



OptimaLite

General Insurance
Insights 2021



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Overall Industry Outlook

After a pandemic-induced collapse in ROEs in FY20, it went from bad to worse in FY21. With ROE of just 2% (2 points lower than FY20), FY21 turned out to be the worst industry ROE outcome in the 'post HIH era'.

Reserve strengthening for COVID-19 business interruption claims was the key driver of this outcome. Offsets from better investment returns and a much less severe year for natural perils events were only modest and were not enough.

Top line growth (gross earned premium) was surprisingly strong in FY21 at around 5.5%, and was 7.5% if we normalise for the collapse in Travel premium. In very broad terms, this reflects a response to claims inflation in Personal Lines (so it does little to expand margins) and to a continuation of the hard market in Commercial Lines to address below target profitability.

The industry's reported net loss ratio was 2 points worse in FY21 than in FY20 due to reserve strengthening for COVID-19 business interruption claims which added 5 points to the loss ratio. Reserve releases from other lines were, in aggregate, not really meaningful. A return to average levels of natural perils losses and a slight tailwind from discount rate movements were helpful but not enough to arrest the decline in loss ratios.

Expense ratios increased by only 0.3%. Interestingly, we observe the expense advantage that Large insurers have enjoyed over other insurers continues to narrow.

The combined operating ratio reported was 102%, 2 points higher than FY20 and it is some 10 points higher than it was in FY18.

There was a slight rebound in FY21 from the decade low investment returns in the previous year. But at \$1.4b they are well below historical levels.

Putting it all together, the reported insurance margin was a mere 0.2% of net earned premium, barely above break-even, and the ROE at 2% was at its lowest in two decades.

With an improvement in underlying profitability, FY22 should be a much better year in the absence of any further large COVID-19 surprises. Nevertheless, reported ROE is forecast to remain in single digits – at 7%.

Looking to FY22, there are encouraging signs that reported margins can improve on FY21. Premium growth should continue to be strong due to both system growth and margin improvement. It should be another year of Commercial Lines leading the way on pricing with Private Motor and Household not far behind. Sadly, we don't expect to see the Travel insurance market re-establishing itself until at least FY23.

Most of these price increases will be needed to counter claims cost inflation which would otherwise be eroding margins in many classes. Overall, we see just enough to improve underlying loss ratios by 1% for the industry. Prior year reserve releases are not what they once were and, aside from the potential surrounding COVID-19 business interruption reserving, we do not see significant scope for reserve releases in FY22.

Investment return expectations for insurers continue to edge lower, with yields rapidly approaching zero. Favourable returns from the industry's small holdings of growth assets along with the credit risk margins earned on corporate bonds are now virtually the only way for insurers to make a significant positive return. Profitability is very much all about underwriting margins in FY22.

Bringing this all together, with the proviso that weather-related claims will remain at average levels and assuming no COVID-19 business interruption reserve changes, we estimate a reported insurance margin for the industry for FY22 of 6%, and an ROE of 7%.



Premiums

In FY21, industry premium growth on an earned basis was just north of 5%. On the surface this was similar to FY20. But if we normalise for the loss of 80% of the industry's Travel premium, earned premium growth was a surprisingly solid 7.5%.

As we have seen for a while now, the market continues to harden in most Personal and Commercial Lines of business. On the surface, this rate growth in FY21 appears positive for industry margins. However, much of it is in response to ongoing claims inflation in property classes, with COVID-19 related supply chain pressures only exacerbating the problem. Hence, rate increases only serve to maintain, rather than expand, margins. In certain Commercial Lines classes, while rate increases are helping to push margins upwards, this is necessary to move profitability closer to target levels.

Looking to FY22, we are forecasting continuing strong premium growth of 6%. The combination of notable volume growth across most classes, as well as significant rating strength, is expected to add roughly \$3b in Gross Written Premium. Unfortunately, we do not see the Travel class recovering in the short term due to ongoing international border restrictions, leaving a further \$900m in gross premium still missing in action.

Claims

Net of reinsurance, the industry loss ratio in FY21 was 75%, 2 points higher than in FY20. Having deteriorated three years in a row, it is some 10 points higher than it was in FY18. Strengthening of reserves for COVID-19 business interruption claims was the key driver of the FY21 deterioration, adding 5 points to the loss ratio.

This was only partially offset by a return to an average level of natural perils losses (although most of the benefit accrued to reinsurers) and a weaker hit from discount rate movements.

Ignoring the COVID-19 business interruption reserves impact, reserve releases were a mere \$150m, which is just 0.5% of NEP (vs just 0.7% in FY20). So, for the second year in a row, margin support from this area – for so long a useful tailwind for the industry – was minimal. Aside from potential movements in COVID-19 business interruption reserves, we do not see significant scope for reserve releases in FY22. CTP seems likely to continue shrinking as a source of reserve releases while there also remains the ongoing risk of further deterioration in Public Liability.

Looking to FY22, claims cost inflation is expected to continue quite strongly. However, it should be more than offset by rate improvements leading to a 1 point improvement in the underlying loss ratio. Notably, the hard market that has driven up prices in the Commercial and Financial Lines classes appears to be moderating as we head into FY22.

While our forecast on the weather front assumes an 'average' year, the BoM is forecasting a La Niña system which is likely to bring a wetter than average summer, somewhat similar to last year.

Yield curve pressures look set to continue with discount rates having moved close to zero driven by the RBA. The possibility of increasing yields at this stage looks closely aligned to the risk of rising inflation, which is clearly a double-edged sword scenario for insurers. Given the matched approach most of the industry adopts, the impact of yield curve increases on fixed interest portfolios should combine with reserve discounting to end up profit neutral.

Bringing premiums and claims together, we estimate the industry reported loss ratio in FY22 to be 69%. This is a 6 point reduction relative to FY21. However, most of this improvement stems simply from assuming the industry does not experience another shock COVID-19 business interruption loss.

Profitability

Investment returns on assets backing insurance liabilities (ABIL) in FY21 were down by about \$100m. On the other hand, investment income on shareholders' funds was up by \$460m. Therefore, while investments overall served as a small drag on the industry ITR, they contributed positively to the ROE.

In FY21, the industry reported an ITR¹ margin of just 0.2% – essentially a breakeven margin result. This is 2.4% below the FY20 margin, with the loss ratio movement by far the main driver but higher expenses and lower investment returns on ABIL playing a minor part as well.

ROE of only 2% in FY21, was over one point lower than the already very poor FY20 result and is the worst outcome in two decades.























Looking forward to FY22, we expect a substantial bounce-back in reported profitability without the impact of COVID-19 business interruption losses that so badly impacted FY21. While we no longer expect too much of a tailwind from reserve releases, there has been some encouraging improvement in underlying loss ratios which should further support the forecast improvement.

Investment return expectations continue to be very low at just 1.7% and, despite this, still carry plenty of potential for volatility with an unsettled global economy and rising inflationary risks. Once again COVID-19 is the wild card, it is not clear whether FY22 will see a return towards normality or a further evolution of the pandemic's disruptive and unpredictable effects.

For FY22, we are forecasting an industry ITR margin of 6% and ROE of 7%, a significant improvement on each of the last two years but still clearly below target.

¹ As well as underwriting expenses, our ITR definition includes other operating expenses (with other operating income netted off). In our opinion, this provides a more useful metric for assessing insurance profitability than a definition which only includes underwriting expenses.

Class of Business Outlook

Class	Gross Earned Premium Growth		Reported Profitability		Key Risks
	Recent	FY22	Recent	FY22	
Overall Industry	5%	6%			Claims inflationary pressures, above average weather-related claims, reserve strengthening (including pandemic-related business interruption claims), low investment returns.
Private Motor	6%	6%			Reversion to pre COVID-19 frequency (FY23+), ongoing claims inflation, inability to achieve efficiency benefits.
Householders	6%	9%			Ongoing buildings claims inflation, climate change and perils.
Travel	-78%	0%			Protracted government travel restrictions, changing travel landscape, customer expectations, regulation.
CTP	-3%	2%			Average size pressure due to psychological claims, regulator pressure on premiums/profits.
Corporate Property	10%	6%			Pandemic-related business interruption claims, claims inflation, cost of reinsurance and slowing rate increases.
Business Packages	7%	7%			Pandemic-related business interruption claims, increasing competition, claims inflation, cyber risk.
Standalone Liability	12%	6%			Prior year deterioration (including worker-to-worker and child abuse claims).
Commercial Motor	4%	6%			Reversion to pre COVID-19 frequency (FY23+), ongoing claims inflation, increasing competition.
Financial Lines	30%	11%			Class actions, COVID-19 impacts, Royal Commission.
Workers' Compensation	8%	10%			Growth in both primary and secondary psych claims, above inflationary growth in claim sizes, direct and indirect impacts from COVID-19.

Profitability definitions



Loss making = Below 0% ROE



Below target = 0-10% ROE



Within target range = 10-15% ROE



Above target = Over 15% ROE

Private Motor

Private Motor performance for FY21 largely mirrored FY20, with another exceptionally high ROE delivered off the back of ongoing COVID-19 related reductions in claims frequency.

FY22 will continue to benefit from the impact of COVID-19 restrictions and, as a result, FY22 ROE should remain very strong. However, this is only a temporary respite from the challenges ahead.

With claims frequencies set to climb again from FY23, and with claims inflationary pressures not abating, insurers will need to achieve strong rate increases (difficult given the competitive market) and/or deliver expense savings to deliver returns within target range in FY23 and beyond.

Premiums

The total GWP for Private Motor in FY21 was \$11.3b – a solid 8% increase over FY20, and comfortably above the 10-year average growth rate of ~5%. Growth was driven by both policy count (at 3.6%) and higher average premiums (4.2%).

FY22 renewal rates are likely to be impacted by consumers seeking better ‘value for money’ in a post COVID-19 economic environment, with a historically high level (~30%) of customers now shopping around. However, the renewed demand for new vehicles will support continued volume growth as well as average premium growth (as a result of the flow on impacts of this demand on used car values). As a result, we are forecasting another above average GEP growth of 5-6%.

Claims

At the national level, claim frequency for FY21 was 13.5% (down from the previous low of 14.1% in FY20), reflecting the ongoing COVID-19 impacts, particularly in Q1 of 2021. This decrease was observed across all states and was particularly prominent in Victoria, in line with broader lockdown experience. The national average collision claim size in FY21 was ~\$4,100 (a 3% increase from FY20). Increases in collision average claim size varied greatly by state – while NSW and Victoria recorded a ~2.5% increase, most of the other states experienced double digit increases.

Claim frequency benefits will clearly extend into FY22. However, with the stated government intent to minimise the use of lockdowns in the future, it is less likely that these COVID-19 related frequency benefits will extend into FY23 and beyond. We expect ongoing claims inflationary pressures as a result of rising parts costs (including from substantially higher shipping and freight costs), parts delays (impacting on ultimate claims costs) and labour shortages exacerbated by COVID-19.

Profitability

Private Motor continued to reap the benefits of COVID-19 related frequency reductions into FY21, leading to a second year of historically high ROE levels.

Given the prolonged lockdowns in NSW and Victoria through the first half of FY22 it is clear that frequency benefits will extend into next year, almost certainly providing a third straight year of exceptional profitability for Private Motor.

However, the COVID-19 frequency benefits mask the longer term profitability challenges faced by Private Motor, and where post COVID-19 frequency ultimately settles will be key to future performance. With ongoing claims inflationary pressures, a reversion to pre COVID-19 frequency levels would require a ~7% p.a. rate increase over the next two years to achieve the minimum target ROE in FY23. This level of rate increase is significantly higher than has been achieved in recent years, and would be challenging to achieve given the competitive environment.

Householders

Despite a more 'normal' year for perils, Householders profitability was again very poor in FY21, with the combined operating ratio the worst recorded since 2011.

Householders faces a tough future, with a number of key threats to its long term sustainability, including future climate change impacts and persistent Building claims inflation.

A substantial improvement in underwriting performance (we estimate at least 13 points) is required to get to within target ROE levels, and with no quick fixes we expect it will take a number of years for Householders profitability to return to acceptable levels.

Premiums

The total GWP for the Householders portfolio in FY21 was \$10.4b, up 8.7% over FY20, and the highest growth level since FY13. Growth again came primarily from higher average premiums (~6%), alongside a 2.6% increase in risk count. Notably, Buildings recorded a rate increase of 3% following two years of negligible rate movements.

The Householders portfolio faces longer term volume growth pressures from the changing housing profile (with units continuing to grow as a percentage of total dwellings). In addition, there are more immediate rate growth pressures with insurers unable to achieve rate increases to the levels required to match claims inflation. Given the two consecutive years of very poor performance, however, we expect relatively strong rate growth to be achieved in FY22 as insurers work to return this class to an acceptable ROE level.

Claims

From a frequency perspective – and on a positive note – the (very) long term downward trend in attritional claims frequency continued into FY21 for both Buildings and Contents, further supported by COVID-19 lockdowns. Unsurprisingly, weather and events frequencies also improved in FY21 from the high FY20 levels.

From a severity perspective, claims inflation continues to be a concern for Buildings, with the average claims size for Buildings continuing its (also very) long term trend of growing well in excess of economic inflation in FY21. The average Buildings claim size for FY21 was \$8,800, a substantive 20% increase over FY20. In contrast to FY20, the main driver of FY21 growth was weather (excluding events) claims. These claims grew by a remarkable ~50%, with attritional claims experiencing a much smaller increase of ~2%.

Profitability

The APRA data shows a combined operating ratio for FY21 of 106% (including ~3 points of unallocated industry expenses) for Householders. This COR represents further deterioration from an already poor FY20 result, and is the worst recorded since 2011.

Increased reinsurance costs (following two consecutive years of reinsurer losses), along with a higher expense ratio were the key drivers of the COR deterioration. Both the net loss ratio and net expense ratio worsened by more than a point each.

The long term sustainability of this class of business is being challenged from a number of angles. Along with ongoing climate and peril challenges, the long-held feature of Contents subsidising Buildings (as well as the cushioning impact of strong Private Motor results in recent years) has provided some buffer for Householders insurers, but will not continue indefinitely. Building claims inflation remains a key concern for future profitability, further exacerbated by COVID-19 related supply chain disruptions and shortages. It is clear Householders faces a tough road ahead, and while we expect some improvement in FY22 we also expect it will be a number of years until profitability can be restored to acceptable levels.

Travel

A tumultuous FY20 continued into FY21, with COVID-19 continuing to hamper gross premiums written. Premium refunds led to negative premiums in the first quarter of FY21, with small volumes of travel in subsequent quarters resulting in a positive, but small, written premium for the year.

The combined operating ratio decreased dramatically, from 106% to 75%. Expense ratios slightly increased as many brands went into hibernation during the worst of the pandemic, however, this was eclipsed by a significant fall in claims ratios. These low claim volumes drove what was ultimately a profitable year for the industry, recording an underwriting result of \$48m, in stark contrast to the previous year's \$28m loss.

The outlook for the industry in the coming years will continue to be dictated by travel restrictions, with a full recovery in written premium unlikely to occur before 2024. Further pressure around regulation, product design and changing customer expectations will also continue to play out over the course of the coming years.

Premiums

Written premium volumes in FY21 remained very low at 90% of pre COVID-19 levels (80% lower on an earned basis). The gross written premium pool for Travel insurance in FY21 is estimated to be \$109m (\$96m from APRA authorised insurers and \$13m from Lloyd's¹). Premium volumes were negative in the September 2020 quarter due to pandemic-related refunds and credits to customers but moved to positive territory in subsequent quarters.

We expect growth in written premium in FY22, but this will be hampered by ongoing travel restrictions amidst Delta-variant outbreaks in the latter half of 2021. We note that because FY21 earned premium was unusually high relative to written, we expected FY22 earned premium to be at a similar level to FY21. A full recovery to the levels observed in FY19 is not expected until after 2024: pent-up travel demand remains a source for future optimism; however, a return to full normality is likely to take years.

Claims

The gross loss ratio in FY21 fell to 33%, significantly lower than previous years. This result can be attributed to a combination of significant prior year reserve releases and a low current year loss ratio brought upon by pandemic exclusions, a change in travel composition and some increases to average premiums.

Loss ratios are expected to normalise to more typical levels (50% to 55%) as borders re-open and travel patterns return to normal.

Profitability

The APRA reported net combined ratio for FY21 improved by 31 points from 106% to 75%. This significant improvement reflects favourable claims experience, which was only partially offset by an increase in the expense ratio from 44% to 55%.

The increase in expense ratio comes as no surprise: cuts to operational expenses were unlikely to be able to match the extent by which premiums fell. Nevertheless, the industry as a whole has shown remarkable resilience in its ability to hibernate operations throughout the pandemic; however, this is not to say that all industry segments will have avoided an adverse bottom line impact.

The strong underwriting result is not expected to continue into FY22, with small losses or small profits expected in the future years as the industry resets. Profitability for FY22 and beyond is heavily dependent on the ability of insurers to price coverage adequately and manage expense strain as sales ramp up.

¹ Approximation based on Finitly analysis of APRA and Lloyd's Class Review data.

CTP

CTP profitability has fallen to its lowest level in a decade. Lower expected frequency in FY22 due to further lockdowns should lead to a better result next year although, on an underlying basis, we expect that this class is not meeting target.

Prior year reserve releases in FY21, which have previously been a significant contributor to the financial year profit for this class, were less than half their historical level. Average claim size pressures due to psychological claims as well as a higher wage inflation outlook should lead to premium rate increases although regulatory and competitive pressures will limit their extent and the impact on profit margins. However, we forecast FY22 reported profitability will improve (but remain below target) as a result of reduced mobility due to COVID-19, leading to lower expected frequency with lower prior year reserve releases only partially offsetting.

Looking forward, the impact of changes in mobility patterns on driving behaviour, road accidents and the utilisation of CTP schemes remains to be seen. The impact of COVID-19 on mental health is likely to exacerbate trends in secondary psychological claims already observed across all markets and will have implications for the size of CTP claims in the future.

Premiums

The GWP pool decreased by 1% in FY21. NSW and SA premium rates were flat while in Queensland the regulator decreased the ceiling price over the year by 2%.

Growing proportions of claims with a psychological injury are putting some pressure on average claim size in all markets but with the expectation of a strong regulatory focus on affordability it is unclear to what extent premiums will increase. With an expectation of some premium rate increases and renewed growth in new vehicle sales we are expecting above inflation growth in the premium pool in FY22.

Claims

Claim frequency in FY21 returned to pre COVID-19 levels in NSW but remained lower than pre COVID-19 levels in Queensland, probably due to the impact of claim-farming legislation introduced at the end of 2019. We expect lower NSW frequency for FY22 given the extended lockdown impacting the first half of the financial year.

The net loss ratio of 79% (excluding yield curve impacts) for FY21 has continued to increase and compares with an average of 60% in FY15-19 and 72% in FY20. Lower prior year reserve releases are the primary driver of the lower result, having reduced from an average of \$1.1b in FY15-19 to \$0.7b in FY20 and \$0.5b in FY21.

Looking forward, we anticipate a slightly better result in FY22 with a better current year loss ratio (due to COVID-19-related lower frequency) partly offset by lower prior year reserve releases.

Profitability

On a reported basis, CTP profitability was below target in FY21. The FY21 insurance trading result of around 13% is the lowest yet and is driven by lower prior year reserve releases, lower investment income and a continuation of higher expenses. The higher expenses in the last two years are likely due to how insurers are accounting for the excess profit provisions in the new NSW Scheme although it is unclear exactly how these provisions are impacting reported results.

On an underlying basis we do not expect the profitability of this class to meet the target level. However, due to lower expected frequency during FY22 (COVID-19 related) we anticipate reported profitability to improve, but remain just below the target range.

Corporate Property

Corporate Property remained profitable on a net underlying basis in FY21. However, on a reported basis, it continued to be loss making due to reserves for potential pandemic related business interruption claims.

This class saw a slowdown in premium rate growth and favourable natural peril claims experience.

The outlook in FY22 is a slight deterioration in profitability (putting COVID-19 business interruption losses aside) due to increased competition, significant claim cost inflation in the property classes as well as a continued hardening of the reinsurance market.

Premiums

The hard market showed signs of softening in FY21 after five years of strong rate increases, as capacity increased for low to mid risk segments of the portfolio.

Single digit rate increases are expected going forward but the pace at which the market will soften will depend on insurers' risk appetite in the current market conditions and uncertainties around outcomes of COVID-19 related business interruption claims.

Claims

Despite FY21 being declared a La Niña year, natural peril claims costs were well below average and at their most benign level in the last five years. Insurers reserved \$3.0b gross (\$1.6b net) for potential COVID-19 related business interruption claims but there is significant uncertainty about the financial outcome which depends, in large part on the courts' decisions on the second test case.

Significant claims cost inflation has been observed in property insurance segments due to both supply and demand side pressures exacerbated by COVID-19 related disruptions. We might expect this to continue over the next 12 months and ongoing premium rate increases will be required just to maintain loss ratios at current levels.

Profitability

Despite the rate increases achieved, key challenges to underlying profitability are the higher than normal claims inflation. Reported profitability in FY21 was dominated by the COVID-19 related business interruption reserve strengthening.

Our forecast outlook for FY22 is for the Corporate Property portfolio to remain below target profitability (on a net normalised underlying position) with inflation and the cost of reinsurance as key risks. Reported profits will be impacted by the outcome of the second test case on the level of business interruption losses across the market, as well as the normal volatility inherent within this class due to large losses and natural perils.

Business Packages

On an underlying basis, rate increases are continuing but more is needed to reach target profitability, particularly in light of potential claim cost pressures and higher reinsurance costs.

Insurers are also facing a number of strategic issues, including increasing competitive pressure, greater pricing sophistication, the potential need to offer automatic flood cover and the growing demand for cyber cover. Having said this, we feel there is strong potential for profitability and profitable growth for insurers who can navigate these issues successfully.

With regards to the impact of COVID-19, business interruption claims remain a key area of uncertainty, with the second test case expected to provide a lot more clarity around costs to insurers. Current industry reserves, following an unfavourable first test case for insurers, imply significant once-off losses.

Looking ahead we don't expect COVID-19 to have a significant impact on this class of business. Insurers have updated their policy wordings to exclude future pandemic or COVID-19 related claims, and we don't expect existing lockdowns to have an adverse impact on top line with governments providing support to businesses and lockdowns expected to be less of an issue going forwards.

Premiums

Overall, average premiums for Business Packages increased by approximately 4.5% in FY21, although after allowing for inflation and adjusting for exposure growth the rate increase was only about 2% higher than inflation. Average premium increases were higher than 4.5% in the intermediated channel but were offset by a substantial reduction in new business premiums of about 8% in the direct channel.

Over the next year we expect slightly higher rate increases in response to claims and reinsurance cost pressures, and in response to current below target underlying profitability.

Higher rates, along with growth in small business numbers, are expected to drive further GWP growth next year. Small business numbers grew strongly over the previous year as the government provided a range of support due to COVID-19, and small business numbers are expected to rise again next year as lockdowns are lifted.

Claims

Excluding the impact of COVID-19 business interruption claims, Property claims saw a significant reduction in claim frequency over FY21, as lockdowns forced many businesses to either shut down or work from home. Early indications are that Liability frequency has also reduced due to COVID-19 and the associated lack of foot traffic, but due to the long-tail nature of Liability it's still too early to make a definitive call on this. On an underlying basis, however, after lockdowns are lifted we expect frequency for both Property and Liability to return to pre COVID-19 levels.

From a claims cost perspective, FY21 saw average claim sizes for Property remain relatively stable compared to FY20. However, for Property, claims cost pressure is building due to higher labour and raw material costs. This is in turn driven by high levels of both construction and building approvals, as well as supply chain shortages and significant increases in shipping costs. For Liability cost pressures are also appearing, partly driven by worker-to-worker claims, and in addition mental health claims are an emerging risk due to both the disruption of the last year and general trends in the population.

Profitability

On a reported basis, which includes the impact of COVID-19 business interruption reserves, Business Packages was loss making in FY21.

Excluding COVID-19 business interruption impacts, on an underlying basis we expect this class to be profitable but still below target profitability. We expect underlying profitability to remain largely unchanged in the short term. The combination of claim cost risks and higher reinsurance costs is likely to offset most of the benefit of premium rate increases.

We estimate underlying net COR to be 101%, and we estimate that a net COR of 91% is required for Business Packages to provide a return on equity of 10%. This implies that a further rate increase of around 13% is required to bring this class up to target profitability.

Turning back to the reported basis and assuming no change to COVID-19 business interruption reserves in FY22, we expect this class to be considerably more profitable than on the underlying basis but still below target profitability, with the higher profitability driven by lockdowns and associated reductions in claim frequency extending to a significant part of FY22.

Standalone Liability

Standalone Liability profitability has been particularly poor in recent years, with a large prior year reserve strengthening once again contributing in FY21. Insurers remain focused on profitability and have continued to increase rates while the capacity in the market remains restricted.

Looking forward to FY22, we expect the performance to improve as rate increases continue to earn and lower levels of reserve strengthening are expected relative to FY21, although the latter remains highly uncertain. The reinsurance market is expected to remain in a hardening phase and will not provide the same level of benefits observed historically.

The impact of COVID-19 lockdowns was less than anticipated, with premium volume appearing to have grown in FY21 off the back of rate increases and a rebound of economic activity after the initial lockdowns in Q2 of 2020. We expect a temporary reduction in slip and fall type claims in the retail and hospitality segments, but it is still too early to assess the full impact of the pandemic on claims costs.

Premiums

Gross written premium for Standalone Liability is estimated to grow by around 8% in CY21, continuing the increasing trend observed since 2015. Premium rates for Standalone Liability are estimated to increase by 8% in CY21, similar to CY20, and higher for poorly performing segments (such as construction). Capacity in the market remains restricted at levels similar to what was observed last year.

Looking forward, we expect both premium growth and rate increases to continue, albeit at a moderated level.

Claims

NCPD data showed stronger than anticipated claims development over CY20, resulting in higher projected ultimate loss ratios for a number of accident years. APRA data showed a high net loss ratio for FY21 of 99%, similar to what was reported in FY20, with prior year reserve strengthening adding 23 points to the reported loss ratio. This is linked to continued development of child abuse and worker-to-worker claims and these remains an ongoing challenge for this class of business.

Profitability

We estimate that Standalone Liability was loss making in FY21 with a net COR of 129%, in large part due to significant prior year reserve strengthening.

Looking forward, we expect reported profitability to improve but still remain in loss making territory in FY22. These improvements are due to rate increases continuing to earn and a reduction in the impact of prior year reserve strengthening (albeit we still expect reserve increases to be material).

Commercial Motor

Commercial Motor profitability was again above target due to the ongoing COVID-19 related reductions in claims frequency. Premium growth was also strong and entirely attributable to vehicle growth.

Commercial Motor is a growing segment with demand for delivery vehicles accelerating due to COVID-19. As demand increases, competitive pressures have also increased, particularly in the intermediated distribution channel which saw a number of new entrants. Based on Finity Vantage data, we have also observed an increase in the number of brokers shopping around, with the average number of quotes per customer increasing.

Achieving profitable growth over the next two years as the economy opens up will be a significant challenge for Commercial Motor insurers. In the short term, while mobility is low, insurers are facing the risk of competitors reducing prices as a way of growing market share. However, in the medium term, as mobility returns to pre COVID-19 levels, premium increases will be required to maintain target profitability, particularly as claims inflation continues to emerge. Optimising the timing and level of premium changes will be a key focus for Commercial Motor insurers over the next two years.

Premiums

Total gross written premium for Commercial Motor in FY21 was \$3.1b, representing an 8% increase over FY20. Unlike previous years, premium growth in FY21 was entirely attributable to vehicle growth (12%). New vehicle sales data suggests this is driven by light commercial vans and is likely in response to the increased demand for delivery vehicles accelerated by the pandemic.

On the other hand, average premium rates decreased by 4%. Insurers were well-positioned to decrease premium rates in FY21 as a means to support businesses through the COVID-19 pandemic. This is because decreased mobility has significantly reduced collision claims frequency. However, in the face of significant emerging claims inflation, if vehicle usage was to return to pre COVID-19 levels, significant premium rate increases will be necessary to maintain target profitability.

Growth in the premium pool is expected to be similar to that observed in FY21. While vehicle growth will slow slightly, this will be offset by modest premium rate increases in FY22 (around 5%).

Claims

COVID-19 continues to have a positive short term impact on this class, with a net loss ratio of 61% achieved in FY21. The reduced number of vehicles on the road as a result of COVID-19 lockdowns has led to reduced claim frequency.

While claim frequency benefits are expected to extend into the first half of FY22, we expect claim frequency to return to pre COVID-19 levels as the economy opens up in the second half of FY22. Furthermore, we also anticipate ongoing claims inflationary pressures as a result of rising parts costs (including from substantially higher shipping and freight costs), parts delays (impacting on ultimate claims costs), increased adoption of safety features (which add to repair costs) and ongoing higher prices for used vehicles (increasing the cost of total losses).

Profitability

Commercial Motor has continued to perform well above target ROE levels due to the decreased mobility from COVID-19, achieving a net COR of 89% in FY21. However, on an underlying basis (assuming pre COVID-19 mobility and frequency), we estimate that Commercial Motor is currently performing at a COR of 102%. This implies, on an underlying basis, profitability is below target.

Given the significant recent lockdowns in NSW and Victoria, we expect reported profit to continue to be favourable in the first half of FY22. However, as the economy opens up in the second half of FY22 we expect profitability to deteriorate significantly – as frequency increases to pre COVID-19 levels and ongoing inflation pressures impact claim sizes. Nevertheless, across the whole of FY22, we expect profitability for this class to be within target.

Looking further forward, a rate increase of 5-10% p.a. in FY22 and FY23 will be required for the portfolio to achieve target profitability in FY23 and beyond.

Financial Lines

The strong premium rate momentum has continued through 2020 and into the first half of 2021 with impacts felt across most segments of the market. However, there are signs that capacity constraints and rate momentum are starting to ease in certain segments of the market.

The claims environment has been benign relative to what might have been expected following COVID-19, but this is likely a timing issue due to the disruptions caused by COVID-19 and the government's temporary easing of certain rules. Tort temperature remains warm and 2020 saw a number of COVID-19 related class actions being notified.

A number of regulatory and legislative changes brought in over the past 12 months (continuous disclosure changes, NSW's Design and Building Practitioners Act and improved Financial Services regulation) should present a favourable outlook over the medium to long term. However, short term impacts are more uncertain.

Looking ahead, we expect premium rate increases to moderate in FY22. ROE outcomes will depend on COVID-19 impacts and the extent to which prior year reserve deterioration continues. We estimate the class will see well below target profitability in FY22.

Premiums

The Financial Lines premium pool has increased to over \$4b in FY21, driven by substantial rate strengthening. These rate increases have trickled down to most segments of the market with increases of 10-15% for Professional Indemnity, and substantially higher increases for D&O business.

Looking ahead, we expect premium rate increases to generally slowdown in FY22. Historically worse performing segments (such as construction and finance) are likely to continue to see upward pressure as capacity issues persist and COVID-19 impacted sectors (such as tourism, retail, healthcare and aged care) could also see increases due to heightened claims risk. Other segments can expect some easing as higher rates prove attractive enough to bring new capacity into the market.

Claims

Significant prior year reserve strengthening was the main reason for the high reported loss ratio (100% in FY21). After stripping these out, the current year underlying performance is much improved due to the premium rate increases achieved over the last four years.

Class actions have been a major driver of claims for Financial Institutions and D&O in recent years and 2020 was no different. 2020 was a record year for class action notifications (equalling 2018), including a number related to COVID-19 (government hotel quarantine, aged care, etc) and the Royal Commission.

COVID-19, together with recent regulatory and legislative changes (continuous disclosure changes, improved regulation in financial services and construction) add uncertainty but the prospect of improvement to the claims environment. Their impacts should become clearer over the next few years.

Profitability

Following another year of significant reserve strengthening on prior years, the reported net profitability in FY21 remains considerably below target levels. Despite favourable reinsurance terms and rate increases cushioning the impact, FY21 was loss making.

However, on an 'underlying (current year) basis', the estimated net COR has improved to under 100% (i.e. profitable) for the first time in many years, but it is still below target levels.

Further rate increases in the order of 10% to 20% are needed to bring both PI and D&O underlying profitability to within the target range. Our view is that these rate increases are achievable. However, on a reported basis we expect further claims pressures as the Royal Commission and COVID-19 impacts continue to come through. This makes it less likely that the industry will report a profit for this class in the short term.

Workers' Compensation

Workers' Compensation will continue to face challenges in meeting ROE targets over the next few years. While COVID-19 did not have a significant impact on Workers Compensation claims during FY21 (given the very low infection numbers in the privately underwritten States (WA, Tasmania, NT, ACT), as states begin to 'live with COVID' there are material risks that this will not be the case in FY22.

Workers' Compensation premium rates have grown strongly over the last four years, but remain lower than recommended premium rates. Premium rate increases over the next few years will still be required to increase profitability to target levels, even if COVID-19 impacts are minor. The low yield environment also adds to the pressure on premium rates, as investment income from the assets backing technical reserves has fallen to a historic low.

Claims costs have been under pressure in recent years from longer durations and growth in the number of complex claims. Claims performance in FY21 deteriorated in WA but was partially offset by improvements in other states.

Opportunistic rate increases, better than average risk selection, outperforming competitors on claims management and/or process improvements (such as straight through processing) will all be important to an insurer in maintaining reasonable returns from Workers' Compensation.

Premiums

Strong earned premium growth continued in FY21, representing four years of increasing premium rates.

Achieved premium rates however, continue to be lower than the rates recommended by privately underwritten scheme regulators. In part this is linked to the low yield environment, where each 1% point drop in expected investment returns needs to be offset by around a 3% increase in premiums to achieve the same target ROE.

Insurers' appetite to push rates up in an environment of very low (albeit potentially increasing) inflation will be a key decision over the next few years. There are also likely to be industry segments where COVID-19 pressures will continue to impact on employer wages that may constrain the degree of rate increases.

Claims

The trend in recent years has been for a lower overall claims frequency but higher average claim sizes, due to both longer durations on physical claims, and higher psychological (both primary and secondary) claims.

Overall there was an improvement in the net loss ratio in FY21, due to the premium increases noted above. The impact of prior year reserve changes and yield curve movements during FY21 was minimal.

While the continuing impact of the pandemic is still uncertain, our general view is that the claims costs from COVID-19 will increase during FY22 as border and other restrictions begin to ease. How many of the increasing infection numbers become claims, and then how many of those claims become 'prolonged', will determine the impact this has on profitability.

Within individual insurer portfolios there is likely to be more variation in performance, particularly where an insurer is over or under weight in highly impacted industries (and noting also that the variability in vaccination rates by industry will be a risk factor in the year ahead). Claims outcomes remain a key risk to financial outcomes.

Profitability

FY21 profitability was lower than ROE targets, but similar to FY20. The COR was 97%, which combined with historically low investment returns to achieve an ITR of 7%.

The underlying loss ratio improved, which was partially offset by a higher expense ratio. If an 8% overall increase in premium rate can be achieved (broadly consistent with recent rate change movements), we anticipate a COR in FY22 of 97%. This suggests the class, while profitable, will remain below target ROE.

With pressure on investment returns expected to continue (expected to be 1.5% p.a.), then the COR will need to reduce below 92% to achieve target ROE of at least 10%. This means premium rate increases of more than 8% are needed to get Workers' Compensation profitability back to target levels.

About Finity

Finity is the strategic analytics firm that brings your data to life with an actuarial approach, a practical lens and a human perspective.

As actuaries and strategic analytics experts, we share a deep interest in understanding how the events of FY21 will impact the General Insurance sector into the future.

Working with over 250 clients in any given year, our industry expertise and months of research by some of Australia's leading actuaries, statisticians and management consultants culminates in this in-depth state of the market report.

OptimaLite summarises key market trends and presents our in-house view of financial forecasts for the future. We take a look at overall industry and class of business performance and trends.

For a more in depth review Optima, which is available for Finity clients contains detailed commentary on each class of business and also provides an update on the industry's key topics – climate risk, regulatory developments, insurtech, the Northern Australia cyclone reinsurance pool and, of course, COVID-19 business interruption losses.

To request a copy of Optima 2021, [contact us](#).



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In the spirit of reconciliation Finity acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respect to their elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples today.

At Finity, we recognise the importance of climate action and strive every day to reduce our environmental footprint. We are currently on our way to being carbon neutral and practice the highest level of ethics, procuring supplies and services to ensure we deliver solutions that contribute to a sustainable future for everyone.

