Appendix 2.4: Marsh – Premium projections & insurance market update

Regulatory proposal for the ACT electricity distribution network 2024–29

Evoenergy Electricity Network

Australian Energy Regulator Report

Premium Projections and Insurance Market Update

Final Report
December 2022

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Executive Summary

Introduction

The ActewAGL Joint Venture (ActewAGL) has engaged Marsh Pty Ltd to provide a forecast of its cost of managing risk for the forthcoming regulatory period, covering the period of July 2025 to June 2029. Marsh understands that this report will be provided on a confidential basis (and not for publication) to the Australian Electricity Regulator (AER) as part of Evoenergy's Electricity Networks (Evoenergy) Revenue Proposal.

Insurance is purchased for the ActewAGL Joint Venture (ActewAGL), including Evoenergy. Marsh has provided the premium cost estimates for the ActewAGL Joint Venture. ActewAGL has provided Marsh with the Evoenergy premium allocation in accordance with the Cost Allocation Methodology (CAM) as approved by the AER.

There are three elements to Evoenergy's cost of managing risk, namely:

- The premium paid for insurances purchased by Evoenergy;
- The expected cost of uninsured risks (i.e. self-insured risks); and
- The extent to which the cost pass through mechanism included in the National Electricity Rules (NER) and regulatory determination limits Evoenergy's risk exposure.

Summary of Evoenergy's program

Evoenergy's insurance program consists of the following insurance classes:

- Property (Industrial Special Risks);
- Liability (including General and Products Liability, Bushfire Liability, Failure to Supply Liability and Professional Indemnity);
- Financial Risks (including Directors' and Officers' insurance (D&O);
- Ancillary lines - Motor Vehicle, Corporate Travel, Voluntary Workers, Employment Practices Liability, Statutory Liability, Crime and Cyber. ActewAGL retains exposure to the following risks:
- Insurance coverage for machinery breakdown – consistent with the industry practice, ActewAGL does not commercially insure machinery breakdown of their assets.

- ‘Below deductible’ risks – ActewAGL retains exposure to all risks for which commercial cover is held but where claims are less than the deductible;
- Risks that exceed the Policy Limit of Liability being purchased

Consistent with industry practice, Evoenergy does not commercially insure electricity poles and lines.

Marsh considers Evoenergy’s approach to procuring insurance to be prudent, reflecting good industry practice.

Assessment

We have prepared our estimates for the forthcoming regulatory period (2024 – 2029) based on:

- Projected growth in Evoenergy’s insured asset values over the regulatory period.
- Continuing hard market conditions in the short term result in premium increases and potential coverage reduction, especially in natural catastrophe limits, which could increase deductibles and may cause capacity contraction. However, we expect market conditions to gradually soften throughout the regulatory period.
- The absence of any catastrophic event causing a major claim, which could have a significant impact on Property and Liability policies, claims performance, and subsequent renewal pricing.
- An allowance for all current statutory tax rates as of 2022 and levies, excluding GST.

The annual rate of increase in dollar value for each insurance premium may be different to the percentage increases for each policy. This is because Evoenergy has adjusted insurance premiums holding changes in the insurable assets constant to ensure that costs are not double counted with other components of the opex forecast, which is consistent with the AER’s preferred base-step-trend forecasting approach. It also reflects ActewAGL Distribution’s CAM, approved by the AER.

The main implications for Evoenergy from the state of the insurance market and continuing associated pressures on price, capacity, and coverage include:

- Increases in the premiums that Evoenergy must pay to continue purchasing Property and Liability coverage;
- Increases in deductibles will increase Evoenergy’s expected value of uninsured risks; and
- Insurer’s retracting policy coverage.

Insurance Premium Forecasts

Our forecast of Evoenergy's total annual insurance premium for the next regulatory period is [redacted] **(**$nominal) inclusive of all costs and stamp duty (excluding GST), which has been allocated with Evoenergy's Cost Allocation Methodology (CAM) as approved by the AER.

Evoenergy's insurance program is from 4pm 31 May to 4pm 31 May each year, the financial year (FY) ending is reflective of this period.

Details of FY23 and FY24 are included in Section 6 of this report.

Evoenergy's Insurance Premium forecast for various insurance classes ($nominal)

[redacted]

Scope of Report

Background and Scope

The scope of our review is to provide a forecast of Evoenergy's insurance premiums payable for the forthcoming five-year regulatory period (2024–2029), with separate estimates for each year Insurance is purchased for the ActewAGL Joint Venture, including Evoenergy. All figures shown in this report reflect Evoenergy's insurance costs, based on the AER's approved CAM.

Our estimates include an allowance for the following insurance classes:

- Property (Industrial Special Risks);
- Liability (including General and Products Liability, Bushfire Liability, Failure to Supply Liability and Professional Indemnity);
- Financial Risks (Directors' and Officers' insurance (D&O); and
- Other ancillary lines, including Motor Vehicle, Corporate Travel, Voluntary Workers, Employment Practices Liability, Statutory Liability, Crime, Cyber and a Group Personal Accident.

Evoenergy retains exposure to the following risks:

- Power poles and Lines – consistent with industry practice, Evoenergy does not commercially insure electricity poles and lines;
- Insurance coverage for machinery breakdown – consistent with the industry practice, Evoenergy does not commercially insure machinery breakdown (e.g. substations);
- 'Below deductible' risks – Evoenergy retains exposure to all risks for which commercial cover is held but where claims are less than the deductible; and
- Risks that exceed the Policy Limit of Liability being purchased.

Approach and Methodology

Where risks are currently insured, we have considered each insurance class separately to derive standalone premium estimates based on the individual circumstances of that insurance class.

In deriving our estimates for each insurance class, we have considered the following factors influencing premium levels:

- Historical changes in insurance cover;
- Historical variation in exposure;
- Historical claims experience;
- Forecasts of exposure;
- Expected market outlook; and
- Other historical market factors (e.g., changes in insurers, changes in insurer profit margins, and industry claims experience) to the extent that historical premium trends are observed which cannot be directly attributable to other factors.

This analysis relies on assumptions regarding insurance policy deductibles for the entire regulatory period. We have made our best attempt to predict the commercial insurance terms during this future period, however given the volatility in insurance market, there will be a level of uncertainty in these projections.

We have referred to the estimated premiums in this report as ‘Insurance Premiums’.

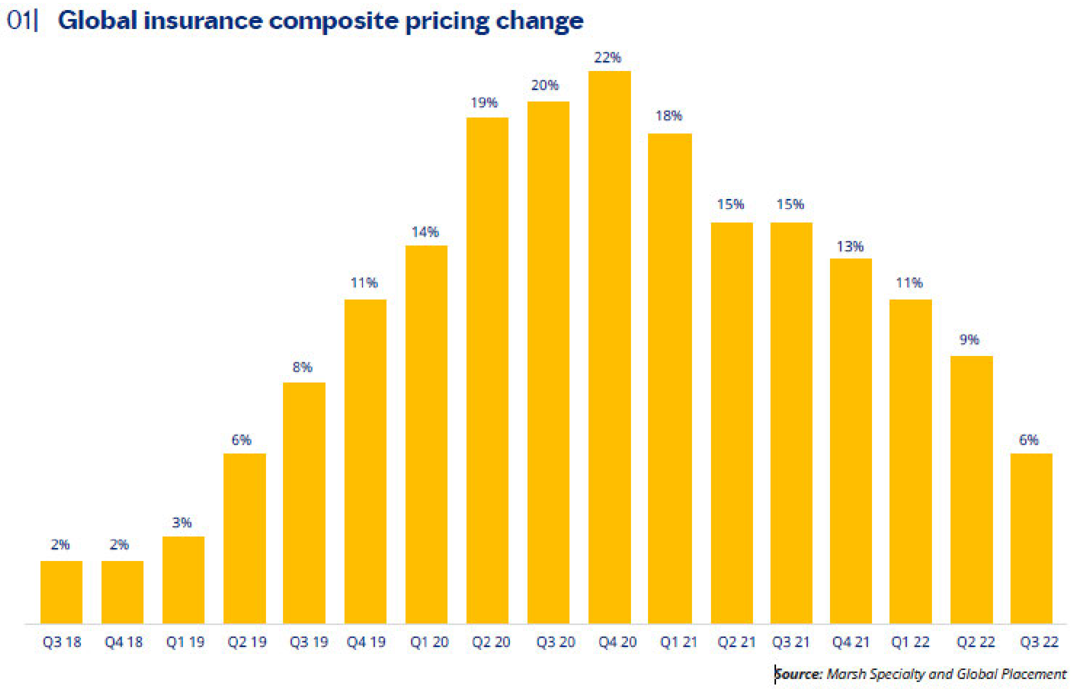
Insurance Market Drivers

The global general (non-life) insurance industry generates approximately US$2.9 trillion in revenue each year. The market cycle and cost of insurance is influenced by a number of key factors including:

- Size of premium pool;
- Claims paid and / or provisioned;
- Major loss events;
- Cost of reinsurance; and
- Investment returns and flow of additional funds into the sector from the Insurance-Linked-Securities.

The current market cycle has been subject to 20 consecutive quarters of premium increases as illustrated in the *Marsh Global Insurance Market Index* and as detailed in Figure 1.

Figure 1 – Global Insurance Composite Pricing Change

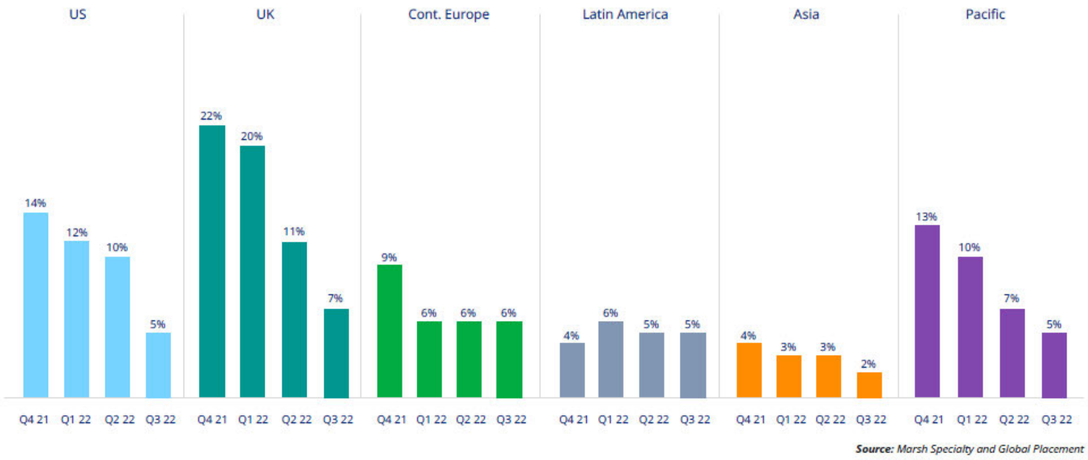


The third quarter was the twentieth consecutive in which composite pricing rose, continuing the longest run of increases since the inception of the index in 2012. In the third quarter of 2022, composite pricing moderated in most regions, driven by the first decrease in financial and professional lines since the third quarter of 2017.

Regionally, composite pricing increases for the third quarter are shown in Figure 2.

Figure 2 – Composite Insurance Pricing Change by Region

02| **Composite insurance pricing change — by region**



As shown in Figure 2, the level of premium increases globally is in decline but there remains consistent pressure from insurers to continue premium increases albeit at the slower pace now that pricing is getting closer to "technical rates" whereby insurers believe they can make adequate profit. The claims environment continues to remain challenging due to COVID-19 claim disputes concerning interpretation and application of policy wordings, which has a direct impact on insurer's profitability.

Whilst each class of insurance unique in respect of insurer appetite and pricing, we generally expect pricing to continue to increase in the next few years but at a more modest rate than what has been seen in previous years. Most insurers globally are now generating profit from their underwriting activities which will develop more appetite for growth and competition in the market.

Please refer to the **Insurance Market Update** on page 20 of this report for more insights.

Analysis of Insurance Related Costs

Basis of Estimates

We have prepared our estimates of Evoenergy's insurance premiums for the forthcoming regulatory period (2024–2029) on the basis of:

- Projected growth in Evoenergy's insured asset values over the regulatory period (changes in asset values is updated for the percentage tables, but not increased for the tables with dollar values)
- Continuing hard market conditions resulting in premium increases, coverage reduction, increases in deductible and capacity contraction, which will begin to soften throughout the regulatory period.
- Absence of any catastrophic event causing a major claim, which could have a significant impact on Property and Liability polices claims performance and subsequent renewal pricing.
- Allowance for all reasonably expected statutory taxes and levies, excluding GST.

The two main implications for Evoenergy from the state of the insurance market and continuing associated pressures on price, capacity, and coverage includes:

- Increases in the premiums that Evoenergy must pay to continue purchasing Property and Liability coverages.
- Increases in deductibles will increase Evoenergy's expected value of uninsured risks.

Comments on insurance program

Marsh considers Evoenergy's approach to their insurance program to be prudent and to reflect good industry practice. The insurance requirements, including limits, sub-limits, and deductibles, are informed by a range of processes comprising:

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
    - [redacted]

- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]

As outlined above, Evoenergy, supported by Marsh, regularly reviews its insurance requirements against the organisational and the external environment. Policy limits, sub-limits, deductibles, and uninsured risks are reviewed annually and may change based on factors including risk profile, market capacity, and pricing.

Property

Summary of Insurance Cover

Evoenergy purchases Property (ISR) insurance to cover its insured assets consistent with good industry practice. Evoenergy does not procure pole and wire infrastructure insurance, as per industry standard due to lack of insurance market appetite to insure those types of assets. Machinery breakdown coverage is also not purchased, this is also in line with industry standards. Coverage for business interruption is limited to Additional Increased Costs of Working due to the redundancy in the network. This approach is also standard for distribution business risks.

[redacted]

Basis of Insurance Premium Projection

Insurance Premiums have been calculated based on the Property base premium for FY2023. The premium is forecast using the projected insurance market rate change in conjunction with the change in asset base, to provide an overall commercial Insurance premium per year for the regulatory period.

Increased asset values

Growth in Evoenergy's value of assets to be insured will drive the cost of property insurance, which is projected to grow year on year [redacted]

Table 1 ActewAGL Joint Venture's projected Regulated Asset growth ($nominal)

Year	FY25	FY26	FY27	FY28	FY29
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Results

In relation to ActewAGL's Property insurance, Marsh expects that premium percentage changes per dollar insured will gradually decline, as shown in Table 2.

Table 2 ActewAGL Joint Venture projected Property Insurance premium rate movement.

Year	FY25	FY26	FY27	FY28	FY29
Industrial Special Risk/Property Rate Movement YoY (%)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

As shown in Table 3, Marsh expects that Evoenergy's cost of property insurance will increase, based on the following adjustments:

- Increases in the Terrorism Levy, NSW ESL and NSW Stamp Duty (excluding GST)
- Evoenergy's share of premiums based on the CAM, as approved by the AER
- Holding growth in assets constant over the 2024-29 regulatory period

Table 3 ISR Evoenergy's projected Property insurance premium changes ($nominal)

Year	FY25	FY26	FY27	FY28	FY29
Industrial Special Risk/Property Premium Movement YoY ($)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Liability

Summary of Insurance Cover

[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted]

Given Evoenergy's underground and aboveground focused distribution area, and excellent claims history from a bushfire perspective, insurers provide favorable consideration when underwriting the liability program. However, the bushfire market remains challenged, insurers continue to monitor their accumulations and set minimum rates regardless of risk profile.

Basis of Premium Projection

[redacted]

Before considering future forecasts for the Evoenergy Liability placement, it is important to explain some fundamental aspects influencing the current insurance market.

Underwriter stakeholders are influencing behaviour

Treaty reinsurers have challenged underwriting approaches taken, which force accountability on direct insurers in way that has not been seen previously in Australia and is more akin to practices in the USA.

In the current environment, underwriters have been required by Lloyds and/or management to assess their portfolios. Lloyds is an insurance and reinsurance market located in London, consisting of financial backers known as syndicates. Underwriters are now faced with a decision to either correct the portfolio and accounts that are under-priced or to which they are overexposed. Many of the insurers need to receive a minimum dollar amount per quantum of capacity offered. Like other businesses, Lloyds are experiencing increased internal costs and increased costs of reinsurance. Coupled with the impacts on their businesses and claim events, these costs are pushing up the minimum price per million dollars of cover insurers are willing to accept.

The liability premium is forecast using projected insurance market rate change in conjunction with projected changes in Evoenergy's revenue, to provide an overall commercial Insurance premium per year for the regulatory period.

It is important to note that the placement/program structure can significantly vary year by year as insurer appetite, capacity, and pricing changes. This could adversely impact overall policy limits available to Evoenergy in the future. The projections assume capacity will be purchased to the extent it is commercially reasonable to do so.

The projections below are based on the following assumptions:

- Expectations of market rate change
- No material changes to Evoenergy's risk profile
- No additional significant losses to the liability program
- No significant bushfire or electricity network related event in Australia
- No further significant deterioration in the global insurance market, and
- Growth in the amount of Evoenergy's revenue will also contribute to the cost of Liability insurance, which is projected to grow 2% YoY.

Results

In relation to ActewAGL Liability insurance, Marsh projects that insurance premiums will change over the forthcoming regulatory period, as shown in Table 4.

Table 4 ActewAGL Joint Venture's projected Liability Insurance premium changes

Year	FY25	FY26	FY27	FY28	FY29
General Liability YOY (%)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Therefore, allowing for premium excluding GST, Marsh projects that ActewAGL cost of Liability insurance will increase, as shown in Table 5.

Table 5 – Evoenergy's projected Liability Insurance premium movement ($nominal)

Year	FY25	FY26	FY27	FY28	FY29
Liability Premium Movement YoY ($)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

We have assumed no change to the current policy limits.

Directors & Officers Liability (D&O)

Summary of Insurance Cover

[redacted]

[redacted]

Basis of Premium Projection

The pace of rate increases slowed significantly by the end of CY21 as insurer competition and the supply of capacity increased due to improved insurer profitability, new D&O insurer entrants, and D&O buyers seeking lower limits.

There exists variation in insurer rating dependent on historic pricing, industry segment, insurer portfolio profitability and strategy.

Some risks are still attracting a double-digit premium increase, including heavy exposure to COVD-19.

Results

In relation to ActewAGL's insurance, Marsh projects that premiums will increase, as shown in Table 6.

Table 6 – ActewAGL Joint Venture's projected D&O Insurance Premium changes

Year	FY25	FY26	FY27	FY28	FY29
General D&O YOY movement (%)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Marsh projects that Evoenergy's cost of D&O insurance will increase over the forthcoming regulatory period, as shown in Table 7.

Table 7 – Evoenergy's projected D&O Insurance Premium movement ($nominal, excluding GST)

Year	FY25	FY26	FY27	FY28	FY29
General D&O YOY Premium change ($)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Cyber Liability Insurance

Cyber Liability Summary of Insurance Cover

[redacted]

Basis of Premium Projection

Cyber liability insurance has significantly increased since FY21 due to poorer insurer profitability as a result of a drastic increase in claims. Insurance claims have predominantly involved extortion and ransom demands, which many new entrants into the market did not fully anticipate. The increased claims activity resulted in a reduction in available capacity with several insurers pulling out of the market or reducing available limits.

The deteriorating loss ratios have led to corrective actions, such as limiting capacity and co-insurance requirements to maintain portfolio profitability. Insurers are actively looking to manage capacity and apply higher retentions (dollars and time) in addition to narrowing coverage terms.

Results

In relation to ActewAGL's insurance, Marsh projects that premiums will increase, as shown in Table 8 and 9.

Table 8 – ActewAGL Joint Ventures's projected Cyber Liability Insurance Premium changes

Year	FY25	FY26	FY27	FY28	FY29
Cyber YOY movement (%)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Marsh projects that Evoenergy's cost of Cyber Liability insurance will increase over the forthcoming regulatory period, as shown in Table 9.

Table 9 – Evoenergy's projected Cyber Liability Insurance Premium movement ($nominal, excluding GST)

Year	FY25	FY26	FY27	FY28	FY29
Cyber YOY Premium change ($)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Other Insurance Classes

As described in the Executive Summary, Evoenergy procures other classes of insurance including:

- Motor Vehicle
- Corporate Travel
- Voluntary Workers
- Employment Practices Liability
- Statutory Liability
- Crime

These policies combined represent a smaller proportion of Evoenergy's overall insurance premiums.

Other classes of insurance will continue to see increases over the coming years at varying levels. Those classes within insurers' portfolios that have experienced high claims activity will see larger increases year on year. Motor Vehicle insurance is likely to continue to increase due to the cost of parts and supply chain delays. Corporate Travel is also driven by the number of trips domestically and internationally. In addition to market movement, if the numbers of trips increase, this will impact the premium.

Table 10 – ActewAGL Joint Venture's projected "Other Insurance Classes" insurance premium rate movement

Year	FY25	FY26	FY27	FY28	FY29
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Marsh projects that Evoenergy's cost of "Other Insurance Classes" insurance will increase, as shown in Table 11.

Table 11 – Evoenergy's projected "Other Insurance Classes" insurance premium movement ($nominal)

Year	FY25	FY26	FY27	FY28	FY29
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]					
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Consolidated Premium Table FY23 to FY29

Evoenergy Insurance Premiums

Table 12 – Evoenergy's forecast annual General and Financial Lines Insurance Premiums for various insurance classes from FY23 to FY29 ($nominal, excluding GST)

[redacted]

Table 13 – ActewAGL Joint Venture forecast annual General and Financial Lines Premium / Rate % Movement Year on Year from FY23 to FY29

[redacted]

Any differentials to the forecast percentage increases shown in Table 13 and premiums shown in Table 12 are due to Evoenergy's Cost Allocation Methodology (CAM), and holding Evoenergy's asset base constant (that is, no growth in insured assets).

Insurance Market Overview

We are currently in the "Hard Market" section of the insurance market cycle (as illustrated), characterised by increasing premiums, selective underwriting, and shrinking capacity is being witnessed on all accounts.

It is not only the cost implications of premium increases. Insurers are also cutting back on coverage enhancements and generous sub limits offered during the soft market phase as they fight to maintain market share in a competitive environment.

It is difficult to predict when the market will move to a transition phase and back towards a Soft Market. It will require sustained profitability of insurers' property portfolios over the next couple of years before they have the confidence to push for growth and market share (thus increasing competition). However, it is not expected that the escalation of rate increases over the past four years will continue at the same pace. Considerable pricing correction has already occurred, and rates should be approaching a more sustainable level. However, the persistent occurrences of significant natural catastrophe events in Australia create substantial volatility and make profitable underwriting challenging for insurers and reinsurers.

The alignment to technical underwriting models, used to justify pricing, terms and capacity, has weighed heavily on property insurers. This has led to limited competition in the market. Overlaid in this process is referral underwriting, where underwriters who were previously empowered to make their own decisions must now refer to their respective head office committees. This process places less emphasis on insurers' prior history and relationships with buyers, favouring an approach that is rooted in technical adequacy and profitability for underwriters.

Notable coverage trends occurring in the current Hard Market include:

- Scrutiny by insurers in policy coverage with attention to removal and limitation of cover for infectious diseases, civil authority intervention, construction, and cyber. The property insurance industry has provided at least some level of coverage for fire, explosions and machinery breakdown which result from a "computer virus" however, due to the rise in frequency and severity of such events, the industry has looked to remove coverage for any loss or damage that occurs from malicious cyber activity.

- Business interruption extensions, including non-damage triggers for customers and suppliers and public utilities (gas, electricity, and water) exposures, are being more rigorously tested for validity and geographical scope.

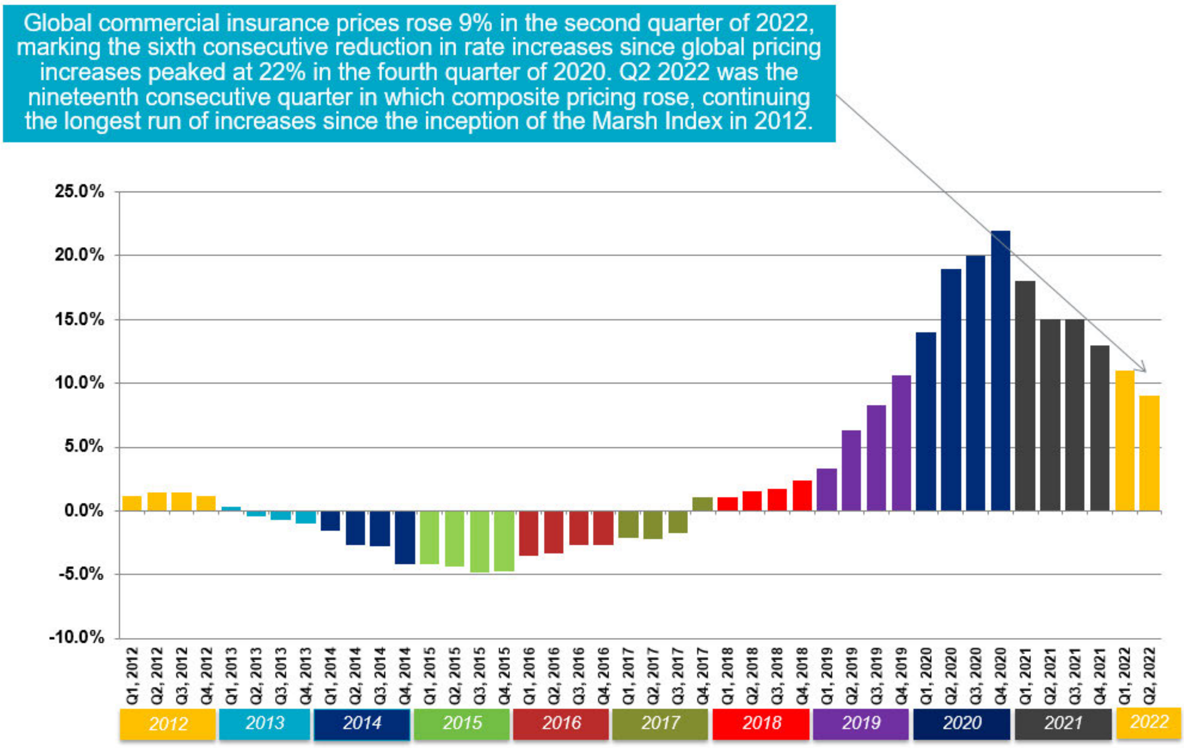
- Natural catastrophe limits are also being reviewed/reduced and imposed for bushfire, wind, flood and hail, along with aggregated limits.

- Declared material damage values are a subject of focus, as insurers seek validation of accuracy and how current they are. In some cases, if valuations are more than three years old, insurers are applying underinsurance clauses (coinsurance/ average) as a penalty to insureds where the percentage of under-declaration is deducted from the loss. This imposition is only removed once insurers are able to sight recent valuations.

The overall presentation of risk is imperative, particularly when reviewing engineering reports. The positive attributes of risk such as fire protection, preventative maintenance, asset monitoring and business continuity plans etc. Can help underwriters differentiate and articulate clients' continued focus on risk management. In respect of capacity, whilst most insurers' individual capacity has shrunk, there remains sufficient market capacity for most risks utilising a larger panel of insurers. However, obtaining that extra capacity to complete placements often sees the program being "split rated" as those insurers previously left off the program due to higher pricing requirements now needed.

The chart below shows the **Global Insurance Composite Pricing Change** over a 10 year period. It notes the extreme acceleration of rate increases across all classes of insurance. The level of increases are moderating but there is still increases being applied generally.

Figure 3 - Global Insurance Composite Pricing Change



Australian Insurer Underwriting Results

Below are a sample of the announcements made by Australian domiciled major insurers:

- **QBE** reported (for Year Ended 31/12/21) profit of USD750m compared a loss of USD1.517bn in 2020. The CEO noted: "In targeting ongoing premium growth, we will remain vigilant in pricing adequately for an appropriate risk-adjusted return on capital, with claims inflation, catastrophe costs and overall portfolio volatility key areas of ongoing focus."

- **Suncorp** reported a FY22 insurance net profit of $174m considerably **down** on $547m in FY21. This was attributed to intense **natural hazard season** and volatile financial markets.

- **IAG** saw Gross written premium increase by 5.7% due to rate increases and improved customer retention. However, their insurance margin was **down** from 13.5% to 7.4% to due higher than forecasted **NAT CAT losses** and increasing reserves from prior year losses. However, the reported profit was much improved at $347m compared to last year's loss of $427m.

See below data released by APRA in on 25 August 2022. It shows premiums were up significantly and outpaced the increase in claim costs leading to improved loss ratio (72% down to 62%). However, the overall Net Profit of industry was flat due to a $2.8 billion investment loss which according to APRA was due to "unrealised losses on interest-bearing investments due to increases in bond yields during the March and June quarters". Insurers have earned less than 4% Annual Net Profit margin over the past three years.

Figure 4 - Global Insurance Composite Pricing Change

	June 2021	June 2022	Change (annual)
Gross earned premium	$54.3bn	$60.4bn	11.4%
Gross claims expense	$42.4bn	$45.2bn	6.6%
Underwriting result	$1.5bn	$6.3bn	328.4%
Investment income	$1.6bn	$-2.8bn	-
Net profit after tax	$0.9bn	$0.9bn	0.3%

	June 2021	June 2022	Change (annual)
Net loss ratio	72%	62%	-10 percentage points
Return on net assets	3.2%	3.1%	-0.1 percentage points
Prescribed capital amount coverage ratio	1.70x	1.69x	-0.01x

Chart 1: Profitability

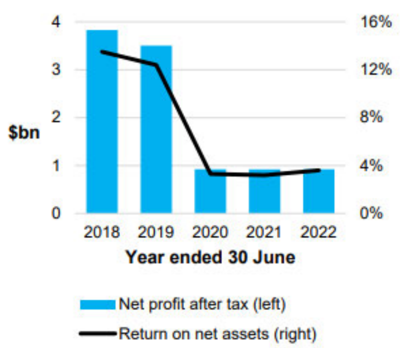


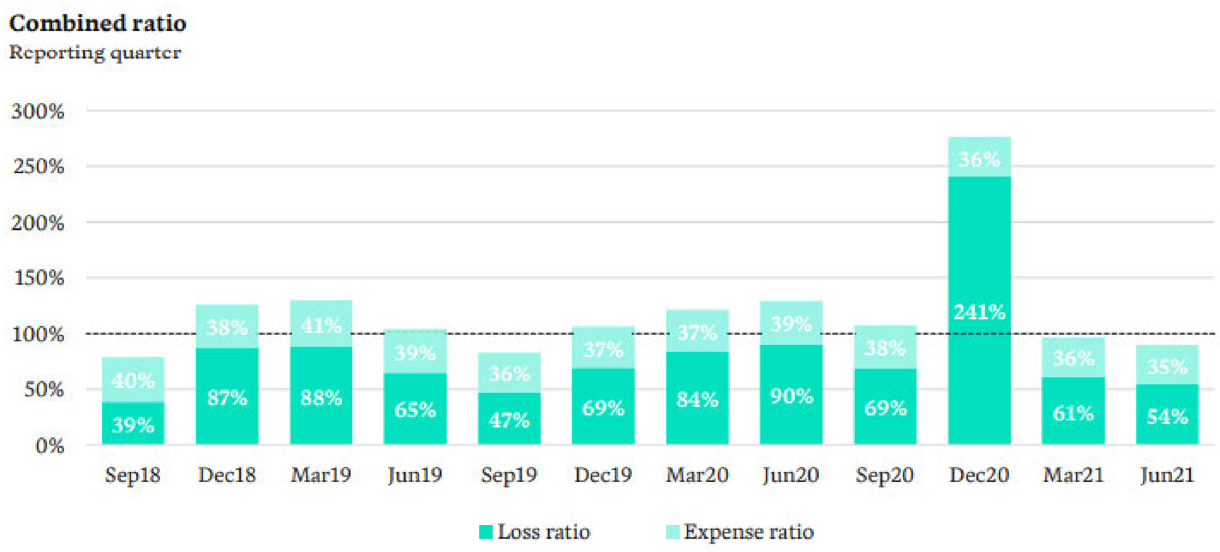
Chart 2: Major Profit Components

Source: Australian Prudential and Regulatory Authority, General Insurance Statistics for June 2022

Australian Commercial Property

The following chart shows that the Commercial Property market in Australia has been non-profitable in 8 of the 12 quarters in the period September 2018 to June 2021. It illustrates the **Combined Ratio** (claims plus expenses divided by premium) of those insurers regulated by the Australian Prudential and Regulatory Authority.

Figure 5 – Quarterly Combined Ratios for Insurers regulated by the Australian Prudential and Regulatory Authority (APRA)

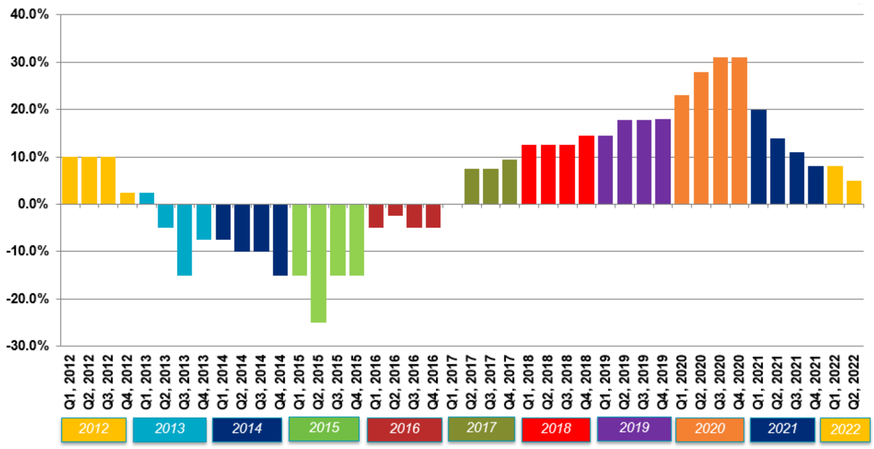


Source: Taylor Fry RADAR 2021

Whilst the insurer expense ratio (commissions paid to agents / brokers, direct costs and overheads) associated with Commercial Property has reduced marginally over the past couple of years, the portfolio still requires a loss ratio better than 65% to return a profit. However, this analysis does not account for the investment income earned by insurers from premiums paid. The analysis above is purely their underwriting result.

The below chart illustrates 10 years of **Property** rate movements in the Pacific. The cyclical nature of market is clearly illustrated. It should be noted that these are property rate movements. The chart does not reflect actual premium increases which would be substantially higher once declared values are adjusted for inflation.

Figure 6 – Pacific Property Rate movements over 10 years



Global Property
Power & Utility Markets

2022 has been marked by some challenging and complex market dynamics driven by inflation, climbing interest rates, and heightened climate concerns. Despite this, we have continued to see a gradual tapering of rate increases during the second quarter for well risk-managed, loss free risks with minimal natural catastrophe (Nat Cat) exposure.

With the London power market significantly recalibrating over the last two and a half years, many underwriters started the year looking to push line size and grow their book on target accounts. Cases of oversubscription buoyed by capacity from international markets have now become more commonplace, driving competition and further flattening out rate uplift; and in certain specific cases even securing rate reductions.

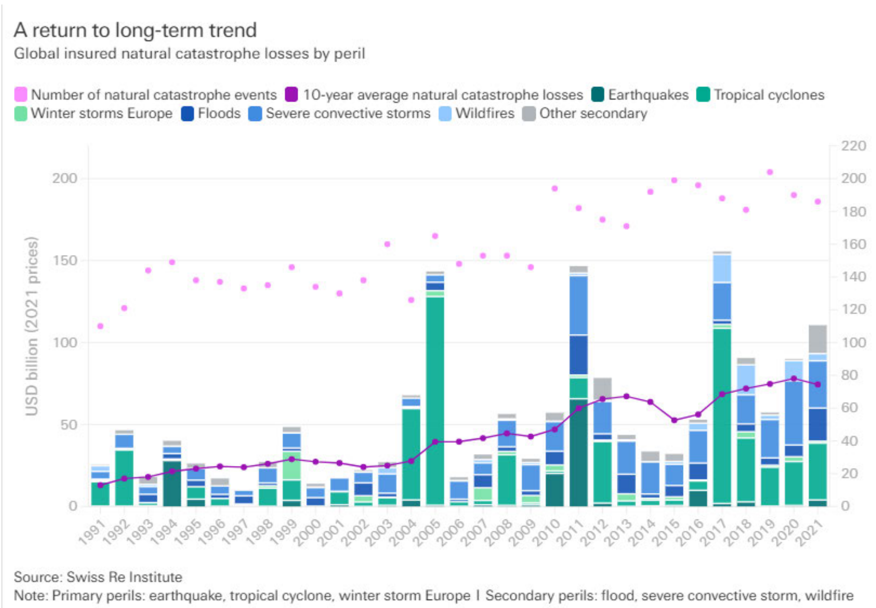
In balance to this, however, where competitive tension cannot be achieved, due to risk quality, Natural Catastrophe exposure, or claims experience, markets have continued to apply robust rate increases. Overall, average rate expectations remain in the single digits.

A clear trend in the market has been the pressure seen from the current inflationary environment. Insurers expect to see demonstrable updates to insured's property values and, where they feel these are out of step with current trends, will instead build increases into their pricing models accordingly. Further compounded by this are the issues around increased labour costs and global supply chain management, leading to a stretching of lead times, greater business interruption volatility and ultimately an increase in the quantum of claims. In consequence, underwriters have found these global economic factors to be a firm footing from which to push back from, citing the increase in associated claim costs as a key driver behind the need to maintain applied rate and focus on tightening terms and conditions, with one prevalent item being the application of caps for Business Interruption.

Natural Catastrophe

Catastrophic losses continue to dominate insurer concerns about pricing sustainability. Please refer to the chart below which shows catastrophe losses over the past 50 years. It illustrates the more frequent and higher value catastrophe losses. 2021 is estimated to be USD119bn, the fourth highest on record and well above the USD83bn 10 year average.

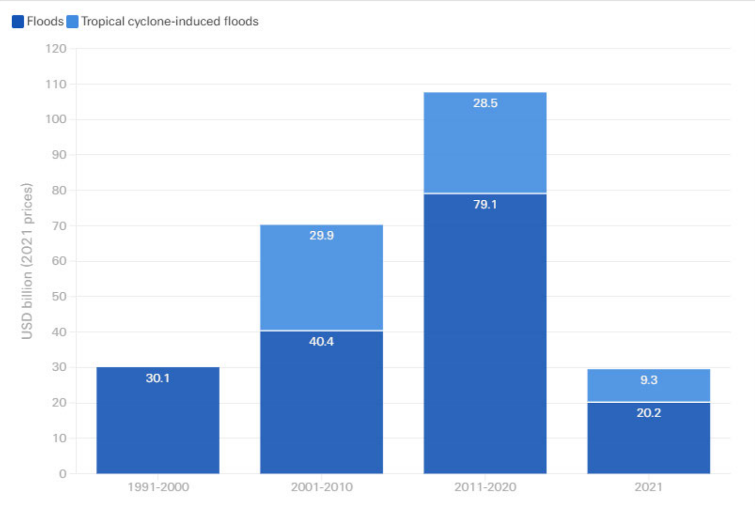
Figure 7 – Global Catastrophic losses over 50 years



Source: Swiss Re Institute – 30 March 2022

As shown below, there has been an upturn in flood losses over the past twenty years with 2021 being as much as the entire decade from 1991 to 2000:

Figure 8 – Global Flood losses



Source: Swiss Re Institute

Global Insurer Underwriting Results

Like insurers domiciled in Australia, the major international insurers have also had challenges with their Combined Ratios. Only a few insurers were able to generate an underwriting profit in 2020 however all had swung to profit in 2021 with premium increases outpacing the growth in claims.

Figure 9 – Insurers Combined Ratio Performance

	Swiss Re Corporate Solutions	Allianz	Chubb	AIG	Zurich	XL Group	FM Global	QBE	HDI	Lloyd's
2021	90.6%	97.5%	85.5%	91%	94.3%	97.1%	83.1%	91.5%	94%	93.5%
2020	122.6%	117.2%	101%	103.7%	99.8%	101.7%	92.5%	109.5%	104.6%	110.4%
2019	107.8%	112%	90.6%	99.8%	96.4%	96.4%	81%	97.5%	104.9%	102.1%
2018	118%	102%	91%	115%	98%	99%	129%	95.7%	113.7%	104.5%
2017	133%	105%	95%	113%	101%	108%	130%	104.5%	112.6%	114%

Source: Marsh Pty Ltd

Figure 10 provides a snapshot of Pacific Pricing, where insurance pricing in the Pacific region increased 5%, continuing an upward trend that began in 2015, although it was the third consecutive quarter in 2021 which the rate of increase slowed (see Figure 26 and 27)

Figure 10 – Global Insurance Market Index – Pacific composite insurance pricing change

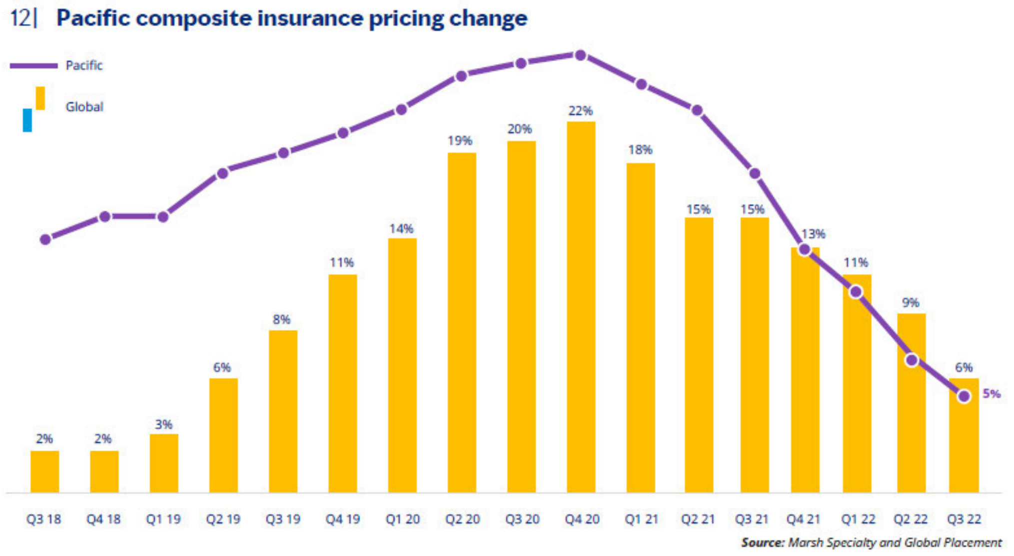
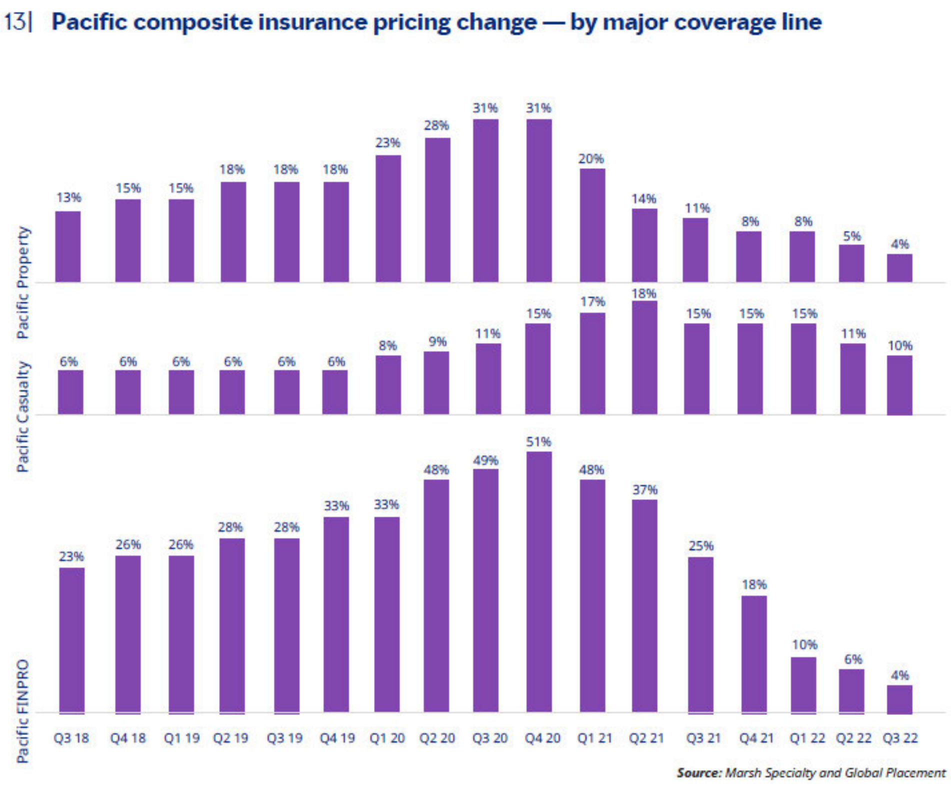


Figure 11 - Global Insurance Market Index – Pacific composite insurance pricing change by major coverage line

The following chart shows the movement in Property, Casualty and Financial Lines rates over the past four years.



Property insurance pricing increased 4%, down from 5% in the prior quarter. Current estimates suggest AU5-6 billion market loss from the New South Wales and Queensland floods curtailed any pricing relief expected for the start of 2022.

- Challenges have increased for risks in Catastrophe zones, with flood a particular concern. Clients experienced an increased underwriting focus on CAT sub-limits, including contingent business interruption, deductibles, and risk mitigation.

- Severe flood events in Queensland and New South Wales earlier in the year — with an estimated insured loss greater than $AUD6 billion has increased the focus on storm/flood risk mitigation, deductible adequacy, and sub-limits.

- Client's commitment to continual risk improvement is critical to renewal success. Insurers also focused on current valuations supporting declared values.

Casualty increased at 10%, down from 11% in quarter two. Pricing remained challenging, and due in large measure to claims inflation and reduced capacity from some major carriers. Risk selection continues to be more pronounced than in previous quarters.

- Changing underwriting appetite continues to spur substantial restructuring of layers for some major programs.

Financial and professional lines pricing rose 10% in the first quarter of 2022, Q3 2022 has seen increases reduce to 4%.

- D&O pricing continued to decline; other financial and professional lines pricing increase continued to moderate.

- Competition continued to develop, particularly for excess layers, resulting in improved pricing.

- Professional indemnity premiums again increased as capacity continued to tighten.

Cyber risk insurance remained challenging, mainly due to frequent and severe ransomware losses that put pressure on pricing and deductibles and brought a marked reduction in capacity and narrowing of key coverages.

Figure 12 provides a snapshot of **UK Pricing**.Q2 2022 saw an average increase of 7%, in comparison to Q3 2022 at a 9% increase.

Figure 12 – Global Market Index, UK composite insurance pricing change

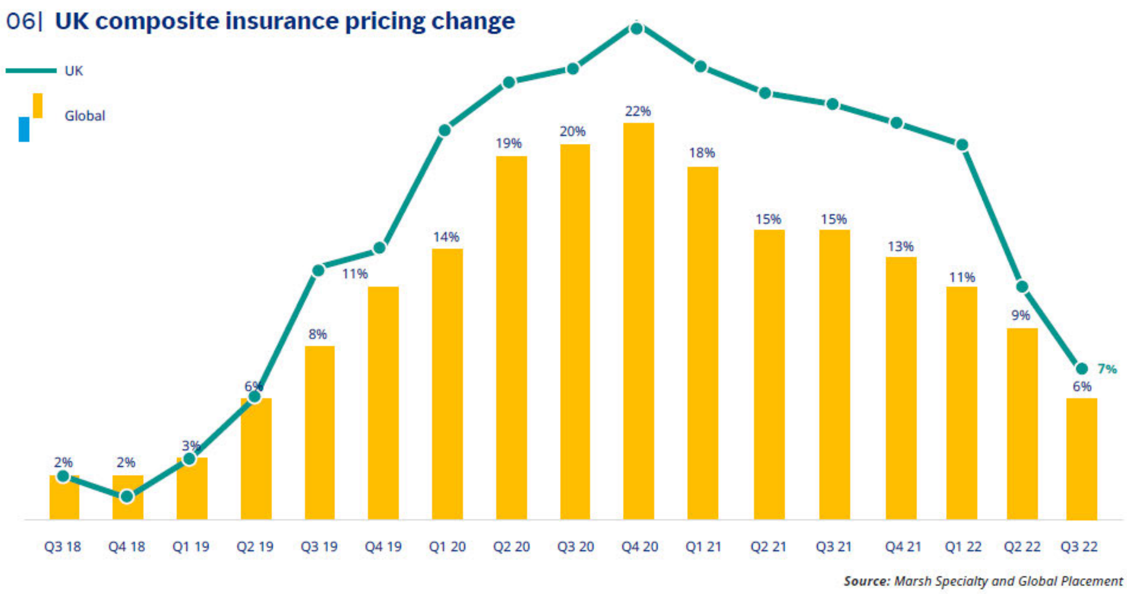
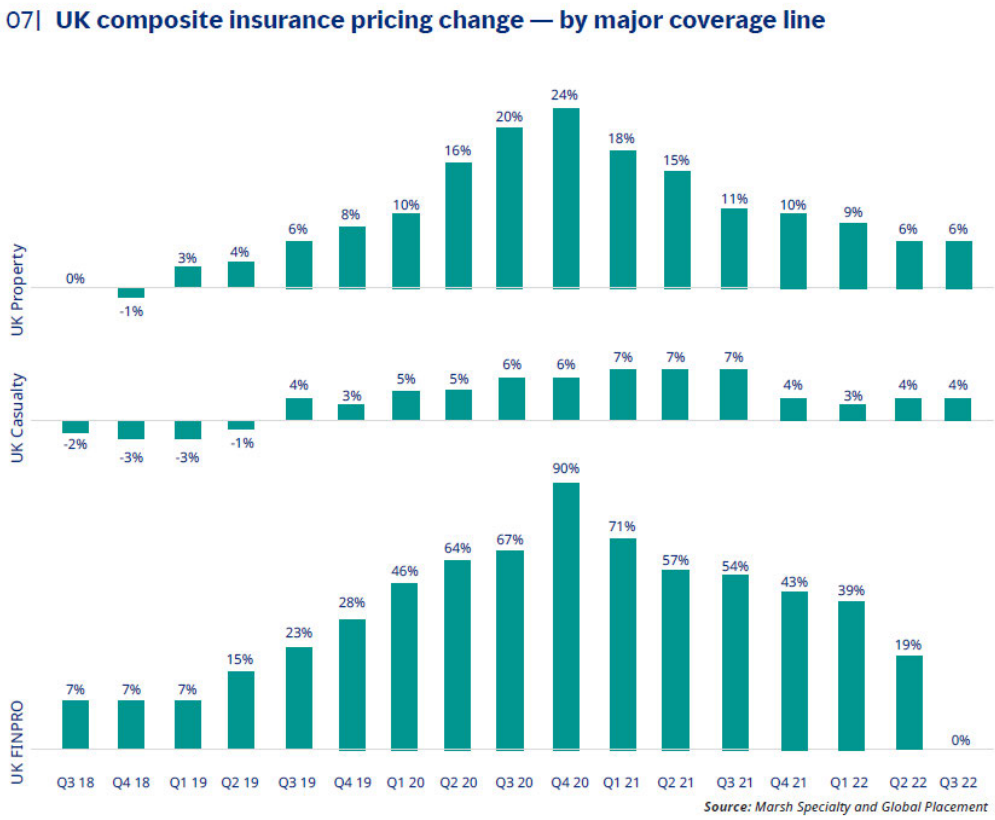


Figure 13 – Global Market Index, UK composite insurance pricing change by major coverage line



Property insurance pricing increased 6% year-over-year, the same as in the second quarter. Property insurance pricing continued to plateau, and was generally less volatile for clients.

- Property insurance pricing remained competitive for low- to medium-hazard industries, and more challenging for higher hazard industries or risks with major loss activity and/ or a challenging occupancy or process, such as food production, warehousing, or waste recycling
- Insurers focused on claims inflation trends by increasing pricing if exposure bases were not, in their view, appropriately assessed.
- As reinsurance treaty renewal season started, Hurricane Ian served underwriters in maintaining pricing discipline.

Casualty insurance pricing increased by 4%, the same as the second quarter.

Rates remained competitive for employers' liability and public and product liability for clients considered to have attractive risks, despite inflationary pressure.

- Exclusionary language created challenges and was increasingly viewed as a competitive edge as clients chose an insurer.
- Inflation played a significant role in renewal discussions
- Electric vehicles continued to affect the auto liability insurance market, with leading insurers saying that damage repair costs are approximately 25% higher for EVs than for cars with internal combustion engines.

Financial and professional lines pricing was flat in the third quarter compared to average increases of 19% in the second quarter. Some classes of insurance experienced a decline in rate.

- D&O pricing typically declined in the 5% to 10% range, with substantial rate decreases for large, multinational clients.

- Crime insurance capacity remained limited following the market's abrupt contraction over the past two years, which saw many insurers withdraw altogether.

Cyber insurance pricing increased 66% in the third quarter, continuing the moderation trend of the past several months, as losses continued to improve.

- The market experienced continued pricing stabilization following a peak increase of 102% year-over-year in the first quarter of 2022.

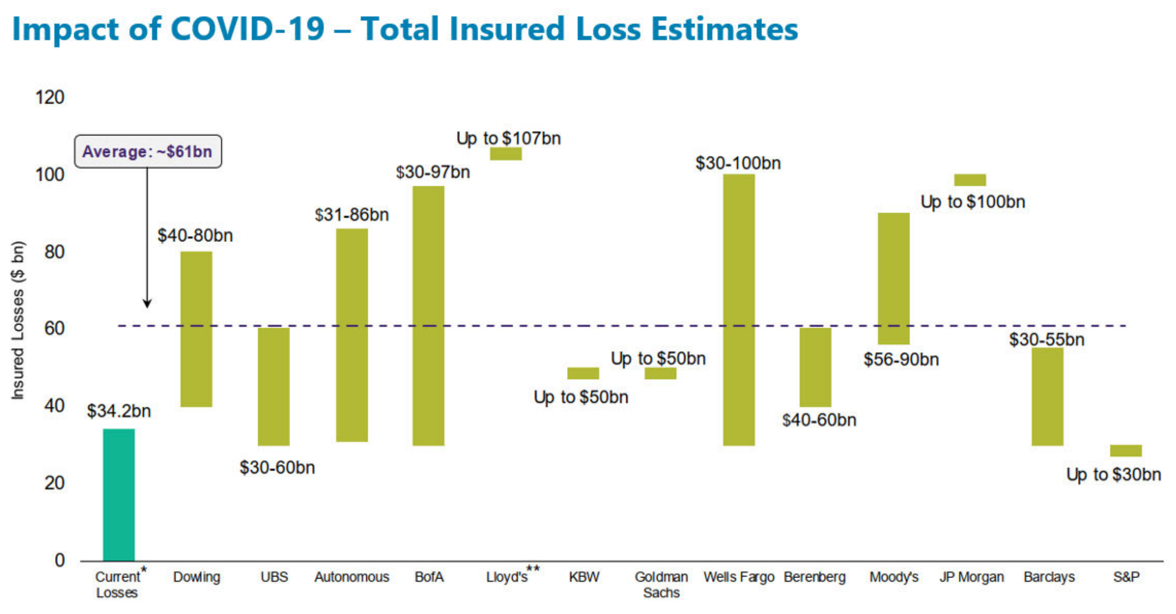
- Strict requirements from insurers regarding key cybersecurity controls continued to positively change underwriters' views on cyber hygiene at the majority of insureds compared to 2021 and before

- We are cautious regarding the improvement in cyber insurance market conditions as other factors could compound the risk. For example, the Russia-Ukraine conflict may have temporarily paused ransomware attacks by disrupting the many cyber hackers based in the region.

COVID-19

The true impact on the industry is still unknown as multiple jurisdictions deal with courts cases between insureds and insurers. Many organisations must quantify the global insured losses. Figure 29 shows the impact of COVID-19 has averaged $61bn up until February 2021.

Figure 14 – Impact of COVID-19 – Total insured loss estimates



Note 1: * Represents the consolidated COVID-19 losses reported in company earnings releases, as of 12 February 2021.
Note 2: **Lloyd's estimate is for underwriting losses from COVID-19. This includes claims as well as anticipated lower profits due to lower premiums.

Source: Dowlings, Autonomous Research, Barclays, Bank of America, KBW, UBS, Lloyd's, Wells Fargo, Goldman Sachs, Berenberg, Moody's, JP Morgan; Updated as of 12 February 2021

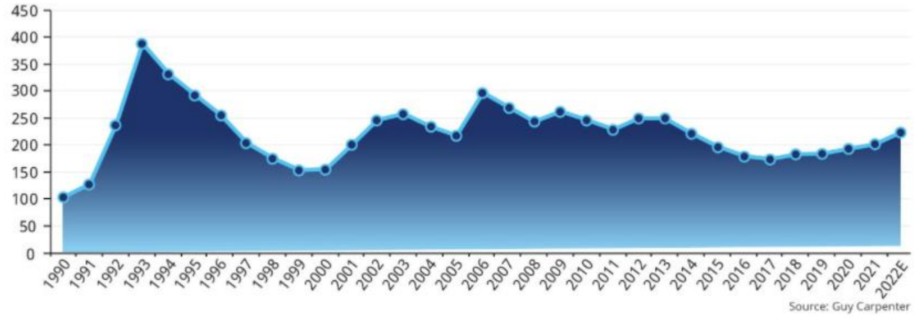
Global Reinsurance

On 1 January 2022, many global reinsurance programs were renewed. COVID-19 related claims, notable natural catastrophe losses, pressure on liability lines fuelled by social inflation, and low interest rates all helped spur price increases across the board.

Global risk-adjusted property catastrophe reinsurance rates on-line **rose by an average of 9% (up from 6% in 2021)**, reflecting the biggest year-over-year increase since 2009, according to research by Howden.

The Guy Carpenter Global Property Catastrophe ROL index was **up 10.8 per cent year on year**, at 1 January 2022. This is up from 4.5% in January 2021. The index is a measure of the change in dollars paid for coverage on a consistent program basis and reflects the pricing impact of a growing (or shrinking) exposure base, evolving methods of measuring risk and changes in buying habits, as well as changes in market conditions. While pricing exhibited a wide range on a risk-adjusted basis, non-loss-impacted business was generally flat to up 7%, with loss-impacted up 10% to over 30%.

Figure 15 – Guy Carpenter Global Property Catastrophe Rates On Line



Liability including Bushfire Liability

Due to significant capacity withdrawal from the sector, there has been a substantial reduction in bushfire liability capacity, with such capacity offered at a significantly higher cost. The loss capacity is due to several factors, including:

- Increased wildfire/bushfire activity locally and globally (see bushfire claims examples later in this report), with insurer's unfavourable perceptions of this risk compounded by:
    i. Bushfire activity in Australia during the 2019/20 bushfire season
    ii. The fact that five of California's six largest fire events since 1932 were recorded in August and September of 2020 alone
- Non-fire related casualty losses being experienced locally and globally (particularly in the mining sector)
- Continued consolidation of insurers through merger and acquisition activity
- Increased focus by insurers on overall capital deployment, and
- Closure of Lloyds Syndicates and changes in insurer appetite.

We consider each key global market below.

Australian Markets

All markets are reviewing pricing, attachment points, terms and involvement as demonstrated by key markets (HDI and AXA XL) that significantly reduced their exposure to bushfire liability in recent years whereby:

- HDI reduced their overall capacity offering by circa 30% (up to $35m reduction in capacity offered by this market);
- AXA XL reduced their overall capacity offering by circa 35% (up to $25m reduction in capacity offered by this market);
- Allianz Global Corporate and Specialty have ceased writing long tail business entirely in Australia. They were a large capacity provider (up to $100m) on utility risks;
- Zurich and Vero have ceased writing bushfire Liability and, in some cases, broader energy risks; and
- AIG Australia is no longer writing bushfire liability. Australian clients can seek to access capacity through AIG Europe only, with an estimated maximum capacity of $30m available per client (total capacity from AIG Australia/Europe in 2019 was $75m+).

Other markets are seeking pricing increases up to 300% reflecting the volatility in this market segment.

London Markets

The Casualty market is still perceived by insurers as in need of corrective action to reach their perceived 'rate adequacy'.

This is reinforced by Casualty being the only class that continued to be loss making according to Lloyd's 2021 results, and by continued concerns of social inflation pushing up loss costs.

There has been no significant new entrants into this sector, nor any meaningful increases in capacity of existing participants, meaning for large limit towers, there are very little alternative options. This is especially true in primary layers; however, we are starting to see some competition in excess layers where total limits purchased are less than the maximum working capacity in the market.

There is growing momentum in the market for new exclusions around Climate Change and expanding 'Toxic Substances' exclusions to include amongst other things per-fluoroalkyl and poly-fluoroalkyl substances (PFAS).

On the back of the argument that rate adequacy has not yet been achieved in this sector, Insurers are still looking to push for rate increases. The market is looking for around plus 10% in the International space (non-US, including Canada) but decreases have been achieved when different layering / deductible structures have been proposed. Accounts with US exposure are paying around plus 15%.

Wildfire, Social inflation, US Auto court awards, and PTSD Class actions remain a concern for the market, as losses from these exposures continue to manifest themselves.

[redacted]

Tokio Marine Kiln is reluctant to offer any capacity on certain bushfire risks, resulting in pricing increases of over 200%. However, recent renewals indicate the increase have remained in place but not to the extent they were in 2021.

Many syndicates have a reduced appetite for new business as they are obtaining increases / growth from existing business written within their quota. Their sentiment is to underwrite existing business profitably, and therefore obtaining new capacity is very challenging

Where capacity is offered, pricing is increasing with some markets being opportunistic

Bermudan Markets

Capacity remains in Bermuda, however it comes at a punitive cost.

Bermuda insurers also utilise their own policy form (i.e. terms and conditions), which is generally more restrictive than the terms of cover from existing insurers.

Bermuda markets looking to substantially cut back their capacity (many from USD 100M to USD 25M) has been largely dealt with over the last 2-3 years, with most markets now willing to offer the same capacity they offered last year. However, adverse claim activity or pricing ambitions at renewal out of step with the broader industry segment can at times be significant enough reasons for markets to review / alter their participation on an account.

The Bermuda market is still seeing increases in the 10-20% range within the Energy & Power industry segment, with underlying pricing achievements / outcomes playing a role in their decision making process

Key considerations are year-on-year exposure changes from an asset base perspective, existing claims maturation, new claims activity, changes to underlying terms and conditions, and any shifts in program structure.

The following are hot topic items for Bermuda Energy & Power Casualty insurers, and Insureds should be prepared to discuss these in the lead up to their renewals.

- ESG Initiatives / Global Warming / Net Zero
- Asset Integrity / System Hardening programs (severe weather events)
- PFAS

- Auto Exposure
- Wildfire (especially location of solar assets)
- Operations in Russia / Belarus / Ukraine

Chinese Markets

While Chinese markets are continuing to expand their geographic footprint, particularly for Chinese connected business, capacity is still not being deployed in any significant way for casualty risks for non-Chinese owned businesses.

International Liability Reinsurance Treaties

There was continued positive underlying rate movement across casualty lines which factored heavily into renewal outcomes, as prospective loss ratios showed continued improvement

Another important consideration in reducing loss projections is ongoing underwriting discipline by insurers. Factors include limits management and tighter underlying policy terms and conditions. Casualty capacity was generally sufficient. However, outcomes ranged widely based on casualty line and capacity requirements.

Financial lines benefited from the healthiest reinsurer appetite, with cyber aggregate being the most challenged.

Source: Guy Carpenter January 2022 Reinsurance Renewal Briefing

Feedback form the recent 1 July reinsurance treaty renewals in Australia show that prices increased +1% to +5% for portfolios with “no loss emergence” and +10% to +20% for portfolios with “loss emergence”. For those treaties without loss emergence, increases followed underlying exposure growth and inflation.

Many buyers continue to evolve their position on silent cyber, with a more disciplined underwriting approach applied to all cyber risks welcomed by reinsurers

Source: Gallagher Re 1st View, 1 July 2022

Summary

In summarising the market conditions, we estimate that **well over $500m in capacity has exited the Bushfire Liability sector since the beginning of 2019.** In today’s market, insurers are scrutinising and revising their pricing models, with a much greater focus on adequacy of ‘pay-back’ period. This is resulting in upward pressure on premium outcomes, and downward pressure on overall policy limit for insureds in the sector.

Bushfire Claims Examples

Bushfire is not a hazard or phenomenon that is unique to Australia. In recent times, major bushfires/wildfires have occurred throughout the world, including in North America (with frequency in California), France, Germany, Greece, Indonesia, Italy, Poland and Russia. The consequences are typically measured in terms of hundreds or thousands of buildings destroyed, number of lives lost, and millions of dollars in property damage and resources spent fighting the fire.

The most recent 2019/20 bushfires in Queensland, New South Wales, Victoria, South Australia, Western Australia and the ACT, have captured attention globally. Insurers have monitored the impact and the size and scale of the associated losses. In addition to utilities related liability losses, estimated insured property losses arising from the 2019/20 bushfire season now stand at $2.32bn.

While there have been a large number of bushfire losses over time in Australia, and there has been increased bushfire activity recently, the largest bushfire events from an insurance perspective (excluding the 2019/20 bushfire events) have included:

- Cudlee Creek and Yorktown fires (SA) in 2019. These fires burnt approximately 25,000 hectares including nearly 100 homes. Overall losses are still to be determined and a class action lawsuit has been issued.

- St Patricks Day Fire (VIC) in 2018, which burnt 400 km2 of land in Victoria's south-west farmland, wildlife reserves and property. Overall losses stand at $22.5m.

- The Black Saturday Fire (VIC) in 2009, which burnt 4,500 km2 of land, killed 173 people and destroyed some 2,000 homes. Overall losses A$1.7bn, insured losses A$1.07bn (in original values).

- The Ash Wednesday Fire (VIC/SA) in 1983, which burnt 5,200 km2, destroyed some 2,400 homes and killed 75 people. Overall losses A$335m, insured losses A$176m (in original values).

- The Tasmanian Black Tuesday Fires (TAS) in 1967, which burnt more than 2,600 km2 , destroyed some 1,400 homes and killed 62 people. Overall losses were A$35m, insured A$14m (in original values).

- The Black Friday Fire (VIC) in 1939, which burnt almost 20,000 km2, destroyed more than 700 homes and resulted in 71 fatalities.

The increase in frequency of bushfire events is contributing to a more selective approach from insurers in relation to where they will provide capacity, how much capacity they will provide, and the cost of that capacity.

Notable bushfire events outside of Australia have included:

- March 2010: Western Russia — several hundred individual wildfires caused an estimated US$15 billion in damage.

- May 2016: Alberta, Canada — The Fort McMurray Wildfire destroyed at least 2,400 homes and buildings. With estimated losses of around CDN$4 billion, it is the costliest disaster in Canadian history.

- November 2018: Butte County, California, US - The Camp Fire was the deadliest and most destructive in California history. It caused at least 86 fatalities and destroyed 18,804 structures. It was also the world's costliest natural disaster in 2018 and is the most destructive wildfire in history with total damage of US$16.5 billion.

- 2020 West Coast Wildfires: well over 2 million hectares have burned across California, Oregon, Washington State and neighbouring Idaho. Tens of thousands of people were forced to leave their homes and at least 27 people have died. At this early stage, the cost of these fires is expected to be similar to the 2018 California fires

Whilst catastrophic bushfire events such as those above gain attention globally, frequent 'smaller' bushfires events overseas still generate substantial losses to the insurance market (just as the smaller bushfire events do in Australia).

Insurers participating at primary layers of bushfire liability risks across Australia have been, and continue to be, significantly out of pocket as a result of bushfires over recent years, with insurance pay outs exceeding the premiums they have received by several fold. To quantify this, across the industry over the last decade or so, insurers participating at the lower attachment points on Australia electricity utility accounts have experienced claims incurred costs (i.e. actual and forecast pay outs) in the vicinity of $100 million across the sector versus premiums received of circa $25 million. The difference of approximately $75 million represents a material loss for these insurers which is not sustainable. This factor is a key contributor in the material re-rating of bushfire liability pricing.

Furthermore, the insurance market is at a level that, should another severe bushfire event occur, significant reductions in capacity will occur (on top of the reductions to date) such that limited capacity will be available, with such available capacity coming at a substantially increased cost.

Cyber

The cyber insurance market is experiencing a severe transitional period in 2021, with rates increasing more than 60 %, capacity decreasing, and underwriting scrutiny increasing.

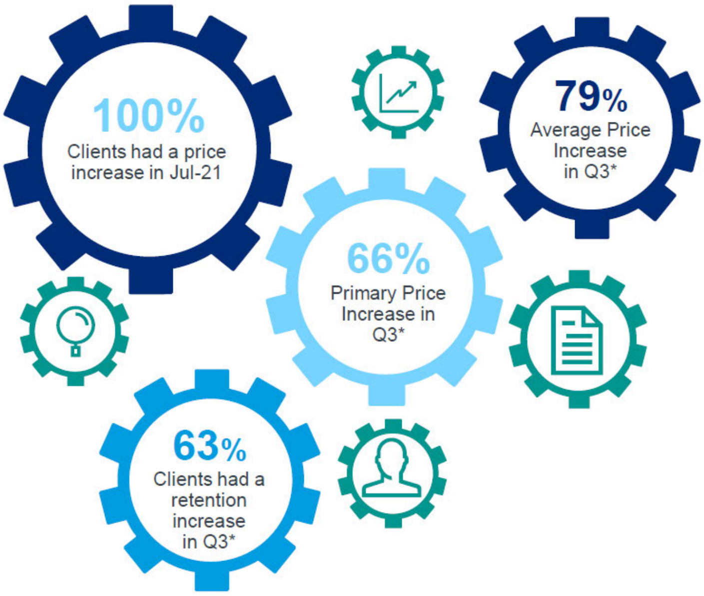
This change is driven in large part by a dramatic increase in both the frequency and severity of ransomware incidents in 2020 onward.

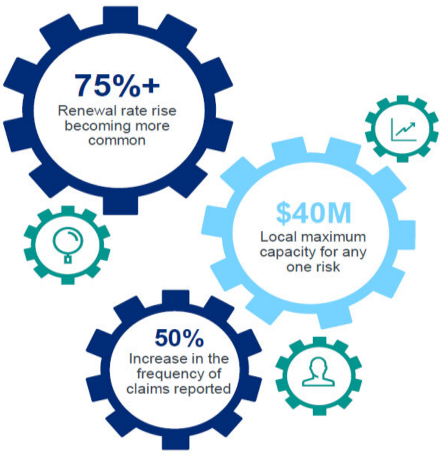
Aggregation risk is a key issue as insurers grapple with the increasing volume and cost of attacks, the increasing number of widespread attacks and the trickle down impacts of cybersecurity incidents in the supply chain

The worsening loss ratios have also led to corrective actions, such as limiting capacity and co insurance requirements in order to maintain portfolio profitability.

Insurers are actively looking to manage capacity, and apply higher retentions ($ and time) in addition to narrowing coverage.

In Q3 2021, total programme cyber price increased by an average of 79% for all industries within Marsh's UK (retail and wholesale) client base.



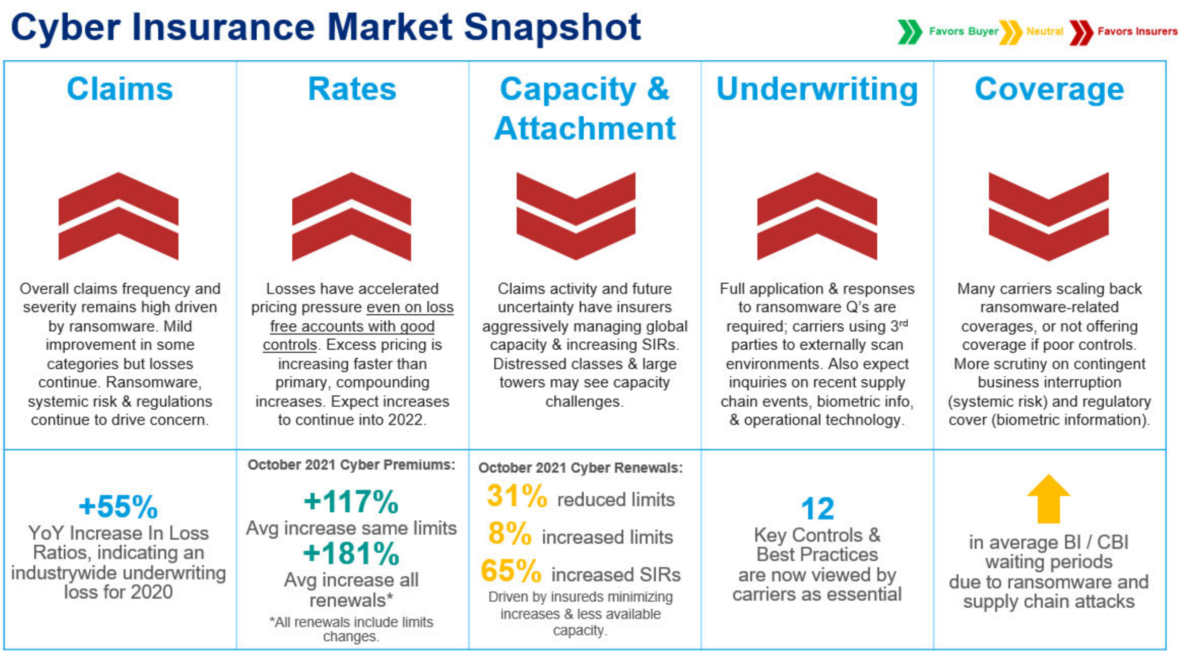


Steady increase seen over the last few month, culminating in average price increases of 53%, 73% and 79% through May, June and July renewals.

The Pacific Market saw sharp premium increases across the board 100%+ not uncommon across all industry. No consistency in pricing where local capacity reduced significantly and as a result highly reliant on London carriers. Bottleneck of submission in London is impacting the Pacific's ability to access additional capacity for new opportunities.

Differentiation is still possible, and the best way to maximise results in the market is to look carefully at the specific controls that lower the likelihood and impact of ransomware for clients

Figure 16 Cyber Market Snapshot



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