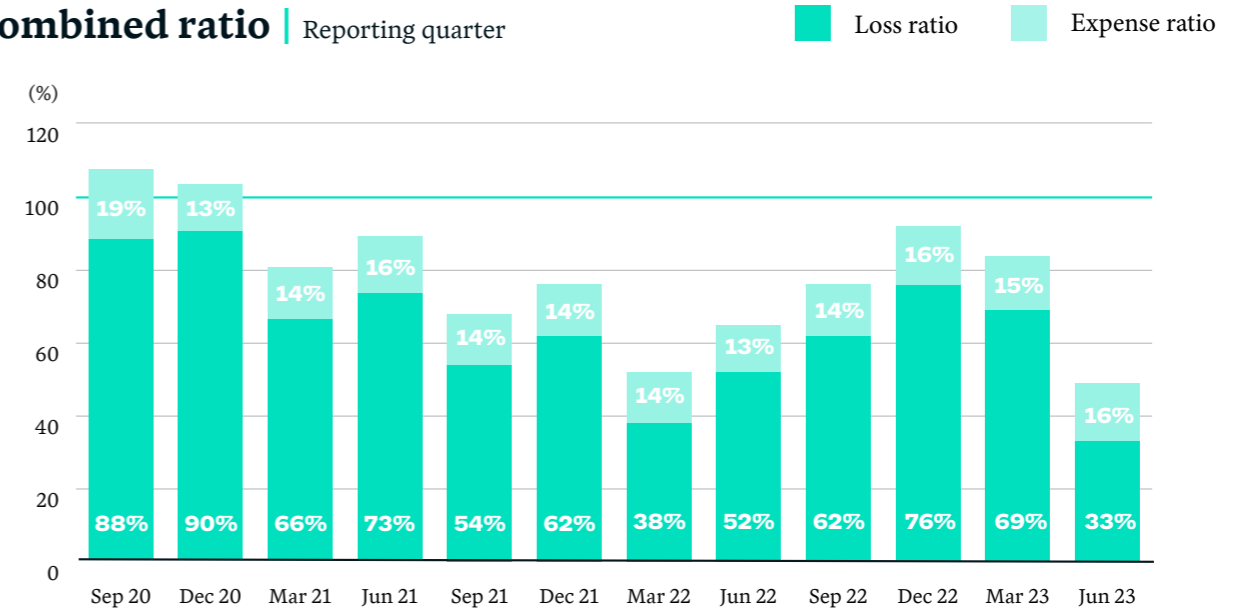
Professional Indemnity & Directors and Officers

Class action activity is escalating – There were 28 class actions filed in the first half of CY23, which is double the 14 class actions filed over the corresponding period in CY22. Most of the class actions were brought by shareholders relating to alleged failures in earnings guidance disclosures, which is consistent with previous years. A growing number of shareholder class actions have focused on alleged inadequate systems and controls, including poor management of cybersecurity risks, although it has become increasingly commonplace for cyber risk exclusions to be present within PI & DO cover.

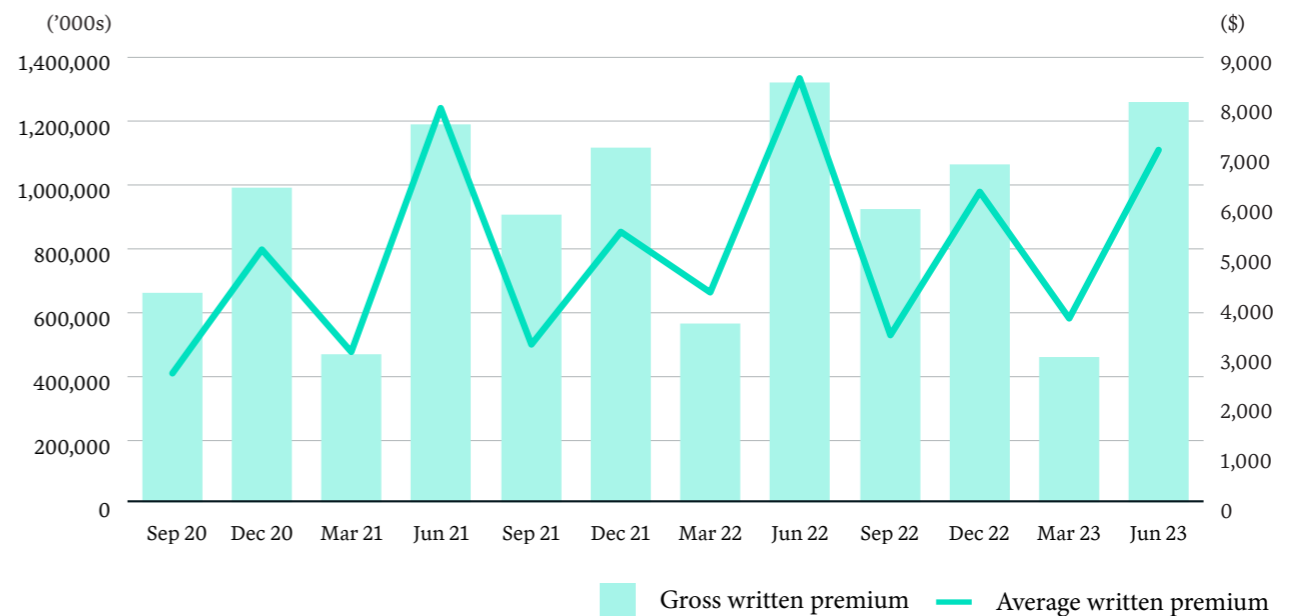
Cost and availability of cover remains an issue for certain occupations – Professionals in the financial sector and the building industry are continuing to experience increases in cost and restrictions on cover availability. The growing risk of cyberattacks is also impacting the cost and availability of cover for professionals in sectors most likely to be compromised by cyber risk, such as those working with sensitive personal data.

Insurers strengthened reserves during FY23 – This was in response to rising inflation, following reserve releases in the previous year. Ongoing high inflation and relaxation of litigation funding restrictions may prompt insurers to continue strengthening reserves. With signs of the market softening, these factors may combine to negatively impact insurer returns, despite overall PI & DO continuing to sustain a reasonable level of profitability over FY23. 

Combined ratio | Reporting quarter



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

Under the new FAR regime, all directors and most senior executives in the banking, superannuation and insurance industries will be personally accountable for a range of new and expanded prudential and conduct-related compliance requirements. The legislation will be jointly administered and enforced by regulators ASIC and APRA. As FAR permits accountable entities to insure an accountable person from the consequences of breaching FAR, insurers should carefully review their D&O insurance policies.

Class action risk is continuing to evolve, with significant impacts on PI & DO covers. While CY22 showed subdued class action activity, the elevated filings seen during the

first half of CY23 may signal a return to the historically intense activity of CY17 to CY21.

The first-ever class actions brought by consumers impacted by data breach incidents (most notably, Medibank, Optus and Latitude Financial) may be just the start, given cyberattacks are on the rise. Impending regulatory changes may also act to increase the risk of consumer class actions and fines for data breaches. In particular, the reforms envisaged to the Privacy Act are all encompassing and touch on every aspect of how personal information is collected and managed, and introduce a multitude of new rights for individuals.

Lenders Mortgage

Insurance

Premium revenues for lenders mortgage insurers were down, impacted by a decrease in new home loans, expansion of the Federal Government's First Home Guarantee Scheme and proportionately more loans falling below the LMI Loan to Value Ratio (LVR) threshold.

However, LMI insurers continued to enjoy solid underwriting performances, boosted by strong economic fundamentals. Reserve releases prompted by very benign claims experience during FY23 contributed to negative loss ratios and healthy return on equity.

While the impact of interest rate rises was initially muted by many borrowers being in fixed-rate loans, there are likely to be increased defaults as fixed-rate arrangements expire, with many borrowers seeking to refinance. If borrowers can successfully refinance, then this may ease the proportion of people faced with large interest rate increases and ease pressure on defaults.

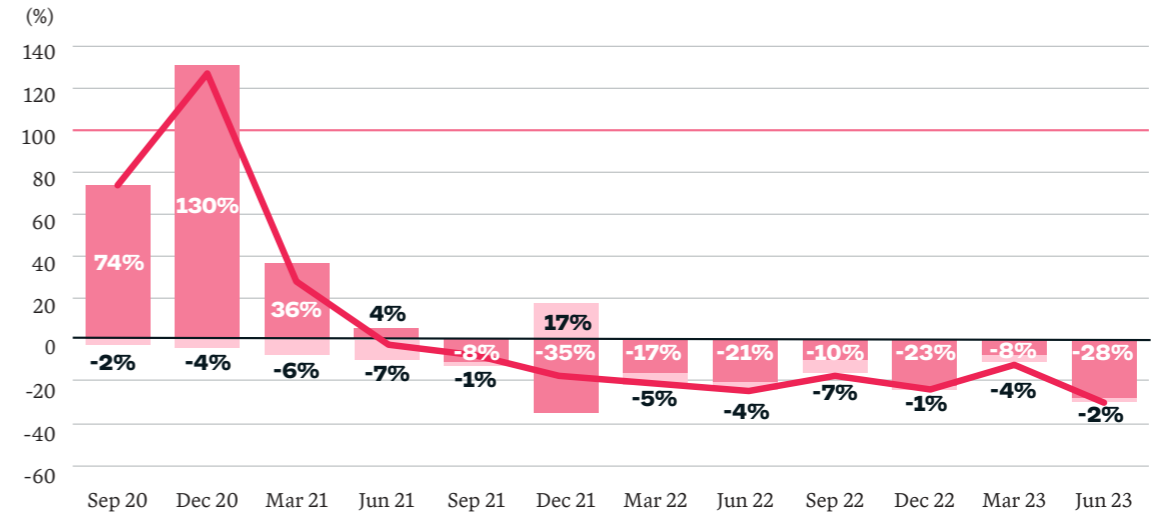
Top-line growth was problematic, with drops in revenue for LMI insurers. The reduced income occurred as banks tightened lending standards in response to rising interest rates. As a result, insurers felt the consequences of lower lending. Other factors impacting negatively on premium revenue for LMI insurers included the growth of LMI waivers for borrowers deemed low risk, expansion of the Federal Government's First Home Guarantee Scheme and a greater proportion of borrowings falling below the 80% LVR threshold that requires an LMI policy.

Revenue setbacks aside, claims experience was favourable during FY23, underpinned by a strong labour market and benefitting from an unexpected recent increase in property prices. The benign claims experience led to insurers releasing reserves built up in prior periods, which in turn contributed to negative industry loss ratios.

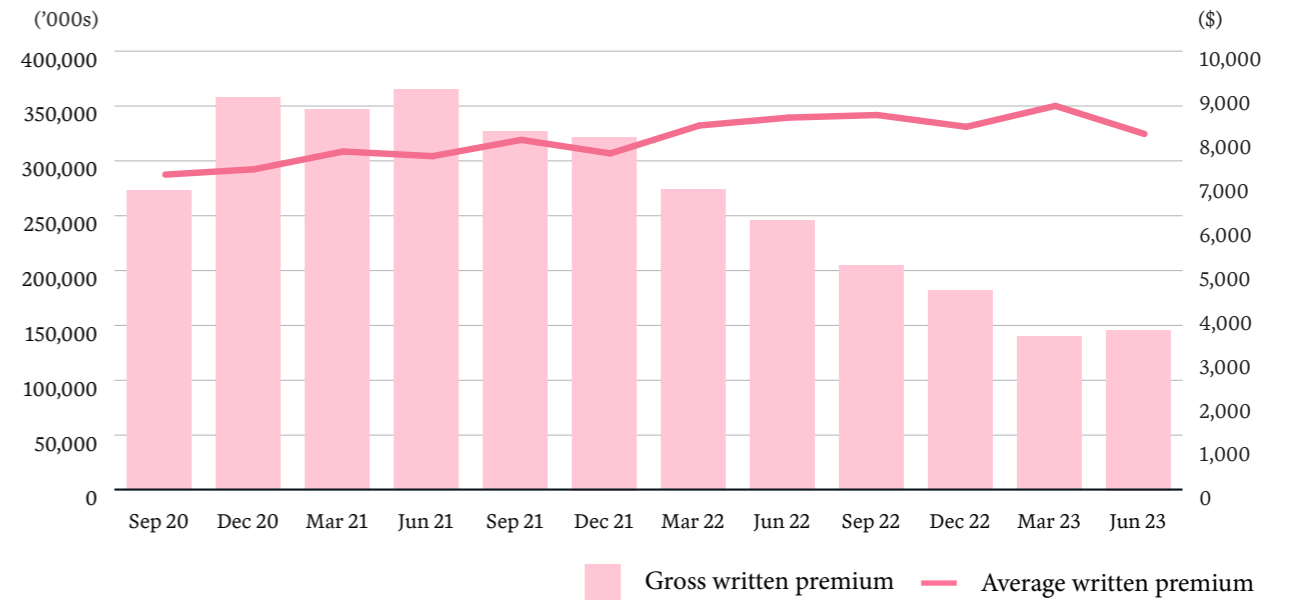
As fixed-rate arrangements expire and borrowers feel the full force of interest rate hikes, many are facing significant increases in loan repayments.

Back in October 2021, APRA increased the minimum interest rate buffer it expects banks to use when assessing the serviceability of home loan applications from 2.5% to 3%. Previously, this provided an extra layer of protection against rising defaults and claims for LMI insurers. Now rate increases for some borrowers exceed the APRA serviceability buffers, and this will likely flow through to additional loan defaults and LMI claims unless borrowers are able to refinance. [®]

Combined ratio | Reporting quarter ■ Loss ratio ■ Expense ratio — Combined ratio



Total premium volume (\$) | Reporting quarter



Impacts and trends at a glance

Loss ratios are likely to trend up in the short term, as reserve releases run out and ongoing high inflation continues to put upward pressure on interest rates, which may in turn heighten the risk of mortgage defaults and increased claims. On the flipside, property markets are showing signs of a recovery after finding a floor in February 2023, and LMI insurers may benefit from improved investment returns arising from the higher interest rate environment. Looking further forward, interest rates are expected to peak in 2024, with falls in rates likely to ease default pressures and trigger growth in lending volumes.



Spotlight on AI

2023 is the year artificial intelligence went mainstream, with the general public now able to use AI and machine learning technology for work, study and play. Many players in insurance have been quietly leading the way for years – realising AI's potential to improve customer experience, increase efficiency and reduce costs. We explore how AI is transforming insurance and what insurers can do to seize the opportunities.

Applications for AI in insurance span a range of operational areas, from pricing and underwriting through to customer interactions and claims processing. We break down how AI is being applied in key areas, where we're seeing the biggest developments and what's next for insurers.

Boosting efficiency, accuracy and possibility in underwriting

AI-led improvements in underwriting efficiency and practices are helping insurers boost sales opportunities by reducing the turnaround time for quotes, and improve risk assessment to support better pricing and profitability. In personal lines, where most customers purchase directly from an insurer, AI helps reduce the number of questions required in quote forms and, in certain cases, pre-fills questions. United States insurer State Farm and local player Suncorp, for example, use machine learning applied to geospatial images to streamline home insurance quoting and tie characteristics of the property to potential losses.

For commercial lines, where much of the underwriting process is manual, AI helps rapidly extract relevant information from documents. In the US, Liberty Mutual is demonstrating the benefits by applying natural language processing to documents to quickly extract relevant information to underwriters. This supports their conversations with brokers and customers, and halves the time required to extract loss data for mid-size and large accounts.

More streamlined, effective claims assessment

Image recognition helps simplify and streamline claims assessment, and supports enhanced digitisation of customer experience. This includes Aviva UK's use of property and motor vehicle damage images to estimate repair costs, and IAG Firemark Venture's recent investment in Ravin AI, an Israeli tech start-up. Ravin AI produces automated motor vehicle damage and repair cost estimates, which are based on customers' mobile phone images.

Moving beyond image recognition, natural language models, including large language models, are helping to extract relevant information from claims forms and notes. This increases the efficiency and effectiveness of claims teams, who can focus their time on claims requiring closer human review. For example, United Kingdom insurer RSA is applying this technology to claims from its pet insurance portfolio, automating the reading and extraction of relevant data from medical reports, treatments and progress notes.

Insurers will need to ensure their risk management practices are appropriately structured to incorporate, manage and mitigate AI-specific risks and provide a firm basis for meeting increasing regulatory and compliance requirements.

Chatbot makeovers for enhanced customer experience

Most people are familiar with the artificial intelligence chatbot. Following recent advancements in large language models, such as those underpinning ChatGPT, the chatbot has benefitted from significantly enhanced capability and performance. Insurers employ these not only as direct-to-consumer instant messaging platforms to answer simple enquiries but also as 'in house' assistants to customer service centres.

US-based Allstate Insurance's 'Amelia', for example, leads call-centre employees through step-by-step procedures to help answer a variety of customer questions. Amelia also 'listens' to interactions she doesn't understand, to expand her knowledge. Allstate says the benefits of Amelia include a reduction in the time taken to train new employees, and she's also helping employees better comply with industry regulations.


Innovations amid a warming world and a focus on bias

With predicted investment in AI growing to \$200 billion worldwide by 2025¹, we're going to continue to see innovations in the insurance field. Budding research into AI for disaster prediction, management and relief is especially relevant for insurers in a warming world, with more frequent and intense weather events. In particular, researchers are developing frameworks that combine pre-disaster images with weather data and trajectory of hurricanes. These provide rapid insights on damage caused by natural disasters, with potential to assist in allocating resources for assessment, repair and disaster relief.

Another strand of research looks to address potential bias and inequities introduced by AI pricing models. Discrimination-free pricing, for example, seeks to produce pricing models that avoid direct or indirect discrimination based on protected features such as gender, while maintaining overall model performance. This has been motivated in part by European Union regulation banning pricing discrimination based on protected attributes. We expect bias and fairness to become a focus of pricing models more globally, as insurers respond to rapidly developing government regulations and directives on the use and application of automated decision processes.

Exciting times ahead, but risk management key

While insurers have a lot to be excited about with the current and emerging uses of AI, it's also a time to ensure systems and processes help them navigate the challenges posed by its use. AI processes can be brittle, exposing insurers to financial, regulatory, legal and reputational risks. Examples include financial losses driven by 'rogue' underwriting or pricing algorithms, legal penalties from breaches to customer privacy requirements and loss of goodwill from inequitable treatment of customers.

Insurers will need to ensure their risk management practices are appropriately structured to incorporate, manage and mitigate AI-specific risks and provide a firm basis for meeting increasing regulatory and compliance requirements. These include impending government regulation on artificial intelligence and significant expansion of requirements under the Privacy Act. By expanding the legislation, the government aims to capture a much broader range of data-related practices, and increase customer rights to control how their data is used and stored. 

1. Source: <https://www.goldmansachs.com/intelligence/pages/ai-investment-forecast-to-approach-200-billion-globally-by-2025.html>

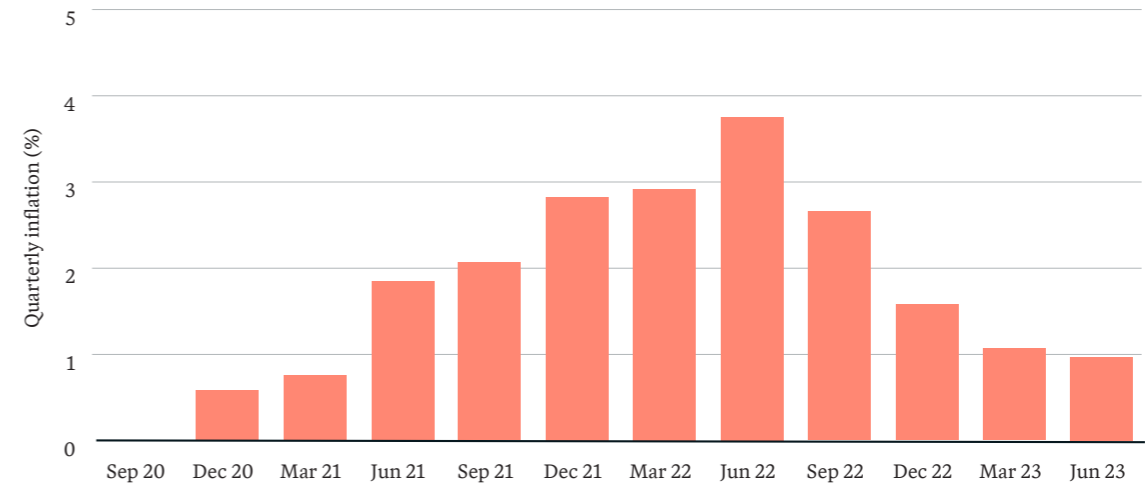
Spotlight on inflation

How is skyrocketing inflation affecting insurers? We look beyond the headline numbers to assess where the current inflationary pressures are, what the outlook is for FY24 and what insurers can do to thrive over the next few years.

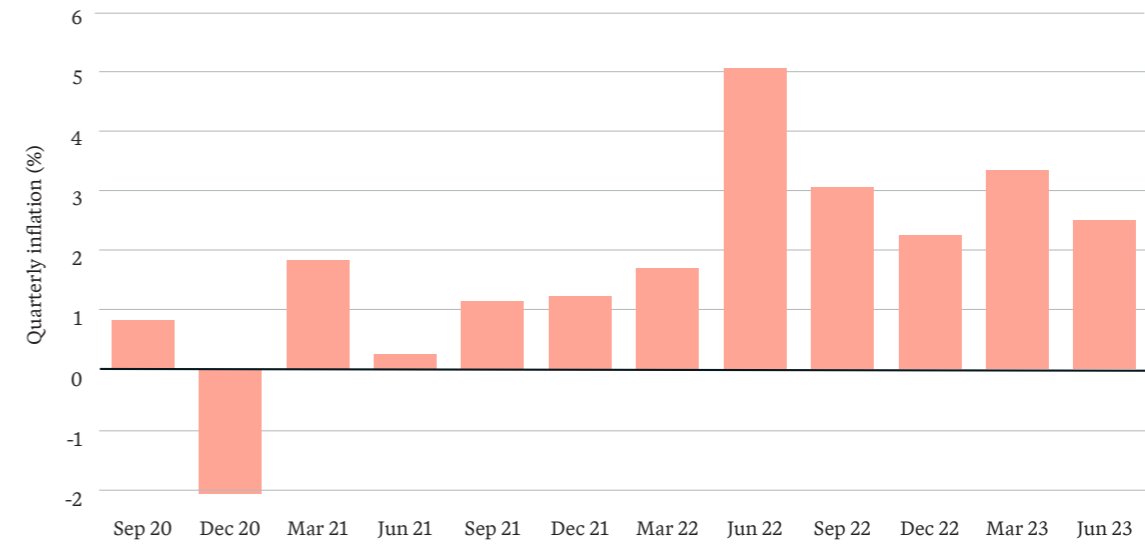
Our analysis shows we're past the inflationary peak for most sectors, but inflation continues to remain above long-term average levels and will increase claims cost pressures for insurers. At a minimum, insurers will need to have a deep understanding of the drivers of inflation for each loss type and the flow-on impact on claims costs and premiums.

Construction, motor parts and travel are key drivers of claims cost inflation for property, motor and travel insurers. We summarise the Australian Bureau of Statistics quarterly inflation figures for the three areas to help us capture the impacts on insurers.

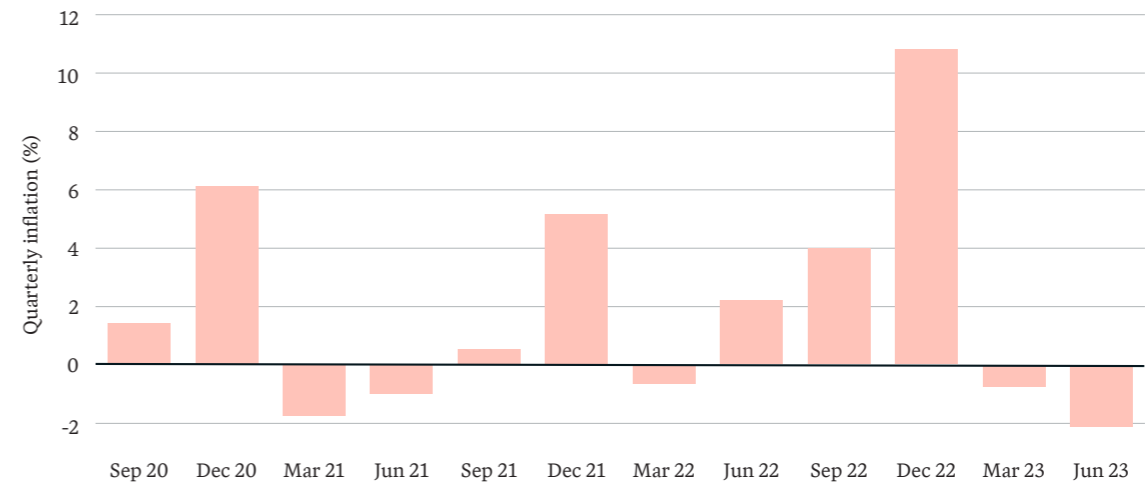
Construction



Motor spare parts



Holiday travel and accommodation



Key driver 1 – Construction

Over the two years to 30 June 2023, construction costs have increased by 20%. Cost pressures have been driven by an increase in demand for materials combined with supply constraints and increases in energy and freight costs. The good news is that the past two quarters show construction cost increases are slowing. We expect material cost pressures will reduce over FY24, as supply chain pressures reduce and demand weakens.

Of course, the cost of construction is only one of the factors contributing to claims costs and premiums. Unfortunately for homeowners, the increasing frequency and cost of catastrophes and increases in reinsurance costs continue to drive up premiums, despite the weakening inflationary pressures on construction costs. IAG increased home insurance premiums by 20% from February 2023.

In its recent thought leadership report, Home Insurance Affordability Update, the Actuaries Institute states 12% of households are now affordability stressed, paying more than four weeks' gross income towards home insurance premiums. Various initiatives and measures to mitigate these risks have been proposed but will take time. Meanwhile, affordability stresses will further increase as the risks continue to rise and insurers are flagging additional premium increases.

Key driver 2 – Motor spare parts

Motor parts costs have increased by 23% in the past two years. Supply chain constraints and labour shortages are mainly behind increases in claims costs for insurers. Advancement in technology used in vehicle components is another key contributor. In particular, components that are most likely to be damaged in a collision such as headlights and windscreens have seen sharp price increases due to technological advancement in modern vehicles, including advanced driver-assistance systems and smart sensors.

The increase in motor parts costs has impacted motor insurance premiums over the past few years. Reflecting this experience, APRA's latest general insurance statistics show a 14% increase in average premiums over FY23 for the industry.

We expect motor vehicle cost pressures to remain elevated in FY24. The main pressures over the next year come from labour shortages in the motor repair industry and the supply of spare parts, which will have an impact on repair times and costs.


Key driver 3 – Holiday travel and accommodation

In good news for travellers, the cost of travel and accommodation reduced by 3% in the six months to June 2023, following record high prices last summer. The price increases in the past two years are due to a combination of increased demand post COVID-19, the cost of aviation fuel and reduced supply of air travel.

The outlook is for prices to reduce further as supply comes back online. Travel insurers will need to watch this space closely and adjust premiums to remain competitive.

Top 4 insurer actions – What it will take to thrive

In addition to closely monitoring claims costs and adjusting premiums, there are several actions insurers can take to thrive in this environment:

- 1. Focus on customer retention strategies, given substantial price increases** – Price is not the only factor that determines whether a customer renews. Improving customer experience – at the time of acquiring a policy or receiving a claim and when responding to a customer enquiry – is now more important than ever. For example, claim settlement times are being slashed with the industry investing in technology and artificial intelligence to help reduce the time it takes to assess a claim from weeks to minutes. The standout in this space is Lemonade Insurance, setting a new record of paying a claim in under two seconds.
- 2. Be alert to an increase in the number of vulnerable customers and review your financial hardship policies** – Vulnerability is broad and can be situational. It's important your customer service team is on high alert and can spot the signs.
- 3. Consider the potential for increased fraud/claim exaggeration activity, as ongoing cost pressures hit home for consumers and businesses** – In 2017, the Insurance Council of Australia reported insurers detected \$280 million in fraudulent claims across personal lines classes. The true cost of fraudulent claims will be multiples higher than this and can be expected to increase in times of economic stress. The industry is investing in AI to detect fraud and flag claims for additional review. Provided these solutions are applied correctly, this is a positive development for consumers.
- 4. Closely monitor customer churn, with a focus on retaining your most profitable customers** – Large premium rate increases are associated with an increase in churn, as customers search for a better deal. In this environment, it's increasingly important for insurers to understand profitability at a customer level and focus efforts on retaining customers who have a high lifetime value. Insurers that have a comprehensive understanding of individual risks and provide a great customer experience, as we outlined in Action 1., will be best placed to weather the storm. 

**Andrew Song | Manager**

Andrew provides insurers and self-insurers with a range of traditional and non-traditional actuarial advice, from liability valuation and financial condition reports to advanced analytics-driven insights. He works closely with our Appointed Actuaries in offering strategic guidance to boards and senior management. Andrew also leads Taylor Fry's IFRS 17 practice and advises multiple insurers on their implementation.

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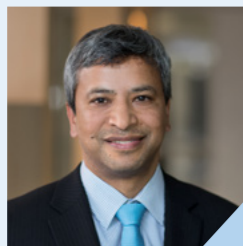
Jonathan combines actuarial expertise with a PhD in computer science to lead Taylor Fry's advanced analytics practice. He works closely with government and business to improve operations. Jonathan's projects range from strategic analytics advice to the design and prototyping of commercially focused machine learning and AI frameworks. For insurers, this includes a wide range of applications covering pricing, claims, fraud and customer analytics.

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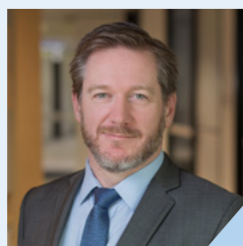
Josh specialises in data analytics, supporting clients with design and development of statistical analyses and advanced machine learning models to improve operational performance and efficiency. He has developed models for insurance pricing and fraud detection, analysed drivers of claims inflation, and modelled customer engagement and loyalty. Josh curates and runs training courses for clients in advanced machine learning techniques and their business application.

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Kevin has deep experience across a range of general insurance business lines, with expertise in reserving, pricing, capital management, and reinsurance and investment strategies. He is the Appointed Actuary for several general insurers and reinsurers, and the project lead on Taylor Fry's engagement as Reserving Actuary for the ARPC. Kevin has a particular interest in identifying ways to improve insurance affordability, having authored a report for the Professional Standards Councils on driving better outcomes in professional indemnity.

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Paul leads Taylor Fry's injury schemes practice, providing advice to accident compensation schemes, scheme regulators, self-insurers and insurers in Australia and New Zealand. Paul's actuarial expertise encompasses compulsory third party, catastrophic injury, and workers compensation insurance and he is an active participant in industry working groups.

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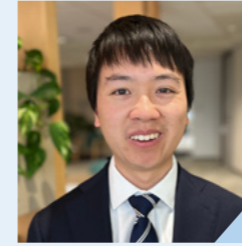
With a background in economics and public policy in Australia and New Zealand, Sarah has more than 12 years' experience working with government and the private sector. She advises on Environmental, Social and Governance risk, helping clients understand and quantify their risks for climate and sustainability, and cyber.

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Scott advises insurers, government and corporate clients, with a special focus on meeting customer expectations. He performs Appointed Actuary roles, is a long-tail pricing expert and advises Australia's largest customer loyalty scheme. Scott explores the role actuaries can play in driving innovation, bridging the gap between industry concerns and community expectations, and in keeping abreast of technological disruption.

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Soroush is an actuary specialising in insurance pricing, data analytics and predictive modelling. He has extensive experience with personal lines insurance and injury scheme pricing and analytics, working closely with regulators and direct insurers to inform premium setting and provide insights into emerging trends. Consulting across government and the corporate world, Soroush transforms technical complexity into pragmatic client-centric advice.

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Tim provides the full spectrum of actuarial advice to general insurers and is a proactive member of the actuarial industry. He specialises in the setting of economic assumptions and has been involved with several working groups assisting the Actuaries Institute to determine the profession's stance on these. Tim is also further developing Taylor Fry's economic assumption framework and is on the Young Actuaries Advisory Board.

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Tom is an expert in data analytics and predictive modelling, especially in designing bespoke analytics solutions to help his clients address their unique challenges. Among his focus areas, he works on insurance projects across home, motor, travel, CTP, and workers' compensation. These include developing state-of-the-art risk-based prices, evaluating the impact of pricing strategies, fraud detection modelling, and building a suite of statistical models to project future outcomes of claims.

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Win-Li leads our general insurance practice, harnessing more than 25 years advising insurers, self-insurers and government across the globe, with a special focus on cybersecurity. She holds several Appointed Actuary roles and is 2023 Vice President of the Actuaries Institute of Australia. Win-Li was lead author on the Actuaries Institute's green paper *Cyber Risk and the Role of Insurance*, and was recently awarded 2023 Insurance Leader of the Year by the Australian and New Zealand Institute of Insurance and Finance.

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We help business and government leaders see a clear way forward.

Our actuarial and analytics consultants support our clients in making strategic decisions to enhance the financial health of their organisations, and benefit communities, people and society.

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.

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.

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