CGU Insuring Ambition

THE STRIVE REPORT

Insights into macro economic, social and environmental issues and their impact on Insurance

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September 2022

Foreword to the CGU Strive Report

For over 165 years CGU has believed in ambition. Not just the idea of it, but the power of it. We believe in working hard and getting things done, knowing that ambition can push us forwards and upwards. We also believe that essential to supporting the success of our broker partners is the delivery of key business insights, equipping them with knowledge and understanding to elevate their value as trusted advisors.

There is no doubt we live in unprecedented times. The COVID pandemic triggered monumental societal and economic change, testing our resilience, and requiring us all to adapt to new ways of working and operating our businesses. But it's in the aftermath we must face into the resultant, unforeseen challenges that will continue to shape the roles we play to protect our customers and build safer communities.

The themes of inflation, supply chain, geopolitical tensions and natural disasters caused by climate change continue to touch each and every one of us, impacting the way we live our lives, manage our businesses, and support our customers. We are bombarded daily with complex information from a variety of news sources, knowing that we should be taking the time to digest and understand what it means but often with precious little time to do so.

As insurers and brokers it is vital that we synthesise and translate this complexity into meaningful insights that can support more nuanced conversations with our customers. As valued and trusted advisors, brokers are playing an increasingly important role to help clients understand how these issues impact their businesses, providing them with the best possible advice on how to protect and grow their livelihoods both now and into the future.

What we have learned in the past few years is that the future can and will change rapidly, and that we need to be more proactive and predictive with the information we have available to us. The STRIVE Report will prepare our broker partners and customers for not only now, but what may lie ahead. Curated from extensive research across a variety of reputable sources and reinforced with insights from subject matter experts across IAG and CGU, we have consolidated these themes into one document that explains what it all means.

One thing we can all agree upon is that our present and future looks vastly different to what we imagined in the past. But in the spirit of ambition we will continue to strive towards the achievement of our goals – to protect our customers and build resilient, sustainable businesses. This STRIVE Report offers an opportunity to connect us through the sharing of our knowledge, and with that an industry that is prepared to face the future with confidence.

Damien Gallagher Executive General Manager, CGU

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INTRODUCTION

As the world navigates the third year of the COVID-19 pandemic, there is a growing realisation that the challenges facing modern economies are only getting more significant.

In certain ways, 2022 is proving to be one of the most challenging periods of the pandemic. Mortality rates and positive Covid-19 cases are increasing, government supports are fewer for those impacted, and a myriad of additional economic headwinds are present.

But remarkably, economies around the world have bounced back strongly after an incredibly challenging 2020 – so strongly, in fact, that new inflationary pressures are being experienced in Australia and internationally.

This disruptive period is being complicated by the Russian invasion of Ukraine, which has thrown more uncertainty into the global economy. It has increased oil and food prices, adding to supply chain pressure associated with the pandemic and exaggerated by China's continuing COVID-Zero policy.

Additionally, the impacts of climate change continue to become more evident, with weather becoming more frequent and severe, at home in Australia and abroad. The science is clear, the impacts of a warmer climate will lead to more significant weather events more often.

Prior to the pandemic, Australia experienced its worst bushfire season on record. And since the *Black Summer* bushfires, successive flood events in northern New South Wales, southeast Queensland and western and suburban Sydney further demonstrates the increasing severity of natural disasters that are likely to worsen with climate change.
The economic impact and community devastation that these catastrophic events cause, particularly to small businesses in regional and rural areas, was highlighted in an IAG report into regional small business resilience[1].
These are a unique set of challenges – for everyday Australians, for businesses and for governments. And they affect our economic settings considerably, particularly when it comes to insurance.

This period of disruption has driven up cost of living pressures. It has created new insurance complexities in workplaces, where COVID-19 can spread and work-from-home policies are challenging conventional workplace structures. And increasing climate volatility is making the likelihood of damaging events more probable, increasing risks and introducing new hazards, which business and community may be both unprepared for, and underinsured.

The CGU STRIVE Report takes a broader look at these trends, providing insights to brokers, the insurance industry, and consumers regarding their insurance settings. Its key message is simple: while Australia is navigating rocky waters, now is the time for planning and preparation, not panic.

2022: A YEAR OF DISRUPTION

The pandemic is still with us, observed frequency and severity of events are increasing, and policymakers are playing catch up

As 2020, the first year of the pandemic, drew to a close, many Australians looked to the New Year as a moment of hope and renewal. But in many ways, the challenges that first emerged in 2020 have become a new normal, and have been accompanied by an increasingly diverse set of disruptive global events and trends that are unsettling the global economy.

In Australia, 2021 saw a remarkable economic turnaround. Active fiscal policy – or major spending programs by both state and federal governments – accompanied by record-low interest rates drove employment to record highs, and helped Australia avoid the worst of the economic consequences brought about by the pandemic. This economic policy playbook – major government spending accompanied by low interest rates – was replicated the world over.

Most advanced economies pulled these levers to protect jobs, and to position their nations for a quick recovery if COVID-19 began to dissipate. But no matter how considered these economic policies were, no government – nor business – has been able to fully prepare for the diverse set of global challenges that are today shaping economies.

The coalescence of these *Black Swan* events was largely unprecedented in modern times. For those in the insurance sector, they were also hard to forecast.

"The suite of unprecedented events in recent times demonstrates the volatile and uncertain nature of the risks insurers underwrite," says Amy Huen, IAG's Executive Manager, Intermediated Insurance Australia Pricing. Much of her and her team's work involves modelling and analysis of the past to provide insights into the future. But increasingly uncertain and unforeseen global events have injected new complexities into this work.

Conflict in Ukraine driving oil and food prices higher

In February 2022, the Russian Government invaded Ukraine, undertaking a full-scale land invasion for the first time in Europe since the Balkan Wars in the early-mid 1990s. While foreign intelligence agencies had warned of this potential scenario, the scale of the invasion shocked global markets and injected new economic uncertainty. The fact that a new major conflict was now occurring between two countries whose economies are deeply integrated into the global economy also created a unique set of challenges.

Russia is one of the world's largest exporters of oil and natural gas. In response to the invasion, western governments and their allies enacted a policy of economic isolation upon Russia, attempting to punish Russia financially for its illegal aggression in Ukraine. In doing so, Russian oil and natural gas exports to many countries were significantly reduced, particularly in Europe and North America.

Though Russia has continued to export resources to other global markets, the scramble from many countries to seek these resources from non-Russian markets, as well as the reduction in supply associated with declining export markets for Russia, added significant upward pressure on oil prices. This in turn led to some of the highest crude oil prices ever seen, soaring above US$120 per barrel in March of 2022. For Australians, this was most evident in high petrol prices when filling up the family car; in many places, petrol rose to above AUD$2.50 per litre. But these costs also filter throughout the entirety of the global supply chain. The higher fuel costs, the higher the costs of producing and transporting many goods. International freight costs have effectively doubled since Russia's invasion, with these costs being passed on to consumers the world over.

But it isn't just Russia that is integral to the global supply chain. Ukraine, too, is a major exporter – particularly of wheat. Long described as the 'breadbasket' of Europe, Ukraine is one of the world's largest exporters of wheat, an essential commodity for not only use in food manufacturing, but in providing feed for livestock around the world. As Ukraine's wheat exports have been impacted by war, the global price of food has, therefore, increased significantly, although prices have been trending downward since July 2022, and are expected to fall further by 2023.[2] Combined with rising oil prices, cost pressures have flowed through to families in an almost unprecedented fashion, and placed considerable strain on economic activity.

Inflation growing globally and in Australia

As the world continues to recover from the economic depths associated with the early phases of the COVID-19 pandemic, global supply chains have been placed under enormous pressure.

FIG 1

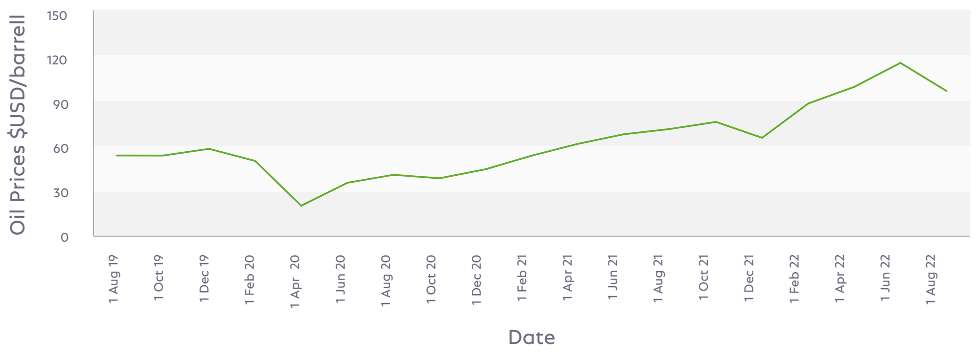


Figure 1. Source: United States Department of Energy.

As COVID-19 began to spread in 2020, Australian and international governments took extraordinary fiscal steps to inoculate their populations from the economic devastation associated with strict, necessary health restrictions. In Australia, unemployment quickly soared in early 2020 to around 7.5 per cent, prompting the government to introduce major policies such as JobKeeper.

WHEN INTEREST RATES BEGAN TO RISE IN 2022, IT WAS THE FIRST TIME THIS HAD HAPPENED SINCE 2011.

Fiscal support measures implemented by governments ensured people remained in work. These policies also stabilised consumer and business confidence during some of the most challenging economic moments early in the pandemic. When restrictions eased, these fiscal support policies hastened economic recoveries, and helped avoid an economic calamity many feared would be significantly worse than the Great Depression.

Household savings boomed during COVID, and interest rates fell

THE COST OF LIVING IN AUSTRALIA IN 2022 IS RISING AT THE FASTEST RATE SINCE 2001, WHEN THE GST WAS FIRST INTRODUCED.

Nevertheless, extraordinary fiscal support measures have extraordinary outcomes. In Australia, the combination of fiscal supports and the limitation on day-to-day spending saw households dramatically increase their savings. In the 2019 September quarter Australian household savings grew by $24.9 billion – a then record, which was buoyed by a midyear tax cut and positioned many households well for the then-unpredictable pandemic that was to come. In the June quarter of 2020, however, this extraordinary growth in savings was exceeded, with household savings growing by $33.4 billion. Early in the pandemic, household spending paused as consumers were wary and uncertain about what was to come. In addition to this uncertainty, fiscal policies saw many individuals receive financial support from the government, much of which was saved.

It wasn't only the Federal Government that was taking extraordinary economic responses to COVID-19. The Reserve Bank of Australia (RBA) was also doing all that it could to ease financial pressure on Australian households, and to stimulate investment in troubling economic times.

In September 2019, the RBA's cash rate target sat at 1 per cent. It was further reduced to 0.75 per cent in November 2019, with pre-pandemic uncertainty in the economic outlook influencing the RBA's decision making process. As COVID-19 emerged, the RBA had little room to move in terms of the interest rates. But it did what it could, quickly reducing the cash rate target to an historic low of 0.1 per cent in order to stimulate investment. Additionally, the RBA undertook a $100 billion bond purchase program, a policy which it argued 'helped lower the whole structure of interest rates in Australia…including lowering borrowing costs and a lower exchange rate than otherwise".[3]

Cheap money & household saving excess is driving demand

These economic dynamics have led to increased demand for both house purchases, new construction, and renovations of existing housing stock. During the pandemic, many Australians took advantage of historically low interest rates to acquire new properties, refinance existing housing stock, or borrow money for home renovations and maintenance.
This influx of demand, however, was met with significant supply constraints.

The supply-side challenges of the COVID-19 rebound, in fact, have been most acutely felt in the construction industry in Australia. In the 12 months to June 2022, Core Logic's Construction Price Index identified a 10 per cent[4] annual increase in building costs across the board. This compares with an economy-wide inflation rate of slightly over 5 per cent in the corresponding period.

The supply shortfalls in construction have not only been driven by extraordinary demand, but by the logistical constraints placed upon the industry by the global pandemic.

The human cost of COVID-19 has always been significant, though the global vaccination program has mitigated against the worst-case scenarios in terms of potential fatalities. Nevertheless, the increasing spread of COVID-19 has impacted labour supplies around the world, creating production shortfalls in economies where many materials are sourced or manufactured.

China COVID-zero policy upending global supply chains

At the same time as this demand has increased, the world's economic engine room has been significantly impacted by pandemic restrictions.

China's ongoing efforts to achieve COVID-Zero have resulted in see-sawing lockdowns in the world's second largest economy, which has in turn limited labour supply within the Chinese market, and constrained production output in all sorts of industries.

China provides many of the materials required (or demanded by) Australia's building industry. It is the world's largest steel manufacturer, and a major producer of timber and metal products that are used by Australian construction firms.
The challenges faced in China's economy, therefore, is resulting in fewer goods entering the Australian market, forcing builders and renovators to pay more for building materials.

FIG 2

Figure 2: ABS, Labour Force, Detailed, June 2022.

The post-COVID recovery saw demand for labour swell

In the first few months of the pandemic, policymakers were staring down the barrel of the largest mass loss of employment since the Great Depression.

As governments around the world took swift and necessary — but unprecedented and costly — measures to contain the spread of the pandemic, Australians' daily lives were disrupted in extraordinary ways. Cafes and shops were closed, students were forced to learn from home while many of their parents were working beside them, borders were closed, and families were separated. These measures constrained economic activity like never before, and risked driving millions of Australians into unemployment. In the first few weeks of the pandemic, before support measures had been legislated, queues at Centrelink offices around the country were a tell-tale sign of the pressures to come.

The swift introduction of programs such as JobKeeper kept millions of Australians in work. And it positioned Australia well for job recovery as restrictions eased. The pent up demand in the economy — and the closure of borders, which led to fewer migrant workers entering Australia — saw demand for workers reach new levels. This demand has seen Australia's unemployment rate drop to just 3.4 per cent, the lowest rate since the 1970s. And while the unemployment rate is an imperfect measure of true slack in the labour market, other measures, such as the underemployment rate, also show positive signs. Simply, more Australians are working than ever before. And while this is good news for many Australians, it is also creating an imbalance between demand for labour, and the supply of labour - in turn, slowing down projects, and putting upward pressure on costs and wages.

AT 3.4 PER CENT, TODAY'S UNEMPLOYMENT RATE IN AUSTRALIA IS THE LOWEST SINCE THE 1970S.

THE PROPERTY & CONSTRUCTION PRICE BOOM

The supply chain crunch is impacting construction prices, leaving some Australians underinsured.

The broader economic dynamics explained above are having marked impacts throughout the economy. But for many Australians, these cost pressures are being seen nowhere more acutely than in the costs associated with building construction.

Since the pandemic began, a major price spike in both new house construction and renovations has been experienced. This includes renovations attributed to unexpected property damage, be it through an extreme weather event, or a household accident, such as a fire. Cordell's Construction Price Index,[5] seen below, jumped dramatically from March 2020, as these economic dynamics began to take shape.

In some cases, individual building materials have increased by extraordinary sums. The rising price of timber, in particular, has been a major contributor to construction cost increases. Between 2021-2022, the cost of timber in Australia rose by 20.6 per cent, compared with an annual increase of 10.6 per cent for most other building materials. Globally, Q2 of 2022 saw some of these prices begin to decline,[6] which if sustained, may alleviate some of these cost pressures within the construction sector.

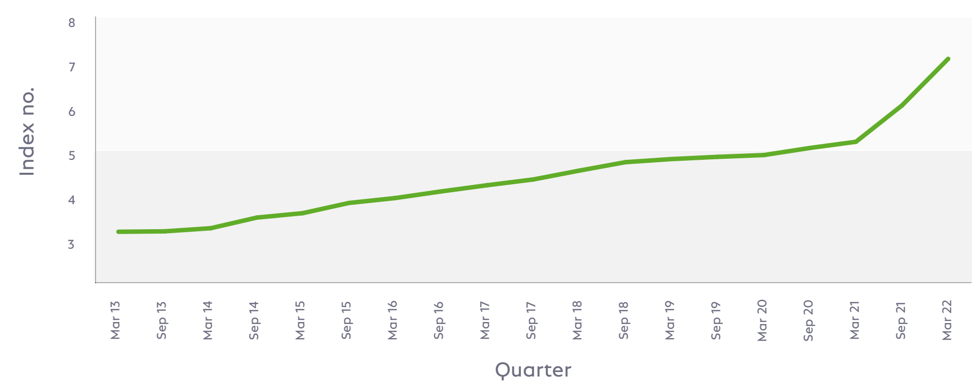
BETWEEN 2021-2022, TIMBER, BOARD AND JOINERY COSTS ROSE BY 20.6 PER CENT, MAKING BUILDING AND CONSTRUCTION COSTS MUCH MORE EXPENSIVE.

In Melbourne, between 2021-2022, construction costs increased by 16.8 per cent, compared to Sydney (the slowest growing), with a price increase of 13.4 per cent.

What rising construction costs mean for policyholders

The cost increases in construction are significantly impactful for property owners with insurance policies. While many property owners might only consider the adequacy of their insurance policies on an annual basis – or, perhaps, even less often – the rapidly increasing prices in

FIG 3



Source Table 3: ABS Producer Prices Indexes, June 2022.

construction materials mean that many properties are becoming underinsured more quickly than property owners might expect.

People or businesses that took out insurance policies prior to the pandemic, and who may not have reassessed their policies and coverage in that period, are acutely vulnerable to this dynamic.

Should an insurance policyholder's property require reconstruction, it is increasingly possible the payouts that the insurance policyholder is eligible for, may not meet the current construction costs of 2022. This exposes many property owners to the risk of underinsurance.

The scarcity of building materials, and the increased demand in construction, doesn't only have impact on direct costs. It also means that buildings are taking longer to construct. For reconstructions, there is an increased risk of delayed works, which may force insurance policyholders to relocate to alternative accommodations for longer than expected during reconstruction after an event.

Mark Chisholm, National Underwriting Manager at CGU says, "With increasing intensity of storms and rainfall, it's important that clients focus on the housekeeping of their facilities. For example, clearing guttering, drains and pipes help to prevent overflow and blockages, and ensure their flood mitigation plans are in place. In addition, when building new properties, clients should consider design adequacy to withstand extreme weather and natural peril events. We understand that affordability is a consideration for many clients so remembering that deductibles and excesses can be a form of premium cost management can assist."

Given the price increases in construction, Australians and small business owners should reassess their sums insured and excess structure more frequently, to ensure they are adequately insured in case of a fire, natural disaster or accident damaging their property. This includes Indemnity Periods with respect to Business Interruption or Delay in Start Up covers. Risk mitigation is a major factor to be considered.

AS AT AUGUST 22, ANALYSIS OF CGU'S BUSINESS PACK PORTFOLIO SHOWS THAT:

- 3 IN 4 BUSINESSES DID NOT CHANGE THEIR PROPERTY SUM INSURED FROM THE PRIOR PERIOD

- 52% OF CLIENTS DO NOT HAVE BUSINESS INTERRUPTION INSURANCE

- AND OF THOSE THAT HAVE BI COVER, 69% DID NOT CHANGE THEIR BI SUM INSURED FROM THE PRIOR YEAR

"SUPPLY CHAIN DISRUPTIONS ARE CREATING SIGNIFICANT INSTABILITY FOR CONSTRUCTION COMPANIES. WITH THE SHIFTING AVAILABILITY OF CERTAIN GOODS AND SERVICES IT'S ESSENTIAL TO INFORM INSURERS IF CLIENTS ARE STOCKPILING SUPPLIES OR ARE INCREASING OFFSITE STORAGE OF MATERIALS, OR ANY INNOVATION/CHANGING OF MATERIALS USED IN CONSTRUCTION AWAY FROM CONVENTIONAL METHODS"

- Chris Jurd, National Underwriting Manager of Construction and Engineering, CGU

UNDERSTANDING PRICE TRENDS IN THE VEHICLE MARKET

COVID-19 shocks led to new and used car prices skyrocketing, impacting the insurance ecosystem

While the housing market in Australia has been perhaps the most obvious frontline of the inflationary pressures in the Australian economy, the vehicle market has also been subject to these disruptions.

In the early periods of the pandemic, Australia's discretionary spending slowed. Simply, Australians were looking for ways to save money, and to protect themselves financially from what was to come. This was seen across many asset classes, but especially the new car market. The same trend was seen across the developed world: consumers were reluctant to purchase new cars everywhere.

This collapse in new car demand, compounded by the supply chain complications that emerged during the pandemic, led to new car production slowing. But it also led to some unprecedented dynamics when it comes to the used car market.

Travel decline led to used car glut, followed by supply crunch

When international and domestic travel markets collapsed in March and April of 2020, there were many disruptions throughout that sector. In particular, rental car companies, seeing their market evaporate, decided to offload much of their vehicle assets. This led to a large supply of used cars flooding global used car markets in those early months of COVID-19.

What followed, however, was anything but a glut. As new car manufacturing and supplies fell, used cars were acquired by cashed-up consumers. This led to historically high used car prices in Australia, especially for utes, and vehicles used for outdoor recreation.

Waiting times for new vehicles of 12-18 months saw many Australian consumers who needed to purchase a car explore the used car market instead. Moody's Analytics have tracked these trends throughout the pandemic, noting a 50 per cent increase in used vehicle prices between 2020-2022.

Prices of repair also increasing, bringing new relevance to insurer's supply chains

Troy Johns is the Claims Cost Strategy Manager within IAG's Intermediated Insurance Australia Division. With an expertise in the motor insurance space, Johns notes that Australia's repair network is highly reliant on imported parts. As Australia's domestic motor vehicle manufacturing capacity has declined, the reliance on the importation of the constituent parts for vehicle repairs have increased. As shipping supply chains have been disrupted over the past two years, Johns highlights just how significant this impact has been.

"WITH RESPECT TO OUR INSURER REPAIR MODELS OUR CURRENT STRATEGY IS TO WORK WITH ALL STAKEHOLDERS TO ENSURE THAT WE HAVE THE BEST SOLUTIONS FOR BROKERS AND THEIR CLIENTS."

– Troy Johns, Manager Claims Cost Strategy, Intermediated Insurance Australia, IAG

For many insurance policyholders, the "choice of repairer" is important. Effectively, many individuals who experience a motor vehicle accident may want to ensure their vehicle is repaired at a repairer of their choosing. Given the cost pressures faced by many in the collision repair sector, however, a clear cost and service advantage can be gained by working closely with the insurer's supply chain. Major insurers in Australia, such as CGU, maintain broad networks of partner repairers, whose scale has created cost and time efficiencies for repairs. For brokers, it is important to communicate the service advantages of utilising the insurer's sophisticated repair network.

USED CAR COSTS HAVE RISEN AS MUCH AS 50 PER CENT BETWEEN 2020 AND 2022, ACCORDING TO SOME MARKET ANALYSTS.

Price volatility demands an insurance rethink

The price shocks in new and used vehicle markets has created a similar dynamic in the vehicle market as to what has been playing out in construction and housing: inflationary pressure creating a situation where many Australians may be underinsured, even without knowing it. If, as a consumer, you bought a $20,000 vehicle in 2020, replacing that vehicle with a car of similar quality and age in the case of an accident will likely now be much more expensive. For comprehensive vehicle insurance policyholders, there is a chance that they are now underinsured. It's important policyholders consider how they may be impacted, based on the cover or policy they have selected, and should speak to their broker or insurer for further information or advice.

MOTOR VEHICLE INSURANCE POLICYHOLDERS SHOULD ASSESS WHETHER ANY SUMS INSURED OR AGREED VALUES ARE ADEQUATE, GIVEN THE PRICE INCREASES IN THE SECOND-HAND CAR MARKET.

FOR BROKERS, IT'S IMPORTANT TO UNDERSTAND YOUR CLIENT'S POLICY AND COVER AVAILABLE, PARTICULARLY AROUND HIRE CAR COVER, DUE TO POTENTIAL DELAYS IN SOURCING CAR PARTS AND NEW VEHICLES.

BUSINESSES WILL NEED TO ALLOW FOR POTENTIAL IMPACTS DUE TO DELAY IN OBTAINING NEW VEHICLES AND PARTS.

THE COVID-19 EFFECT ON THE LABOUR MARKET & WORKPLACE SAFETY

Workers are getting sick, and a scarcity of labour has emerged, creating new pressures on workers' compensation schemes

While this STRIVE Report has outlined the economic disruptions associated with the pandemic, COVID-19 remains first and foremost a health challenge.

As of August 2022, more than 12,500 Australians have tragically lost their lives due to the pandemic.[7] While vaccines and other health interventions have mitigated the worst-case scenarios associated with widespread community transmission, the pandemic nevertheless remains a major health challenge for all Australians.

Managing this new health reality is creating complexities in workplaces, too. As COVID-19 has become more widespread in 2022, millions of Australian workers have contracted the virus. This has led to worker shortages in businesses, as staff enter isolation to recover from COVID and ensure that no other staff members catch the virus.

Of course, this new reality presents an ongoing health risk to workers in their place of work. And it creates new legal complexities associated with the evolving nature of pandemic-era employment.

Are workers adequately covered when working from home?

While millions of Australian workers are unable to work from home, others have taken the opportunity to do so since 2020. For many, this is essential – it reduces the risk of catching and spreading COVID-19, but also enables workers to remain at home if one of their loved ones is ill with the virus, or their child is learning from home.

Working from home arrangements, however, do prompt new questions for employers, particularly when it comes to workers' compensation. Existing schemes may not be fit-for-purpose given the work from home revolution, and employers must be aware of their responsibilities to their workforce, even if they're not in the office.

Labour shortages can create higher risk workplaces

The shortage of staff can also inject new pressures into workplaces, exacerbating health and safety concerns. In high-risk settings, such as aged care and nursing, employers are experiencing consistent staffing shortages. This is leading to health workers undertaking potentially excessive overtime, creating new health risks. Spreading tasks thinly across staff may also sacrifice best practice health and safety standards in high-risk settings such as construction, which needs to be considered in insurance programs.

95 PER CENT OF ALL COVID-19 CASES IN AUSTRALIA HAVE BEEN RECORDED IN 2022.

What COVID-19 means for workers' compensation insurance schemes

The workplace spread of COVID-19 is a new risk for employers. While there have been efforts by governments to move COVID-19 health complications away from the workers' compensation system, it has nevertheless injected new complexities into workplace entitlements.

As with other insurance markets, the disrupted workplace of today requires fit-for-purpose workers' compensation and other insurance products. All employers must be diligent in ensuring their obligations are being met, and that their workers remain safe.

More broadly from a general liability class perspective, David Brown, National Underwriting Manager of Liability at CGU says, "The quantum and frequency of liability claims continues to increase, particularly in the area of non-employee labour (Labour hire and contractors). Adding to the quantum of claims outside regular inflation is an increase in the prevalence of psychological injury damages. We believe this is driven by much more open conversations about mental health, especially since the onset of the pandemic. We would recommend brokers discuss the importance of documentation and record keeping in relation to Work Health and Safety, this includes documented WHS processes, evidence of training, inductions, incidents registers and records of site visitations. Ultimately the availability and credibility of this documentation can have a significant impact on the overall outcome of a claim and influence the level of contribution incurred."

WHILST THE PLACE OF WORK MAY HAVE CHANGED, EMPLOYERS STILL HAVE AN OBLIGATION TO PROVIDE AND MAINTAIN A SAFE WORKING ENVIRONMENT, REGARDLESS OF PHYSICAL ATTENDANCE IN THE 'WORKPLACE'.

"SUPERIMPOSED INFLATION IS A SIGNIFICANT DRIVER OF CLAIM COST INCREASES THROUGHOUT THE VARIOUS WORKERS COMPENSATION SCHEMES, NOTABLY LUMP SUM AND LEGAL EXPENSES ARE KEY CONTRIBUTORS DRIVING UP AVERAGE CLAIM COSTS. IT IS IMPORTANT OUR BROKER PARTNERS DISCUSS THE IMPORTANCE OF MAINTAINING PRE-EMPLOYMENT DISCIPLINE AND CONDUCT EXTENSIVE INDUCTION AND SAFETY TRAINING WITH THEIR EMPLOYEES TO MITIGATE POTENTIAL INCIDENTS AND EXPOSURE TO A COMMON LAW CLAIM"

- Michael Rathjen, National Underwriting Manager of Workers Compensation at CGU

PREPARING FOR AN ERA OF ENVIRONMENTAL UNCERTAINTY

The effects of climate change are becoming more costly

Though COVID-19 and its associated health and economic impacts have upended the world since 2020, the unfortunate truth is that, in the meantime, climate change continues to grow as a threat and challenge to Australia and the world. While this STRIVE Report has focused significantly on the major economic disruptions of 2020, 2021 and 2022, these series of economic events were preceded by one of the worst bushfire seasons on Australian record.

Climate change: a global issue with uniquely Australian consequences

Climate change is a global issue, driven by the actions of the international community. But Australia has much at risk due to this global phenomenon. These risks, too, are becoming clearer every year.

The *Black Summer* bushfires saw flames spread across the eastern seaboard, even scorching tropical rainforests that had never previously burned.

Cities like Sydney became shrouded in a smoky haze for weeks, and the damage bill ran into the billions. 33 lives were lost directly, with the CSIRO estimating that 450 further deaths were a result of smoke inhalation.[8]

Since the 2019/20 summer, Australia has experienced two mild summers, which have minimised the immediate bushfire threat. But these mild summers themselves came about due to an extended La Niña weather pattern, which while bringing cooler summers and increased rainfall. This in turn has contributed to widespread flooding events in Queensland and New South Wales, in particular. What Australians are now seeing is an increased frequency of severe weather events. And while the increased occurrence of these events is certain, it remains a challenge for authorities and communities to accurately forecast with precision when and where these events will occur.

Temperatures & rainfall events both increasing

“PROGRESSIVELY, WE ARE SEEING THAT THE UNDERLYING RISK [DUE TO CLIMATE CHANGE] IS INCREASING”

– Amy Huen, Executive Manager IIA Pricing, IAG

The trajectory is for these types of weather events to increase. As Australia’s population grows, more buildings are being placed in known risk areas, prone to either flooding or bushfire. As the CSIRO’s Garry Cook and Andrew Dowdy have argued, “we need to be ready for more *Black Summers* – and worse”.[9] Given the increasing strength and intensity of both these extreme weather events, this new paradigm has significant insurance implications.

The growing challenges associated with climate change come at an astronomical financial cost. Over the past five years in Australia, almost 1 million insurance claims have been made that relate specifically to major natural disasters, such as floods, bushfires, or cyclones. The cost of this is considerable.

The broader economic impact of climate change related to natural disasters is significant and predicted to increase under scenario modelling of low, medium, and high atmospheric greenhouse gas emissions.

TODAY, NATURAL DISASTERS COST THE AUSTRALIAN ECONOMY $38 BILLION PER YEAR ON AVERAGE. REPRESENTING APPROXIMATELY 2% OF AUSTRALIA’S GROSS DOMESTIC PRODUCT (GDP) IN 2020. EVEN UNDER A LOW EMISSIONS SCENARIO – WHEREBY TIMELY ACTION WILL SEE EMISSIONS START TO FALL AND REACH ZERO BY 2100 – THIS COST WILL RISE AT LEAST $73 BILLION ANNUALLY BY 2060, OR 4% OF AUSTRALIA’S GDP IN 2020.[10]

– Australian Business Roundtable for Disaster Resilience & Safer Communities, 2021

These numbers can be so large that they are almost intangible, but what this figure means is simple: Australians will be increasingly impacted by the social and economic impacts of fire, flood, and extreme natural disasters without targeted investment in disaster mitigation initiatives, enhanced building codes and improved land use planning.

This new paradigm increases risks for insurers, may place additional premium costs on property owners, and creates a new environment in which many Australians may be underinsured given the extent of the risks and hazards they face.

The findings from IAG’s report on Small Business Resilience which analysed the effects natural disasters have on small businesses confirms the same. The report took an in-depth look into two significant events – Townsville Floods (2019) & *Black Summer* Bushfires (2019-20) and found that:

- On average, between 65% - 72% of total economic impact from the floods and bushfires was attributed to small businesses.
- The economic impact of the Townsville floods is estimated at $2.5 billion reduction in GDP with the impact to small businesses estimated at $1.5 billion. While the *Black Summer* Bushfires reduced the GDP in NSW, VIC, SA, and QLD by $2.7 billion. In NSW alone, it’s estimated that small businesses suffered a $1.8 billion reduction in GDP.

The report also highlighted in an ACCC survey of 75 small businesses in Townsville (2019) that flood coverage and business interruption is still underinsured:

- Only 44 per cent of businesses with flood cover for damages also had cover for business interruption, which was the most common impact;
- More than 60 per cent of impacted businesses needed to close or reduce operation, with 28 per cent needing to close for more than three months, and 20 per cent interrupted for 6 – 12 months; and
- 67 per cent of small businesses believed their business wasn’t in a flood zone, while a further 20 per cent chose not to have it because the business didn’t operate out of the ground floor or basement.

RECENT RESEARCH SHOWS THAT RAINFALL IN SOME SEVERE WEATHER SYSTEMS IS INCREASING AT A MUCH FASTER RATE THAN PREVIOUS ESTIMATES OF A 7% INCREASE PER DEGREE OF GLOBAL WARMING. THIS IS LIKELY TO CONTRIBUTE TO EVEN HIGHER FLOOD RISKS IN SOME REGIONS.

– IAG Severe Weather in a Changing Climate Fact Sheet, 2nd edition September 2022

OUR REPORT RECOGNISES THAT SMALL BUSINESSES, THE NATION'S LARGEST EMPLOYER ENGAGING MORE THAN 4.7 MILLION PEOPLE, ARE AT THE GREATEST ECONOMIC RISK WHEN FACED WITH NATURAL DISASTERS, WITH RISK AWARENESS, UNDERINSURANCE, AND A LACK OF MITIGATION ACTIVITIES CRITICAL FACTORS. THESE ARE CRITICAL AREAS WE NEED TO ADDRESS AS A NATION TO SUPPORT PEOPLE, BUSINESSES AND COMMUNITIES INTO THE FUTURE.

- Damien Gallagher,
CGU Executive General Manager

CONCLUSION: INSURANCE IN A TIME OF UNCERTAINTY

Disruption demands planning and preparation, not panic

This STRIVE Report is published during a period of profound disruption, in Australia and internationally.

Lives are being lost from a global pandemic; global economies are experiencing significant inflationary pressures; war has returned to continental Europe, and climate change is continuing to pose real and present dangers to lives, livelihoods, and properties globally.

When confronted with this challenging paradigm, it is tempting to panic or even become complacent. That is true whether you're a home-owner, a worker, a small business owner or an insurance broker working with clients to deliver the best possible outcomes.

But this moment of disruption is not a time for panic; instead, it demands level-headed planning and preparation. This is especially true for the insurance sector, and for households and businesses reliant on quality insurance products for their peace of mind, business continuity and for practically dealing with many of the challenges this paper has described.

Communities, businesses, and governments must embrace a mindset of preparedness, prioritising mitigation activities to lower risks and build resilience against future hazards and natural disasters.

Meanwhile, households and businesses in working with their insurance brokers must increase their understanding of risks, regularly reassess dangers to their environment and acquire adequate insurance to meet their specific circumstances.

This report has detailed this moment of disruption, and aims to offer practical high-level insights into these economic times to better equip brokers in their dealings with clients. The role of brokers now is more important than ever. Given the potential of increasing premiums and an evolving risk environment, delicate, professional advice to current and prospective insurance clients is essential not only for the insurance sector, but to ensure Australian households and businesses are adequately protected.

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