CGU Insuring Ambition

THE STRIVE REPORT

Second Edition

February 2024

CONTENTS

Foreword

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 pushes us forward and upwards. We believe that essential to supporting the success of our broker partners is the delivery of key business insights, equipping them with the knowledge and understanding to elevate their role as trusted advisors to their clients.

As expected, a lot has changed in the 18 months since we issued our inaugural STRIVE Report. With the COVID pandemic now behind us, we face a future that continues to challenge the way we live and work.

The resilience that we forged during a time of uncertainty and disruption continues to be tested in the wake of increasing interest rates and inflation, climate volatility, stressors on the supply chain and the labour market, and emerging technologies. These factors are placing ongoing pressure on household incomes and businesses alike.

As trusted advisors, it is critical for brokers to help their clients navigate this complexity by breaking down the key themes that impact their clients' insurance programs.

As customers, it is important to understand the complex landscape that insurers and brokers contend with as they curate products and services to protect their personal and business assets.

As Australians, we are not immune from global events such as war and natural catastrophes. The world continues to evolve at a rapid pace, with artificial intelligence quickly increasing its depth, scale, and capability, making it essential for us all to stay abreast of what is changing, what it means, and why it is necessary to adapt.

As we did in STRIVE 1, we have researched numerous reputable publications and interviewed subject matter experts from across IAG, CGU, and senior broking leaders to glean key insights on these major themes and unpack what it all means.

Our broker partners and customers found our first STRIVE Report to be of immense value, helping to build their awareness and understanding of the broader themes that influence the insurance industry.

We are proud to deliver STRIVE 2 as part of our ongoing commitment to providing education and insights to demystify insurance, empowering customers and communities to be safer and more resilient in the face of constant change.

It is our hope that the insights within this report are of value as you continue to strive towards achieving your ambition – however big or small.

Damien Gallagher
Executive General Manager, CGU

INTRODUCTION

We first launched STRIVE during a period of significant disruption and change. Australians were coming out of the most acute stage of the pandemic and grappling with what their post-COVID 'new normal' might look like, both personally and professionally.

Our ambition was to empower brokers and customers with information that could help them make sense of the volatile geopolitical, climate, and social changes occurring around them and how they influenced their insurance programs.

The feedback was overwhelmingly positive, reaffirming that the insights contained within the report were both valuable and useful.

Over 18 months down the track we are still navigating an ever-changing world, now with two major wars playing out. With the release of CGU's second STRIVE Report our intention remains the same - to help our broker partners help customers by having more informed conversations about the big themes that continue to impact us all.

In this edition, we revisit the forces of 2022-23 to see what has changed and introduce fresh insights into the Australian economy, the market forces and technological changes that present new challenges and opportunities for the insurance industry to navigate.

We discuss how reinsurers, the world-wide financial safety net for insurers, view the climate challenges facing Australia. We also review how businesses may operate differently and more productively with the emergence of generative AI.

While the world is still in turmoil and our news cycles continue to feed doom and gloom into our daily narrative, there is still hope on the horizon.

At the heart of the STRIVE Report is the intention to empower brokers and customers with the aim of future-proofing lives and livelihoods. With so much seemingly out of our control, we are still in a unique position to consider what these challenges mean, so we can anticipate problems and imagine solutions together.

As a major Australian intermediated general insurer, we are privileged to share a unique tri-party relationship with our broker partners and customers. By inviting you to read our second STRIVE Report, we hope the information and insights contained within add meaningful value to the vital role of brokers as trusted insurance advisors, so they can support their customers to realise their ambition.

An excerpt from the UN Secretary-General's UN Council address

September 19, 2023.

"Excellencies,
Our world is becoming unhinged.
Geopolitical tensions are rising.
Global challenges are mounting.

And we seem incapable of coming together to respond.

We confront a host of existential threats – from the climate crisis to disruptive technologies – and we do so at a time of chaotic transition.

The world has changed. Our institutions have not.

Climate chaos is breaking new records, but we cannot afford the same old broken record of scapegoating and waiting for others to move first.

And to all those working, marching, and championing real climate action, I want you to know that you are on the right side of history and that I am with you.

I won't give up this fight of our lives."

António Guterres,
UN Secretary-General

INSIGHTS FOR GENERAL INSURANCE BROKERS AND THEIR CUSTOMERS INTO THE MACRO-ECONOMIC, SOCIAL AND ENVIRONMENTAL ISSUES THAT IMPACT INSURANCE.

February 2024

PART 1

Insurance affordability

Since STRIVE 1 was released, Australia's post-pandemic economy has continued to be tested. As excess demand collided with significant supply-chain constraints, Australia's rate of consumer price inflation rose significantly.

KEY POINTS

1. **The biggest economic story of 2023 was inflation and monetary policy efforts to contain it.**
2. **Inflation has peaked in Australia and in other advanced economies, but remains higher than desired, and is still higher than wage growth, weakening consumer confidence.**
3. **Aggressive monetary policy has seen the costs of borrowing increase — both in Australia and globally — with the era of record-low interest rates over.**

For everyday Australians, this meant that the price of goods and services kept rising, exceeding the rises in average earnings that have also been seen over the same period. This confluence of events from 2022 has meant that, on average, Australians are likely to be in a worse financial position than they were a year ago, with their earnings able to purchase fewer goods and services than at the same time in 2022.

Since May 2022, the Reserve Bank of Australia (RBA) has increased interest rates thirteen times. The 'emergency' rates of the pandemic, designed to stimulate the economy, have been relegated to history, with the cash rate target now exceeding 4%. Australia's Consumer Price Index (CPI) rose by 1.2% to 5.4% in the September 2023 quarter.

CPI remained lower than the 6% annual rise in the June 2023 quarter. This was also the third quarter in a row of lower annual inflation, down from its peak of 7.8% in December 2022. Nevertheless, prices continued to rise during the September quarter for fuel, rents, electricity, and insurance, however there were some offsetting falls in childcare, vegetables, and domestic holiday travel and accommodation.

For a household with a $700,000 mortgage, the cost of interest rate increases is around $1,000 more per month than it was prior to the monetary policy tightening process. Of course, there are many households, particularly those in Sydney and Melbourne, for whom these mortgage cost increases are much higher. The affordability and availability of rental accommodation also continue to outpace housing growth, triggering a Commonwealth Rent Assistance support increase of 15% on top of CPI indexation, the largest increase in 30 years.

RBA Cash Rate Target Since Montary Tightening Cycle, 1 May 2022

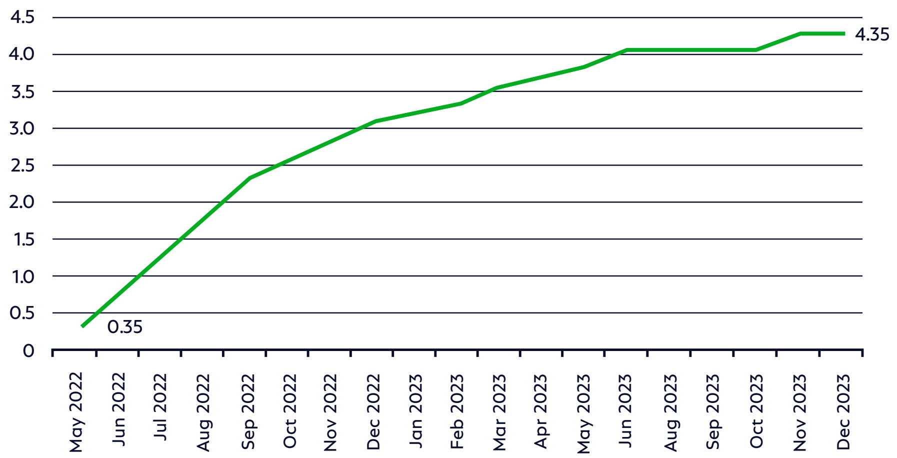


Fig. 1.1

https://www.rba.gov.au/statistics/cash-rate/#cash-rate-chart

During a time of increasing uncertainty and significant transition, consumer demand and confidence is weakening, heavily influenced by rising inflation and its impact on interest rate rises.

Though the RBA and the government are navigating what they call the 'narrow path' - a reasonably timed return to target inflation in a growing economy without losing labour market gains - they remain real challenges for Australians in this economy.

Across the board, purchasing power is down, as is consumer confidence. Because borrowing costs are high, fewer households are participating in leisure activities, or renovating their homes, or building new properties. This outcome, while intended by policymakers, does also have economic costs.

When it comes to insurance, many households facing additional pressures to meet the rising costs of basic essentials are struggling to afford increasing insurance premiums. In this context, there is a risk that some families may become underinsured by not adequately covering their homes, their vehicles, or any other liabilities to manage cost of living pressures.

Many households facing additional pressures to meet the rising costs of basic essentials are struggling to afford increasing insurance premiums.

Although supply chain itself has improved, the sustained rate of building inflation over the past twelve months may lead to consumers underestimating just how much it will cost to rebuild a damaged property or to repair a damaged vehicle - a challenge that remains in this new economic paradigm. While overall inflation has moderated over Q2 and Q3 of 2023, in general building inflation has consistently outpaced the rate of consumer price inflation.

This has led to a scenario where the price of repairing property in mid-2023 is considerably higher than doing so a year ago — and that the pace of this price increase has occurred faster than most other rising costs elsewhere in the economy. Some industry experts predict this could be as high as 20%, with obvious flow on effects to premiums.

Australian Consumer Price Index, 2013 - 2023

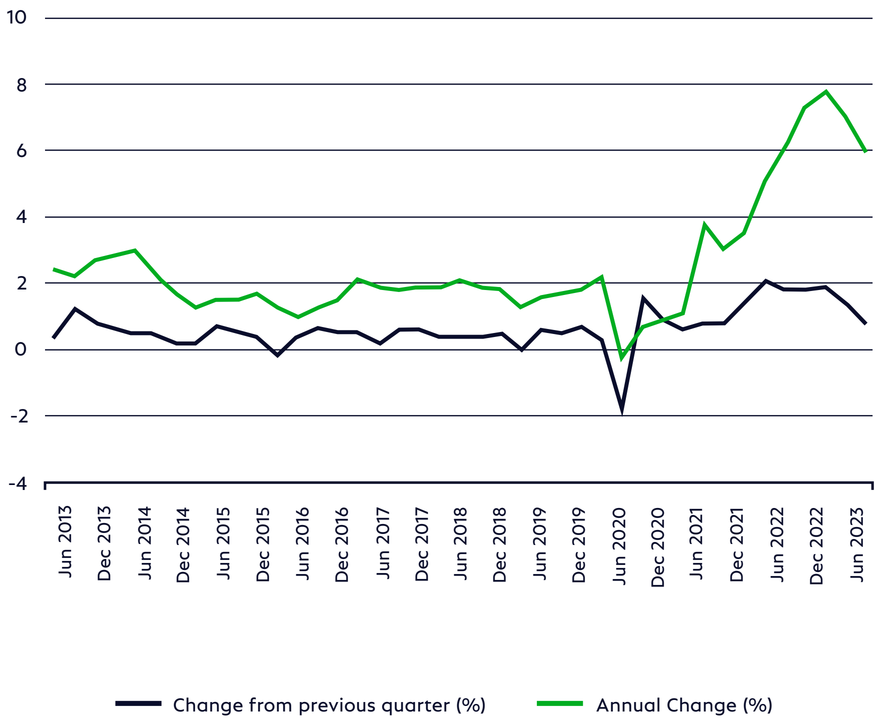


Fig. 1.2

Consumer price index. Source: ABS (Australian Bureau of Statistics) (Australian Bureau of Statistics) Cat 6041.0.

BROKER TIP

Having regular conversations with clients about appropriate sums insured remains an imperative, as relying on built-in CPI increases may not be enough to stay in line with inflation.

Fortunately, many Australians have experienced a largely benign weather period during 2023, however some IAG brands are experiencing more water and fire damage claims that are not driven by natural perils. Although claims lodgement volumes are significantly lower, this leaves us more prone to large loss outliers with claims that are more expensive to fix.

The most noticeable shift has occurred in the second-hand car market. With values now reducing as demand for second-hand vehicles softens, many insureds are now finding themselves over insured. Market data indicates total loss values are decreasing and agreed values are increasing, contributing to higher claims costs on motor policies covering these vehicles. This could be an opportunity for customers to pay less than expected on their yearly renewals (which are often rolled over) by reassessing the value of their second-hand vehicles.

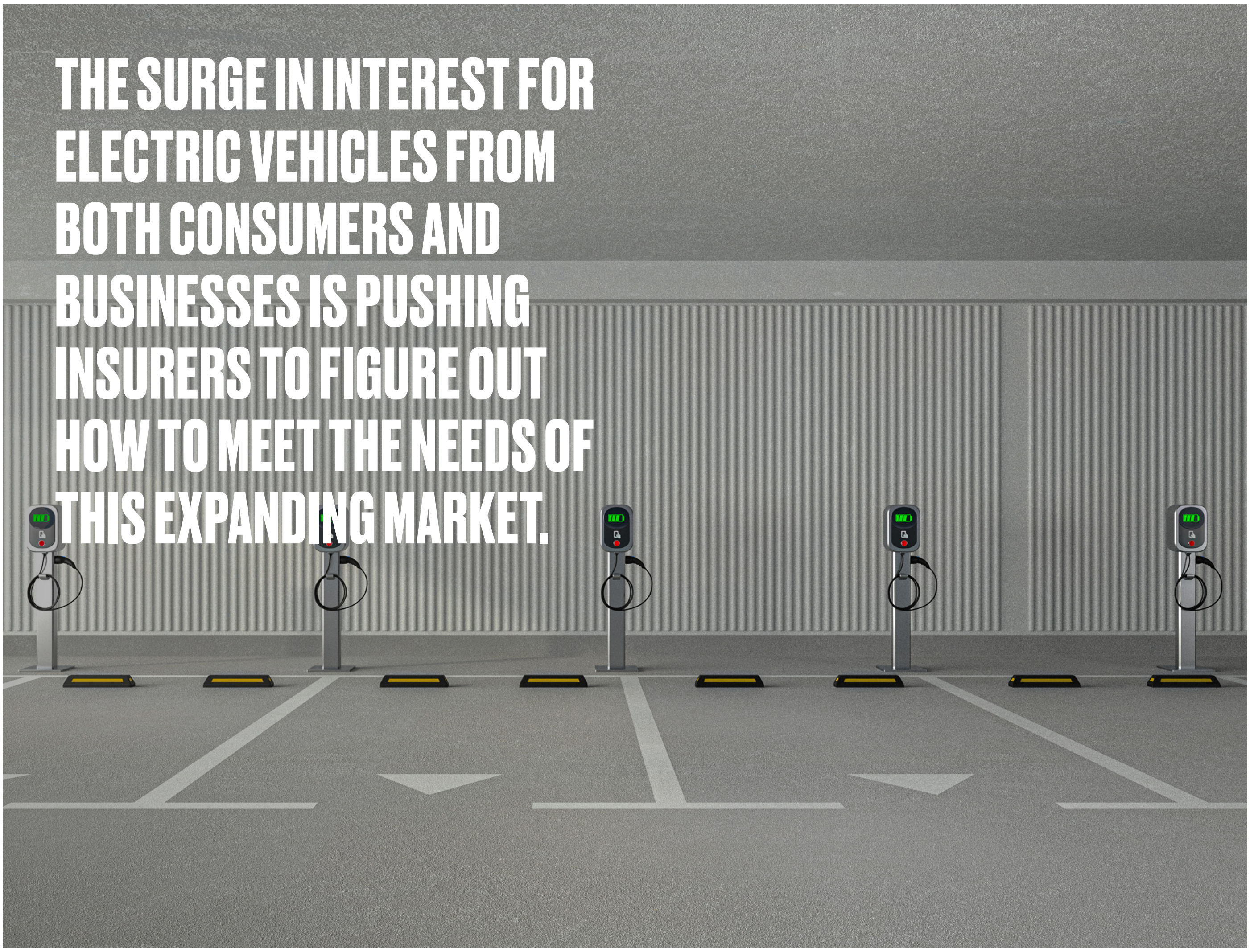
Fortunately, procurement for vehicle parts is occurring at a much faster rate than during the pandemic and its immediate aftermath. Although not back to pre-pandemic efficiencies, the time elapsed between ordering parts and repairs has reduced significantly. After seeing annual increases of 6-7% from Jan 21 through to early 2023, we have now seen labour costs plateau over the last six months. However, parts for popular vehicles such as Toyota Landcruiser and Hilux, Holden Colorado, and SUVs such as Mazda CX-5 and Toyota RAV4 have seen a higher rate of repair cost inflation than other vehicles. The overall rate of increase from 2021 – 2022 was 16% with parts for some models increasing by as much as 25%. Headlamps, bonnets, and windscreens have seen price movements well above the average, largely due to the high cost and design complexity to manufacture with LED lights, sensors, and integrated vehicle safety and driver aid systems. Concerningly, rural and regional Australia is experiencing a dwindling number of options for vehicle repairs, with many smash repairers retiring and closing shop, often without succession planning in place. For insurers, having strong assessing and smash repair relationships is essential to offering a sustainable and cost-effective provider network. As technology continues to evolve, insurers must also evolve this network to continue mitigating rising repair costs whilst delivering effective and efficient customer outcomes.

BROKER TIP

Given these market conditions, consider the merits of Agreed versus Market Value when placing clients' motor insurance.

Demand for new vehicles continues to surge, with continued growth in the automotive sector in 2023. By October 2023, new vehicle sales had increased by 22.3% on the previous year, with five consecutive months of 100k+ unit sales per month. Passenger vehicles remain popular, but SUVs continue to dominate the market with over 55% of sales attributed to this class.

This is a strong indicator of supply chain improvement with Australia reaching one million new vehicle sales in October for the first time – a significantly positive shift since the COVID era. Increasing consumer and business demand for electric vehicles is placing pressure on insurers to find a solution to accommodate this growing market segment. This is not limited to personal use, with large government entities and corporations also looking to invest in electric vehicle fleets. From a supply chain perspective, challenges are arising with electric vehicle manufacturers reluctant to provide parts to providers who are not badged repairers.



In some cases, customers are expected to pay up-front for repair costs before reimbursement by their insurer, creating additional frustrations and delays with the claims process.

Scarcity of labour in the production of essential materials has led to increased costs, broadly characterised as inflation. During 2022, input prices to housing construction rose 4.4% overall, but remained consistently steady with 0.0% change in the September quarter. This followed sixteen consecutive quarterly price rises since December 2019 which saw construction costs peak at the height of the pandemic. While the residential construction sector now maintains a steady level of activity, suppliers have resorted to offering discounts on products used in earlier construction phases (such as paints) to stay competitive in a constrained market. Furthermore, the recent surge in energy prices is further amplifying manufacturing costs for bricks and tiles. Reassuringly, any significant pricing changes have been offset by improved supply conditions for structural timber and easing demand from China for steel.

From a claims supply chain perspective, longer claims periods and higher settlement costs are a direct result of these inflationary and supply chain influences. These costs are often too late to be fully recognised in an insurers' premium, leading to potential future increases by insurers.
This is a pricing tail that is yet to be fully costed into insurance premiums. This, too, creates a risk that households become inadvertently underinsured, although this risk can be curtailed by calculators (such as Cordell's Sums Insured Calculator) that factor in inflation.

PART 2

Labour shortages remain entrenched despite economic headwinds

The impact on insurance remains significant

The Australian labour market remains tight, and the war for talent remains, with unemployment at 3.9% in November 2023, remaining close to historical lows. All industries are struggling to attract new talent to provide additional services in a still-growing economy, compounded by the fact that almost 50% of all businesses have experienced increased operating expenses and still face ongoing supply chain disruptions.

This includes those in the trades and repair industries, which may impact the ability for insurers to meet consumer expectations promptly and economically after claims. The demand for trades is felt most acutely in regional and remote areas, with the sustainability of builders' business operations essential to insurers providing prompt service and quality repairs. With demand for builders in metropolitan areas having stabilised during a benign weather event period, they are now more able to meet demand in regional and remote areas.

Despite predictions that the unemployment rate will significantly increase, so far, this has not eventuated – which suggests that the pressures employers face regarding staffing will likely remain well into 2024. Although wage increases are required to retain key talent, Australia's economy simply cannot afford aggressive wage increases, with many businesses still struggling with increased operating costs and lower consumer demand driven by inflation.

BROKER TIP

We boosted our panel builders during COVID, and these arrangements remain. We encourage brokers to consider our panel builders as this can be an efficient and cost-effective way to finalise a claim.

Inflation's impact on the business sector

Rising inflation has created ongoing ripple effects through all parts of the Australian economy. The rising cost of raw materials and labour to produce goods and services continues to impact the supply chain, with the flow-on effects impacting customers already on tight budgets.

Household spending has dropped significantly as homeowners and renters tighten their belts, contributing towards lower revenues and sluggish economic growth. At the time of writing this report, Australia's economic growth had slowed down to below 2.5% per annum and is expected to remain subdued for the next 18+ months. This is due to the fastest RBA tightening of monetary policy in decades - a response to the elevated level of inflation experienced in the economy, driving a much slower and weaker than expected post-pandemic recovery. Analysts predict further interest rate rises, which, combined with lagging consumer confidence, suggests the weak economic environment will persist well into 2024.

Although the latest forecast from the RBA and OECD statistics indicates Australia's inflation rate may ease to 2 – 3% in the next 18 – 24 months, this is cold comfort for insureds who are likely to keep reassessing insurance coverage and sums insured to save costs, further highlighting the very real risk of underinsurance.

Regularly reassessing sums insured for domestic and commercial property risks has always been significant, but it is now a fundamental conversation between brokers and Insureds in a high inflationary environment. Relying on inflation triggers in policy wordings may be insufficient. Especially for commercial properties, conducting regular valuations at least every three years may assist Insureds in safeguarding against the risk of underinsurance.

In addition, observing risk management and mitigation recommendations on properties can help Insureds to not only avoid preventable claims from occurring but also present more attractive new business and renewal risks to underwriters.

This message is gaining traction in the Property ISR (Industrial Special Risk) space. We have seen post-valuation sums insured having increased on average by 8.18% between June 2022 to June 2023. Conversely, we have not seen the level of increase in SME customers revising their property sums insured. This may be to avoid premium increases that strain already tight operating margins. We are also seeing a 'set and forget' behaviour where sums insured are not increased at renewal, with a lack of movement not reflecting changing inflation. An emerging trend is also a shortage of accredited valuers in the market to meet the demand for valuations, creating a gap of about 12 months to pick up the Insureds who have not yet taken up a property valuation in the past three years.

Businesses and their operations are unique, and business interruption is not a 'one size fits all' cover. Choosing the appropriate coverage structure provides flexibility to protect a businesses' income by considering earning patterns and fixed costs. This can set a lower sum insured that still provides the level of protection without the insured being charged for expenses they do not require cover for.

Within SME, the take-up of business interruption cover has been historically low. It can be perceived as an extra expense on top of a business insurance policy, with customers lacking understanding of the potential loss scenarios (including contingent interruptions to their business) that can severely impact their ability to trade. With increasing frequency of natural perils, labour shortages, and a high inflationary environment, businesses should consider extending their business interruption coverage. In the event of a claim, these factors may influence the length of time required to complete repairs.

Observing risk management and mitigation recommendations on properties can not only help insureds to avoid preventable claims from occurring, but also present their new business and renewal risks in a more attractive light to the underwriters who consider them.

Fig. 2.1

BUSINESS PACKAGE INSIGHTS

9 IN 10
small businesses did not change their property sum insured from prior period

77%
of customers do not have Business Interruption Insurance (BI)

78%
of those that have BI cover did not change their BI sum insured from the prior year

NEARLY 1 IN 5
customers currently only have $5M of Liability cover or no cover at all

Based on CGU portfolio data of 75,751 policies.
Figure 2.1: Analysis of CGU's Business Pack portfolio data, indicating the degree of underinsurance and absence of Business Interruption.

PART 3

Understanding the drivers of higher insurance premiums – reinsurance market spotlight

Throughout 2023, many Australian insurance customers have been confronted by 'bill-shock', when renewal costs exceeded their expectations. Since June 2022, insurance costs have increased due to a confluence of factors, including an increase in natural peril threats, building inflation, higher reinsurance costs, and a tightening labour market.

KEY POINTS

1. **Markets are readjusting prices to account for the consistent increase in frequency, severity and cost of claims.**
2. **In Australia, insurance premiums have risen considerably for households, businesses, and other consumers of insurance products.**
3. **One of the drivers of premium increases is rising reinsurance costs due to more frequent and severe natural peril events.**

Many consumers are not aware that insurance price increases may be driven by external, global forces, as well as the underlying risk profile of the Australian and New Zealand insurance market.

Reinsurance is an essential component of the insurance industry. Insurance companies take out reinsurance policies to protect themselves and their shareholders from catastrophic losses, just as consumers of insurance products take out insurance themselves. But just like consumer insurance products, the price of reinsurance is intrinsically tied to underlying risks associated with the peril being (re) insured against.

"Reinsurers responded to the increase in natural peril losses and economic conditions that have affected us here in Australia and New Zealand, and across the globe. This led to a hardening of the reinsurance market which means reinsurers are charging more for the protection they sell insurers."

- Emma Hill, Executive Manager Placement & Underwriting, IAG Group Reinsurance

The price of catastrophe reinsurance has risen, due to the increase in recent years in (re)insured losses, occurring both in Australia, and globally.

This, combined with other economic pressures such as high inflation and poor investment returns, has led to an increase in pricing as reinsurers seek to improve returns.

"One thing that has impacted us significantly was natural perils and reinsurance costs. We have seen very large increases in natural peril and reinsurance costs in recent times, and it appears to be a common trend in the market. Consideration and allowance need to be made for this as we assess and price for the risks we underwrite."

- Amy Huen, Executive Manager, Intermediated Insurance Australia (IIA) Pricing

STRIVE I described 2022 as a year of disruption, much of which was attributed to natural peril events. Throughout 2022, major flooding events affected much of the east coast of Australia. Additionally, regular rain and hail events saw an increase in insurance claims. The weather events of 2022 came after two years of pandemic related disruption, which was itself preceded by the 2019/20 Black Summer bushfires.

Premiums surged by March 2023

28% Insurance premiums

50% High-risk properties

According to the Actuaries Institute of Australia, home insurance premiums rose by 28% industry-wide to an average premium of $1,894 in March 2023. Unsurprisingly, high-risk properties (such as those in flood-prone areas) attracted the highest increases, by as much as 50%.

According to the Actuaries Institute, the flow-on effects on premiums from the devastating 2022 East Coast floods have impacted the policies of approximately 171,000 households located in Southern QLD and Northern Rivers NSW to the tune of $1.5 billion per annum or $8,800 average premium per household.

Insurance affordability stress is a real concern for many Australians. The Home Insurance Affordability Update assessed that 12% of households are considered to be under affordability stress (determined when the annual cost of home insurance exceeds four weeks of gross household income). The estimated home insurance premium for those 12% of Australian households is $3.6 billion, representing a potentially large 'protection gap' for those affordability-stressed households, which either do not purchase adequate home insurance and are therefore underinsured, or not insured.

This is of considerable concern with government and policymakers being called upon to explore short, medium, and long-term funding packages and other measures to reduce insurance affordability stress, such as the June 2022 Cyclone Reinsurance pool and (in extreme cases) community relocations.

Fig. 3.1

CATASTROPHE 221: SE QUEENSLAND AND NSW FLOODS

Claims Count	Claims Incurred	Outstanding	Closed Rate
243 thousand	6.09 billion	570 million	95.2 percent

Figure 3.1: Insurance Council of Australia (ICA) figures for CAT 221 (Oct 2023).

Cyclone reinsurance pool illustrative of government interventions

In July 2022, the Australian government established the Cyclone Reinsurance Pool. The Cyclone Reinsurance Pool is a reinsurance arrangement between insurers and the Australian Reinsurance Pool Corporation (ARPC). The Pool operates Australia wide and covers cyclones and cyclone-related flood damage. The Pool is intended to make insurance more affordable for eligible home and contents, residential strata, landlord policies and commercial property with maximum sum insured less than or equal to $5 million.

This is a window into the types of government interventions that are being implemented to mitigate against escalating insurance costs.

Additional government interventions

Both NSW and QLD state governments have acted by setting up home resilience funds such as the Northern Rivers Resilient Homes Fund in 2022 and the QLD Resilient Homes Fund. The latter provided $741 million in combined funding from the Australian and QLD governments to deliver three programs: Resilient Retrofit Program, Home Raising Program, and Voluntary Buy-Back program for eligible properties. In addition, improved data, and technology usage such as that provided by the Queensland Reconstruction Authority is contributing $6m towards more accurate surveys that better map flood terrain to mitigate risk factors for future weather events.

Figure 3.2 illustrates the extent to which household insurance claims have risen in recent years in Australia. Over $10.3 billion in claim payments were made to householders in 2022 – exceeding even the disastrous 2019/20 bushfires.

Increased Australian risk profile inflating reinsurance costs

Both the increasing risks of natural perils and price pressures exacerbated by building inflation have contributed towards Australia's changing risk profile for reinsurers internationally. Although not the only driver for increased insurance costs, the unavoidable consequence is that insurance companies across the globe are negotiating much higher reinsurance rates than in previous years.

Inevitably, these costs flow into consumer insurance premiums. In an ongoing environment of economic change and climate unpredictability, it is difficult to project what impacts may be felt in future reinsurance programs. But the ongoing pressure on consumers to adjust to a new normal of increased insurance premiums to adequately protect their risks looks likely to remain for the foreseeable future.

Gross claim payments ($million) by accident year, households 2012-2022

Fig. 3.2

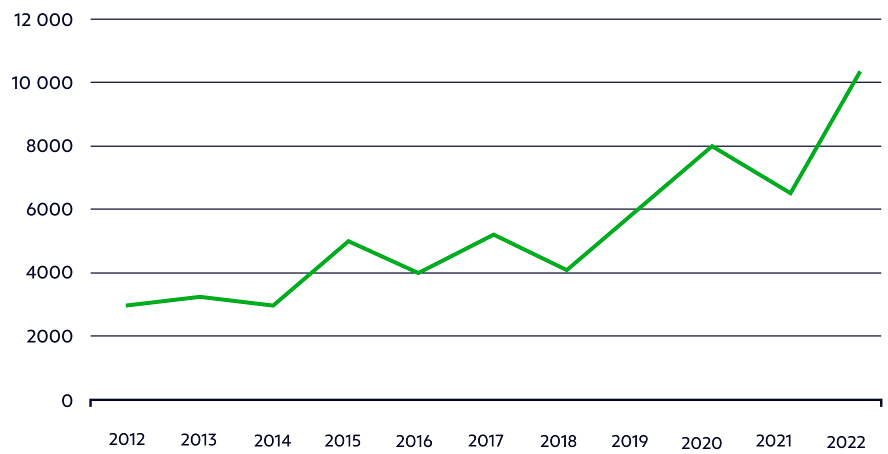
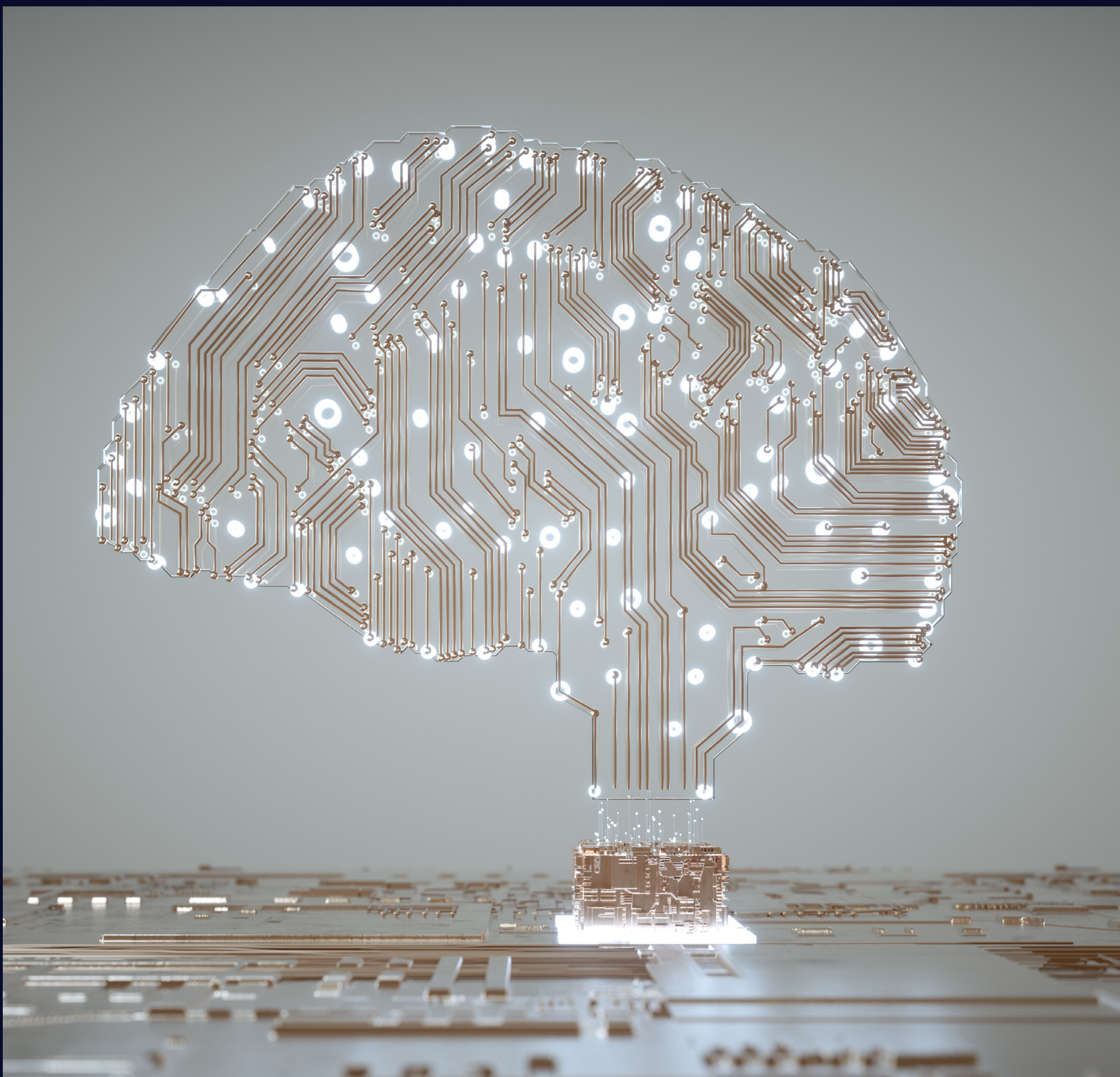


Figure 3.2. Source: Australian Prudential Regulatory Authority (APRA) General Insurance Claims Development Statistics – issued 20 July 2023 (for December 2022).

PART 4

A year of technological change and opportunity



In March 2023, the internet lit up with a bizarre series of viral images. In one, a hyper-realistic depiction of Pope Francis wearing a fashionable puffer jacket went global. In another, images of former US President Donald Trump being carried away by law enforcement circulated widely.

What bound these images was their source: generative artificial intelligence. The images were not only digitally rendered but had been done so through only a human prompt into an AI tool. The near photo-realism of the images spoke to the rapid evolution of artificial intelligence, and its applications.

KEY POINTS

1. 2023 has seen the rapid emergence of Artificial Intelligence (AI) services and products challenging business practices in Australia and globally.
2. Viral content and moments driven by novel generative AI technologies have concerned policymakers and the public, but offer real potential for consumers, too.
3. In the insurance space, novel AI solutions are being considered as a way of streamlining consumer services for insurance customers.

These viral images coincided with the launch of a new AI tool, ChatGPT. A program developed by company Open AI, now owned by Microsoft, and incorporated into the Bing search engine, became one of the most rapidly adopted platforms in recent years. In January 2022, it reached over 100 million monthly users worldwide before being eclipsed by Meta's Threads app. ChatGPT is the most advanced AI language model in operation. With simple prompts, it can generate poetry, reports, software code, or detailed analyses of complex issues.

This has since triggered several lawsuits against Microsoft (MSFT.O), Meta Platforms (META.O) and Stability AI, who are being put on notice by writers and authors challenging these tech giants with copyright infringement class-actions over the unauthorised use of their work to train ChatGPT.

The viral moments AI enjoyed earlier in 2023 spoke to the rapid emergence of these innovative technologies. While AI software and machine learning have been around for years, 2023 has undoubtedly become the year in which these programs became mainstream – and the year in which companies, governments, organisations, and consumers have become both concerned and open-minded about the future AI technologies may bring.

While AI software and machine learning have been around for years, 2023 has undoubtedly become the year in which these programs became mainstream.

Case study: ChatGPT analyses AI's relevance to Australian insurance

Figure 4.1 showcases how ChatGPT, as a language model, serves as a potent analytical tool. Prompted to explain AI's relevance to the insurance industry in Australia, it instantly produces numerous answers.

Fig. 4.1

'Explain artificial intelligence and its relevance to the insurance industry in Australia'

ChatGPT

Artificial Intelligence (AI) refers to the simulation of human intelligence processes by machines, especially computer systems. It involves the development of algorithms and models that enable computers to perform tasks that typically require human intelligence,such as learning, reasoning, problem-solving, and decision-making.

In the context of the insurance industry in Australia, AI has become increasingly relevant and impactful. Here's how AI is relevant to the insurance sector in Australia:

1. **Risk Assessment and Underwriting:** AI-powered algorithms can analyze vast amounts of data from various sources, such as customer profiles, historical claims data, social media, and external databases, to assess risks more accurately. This enables insurers to offer more personalized and competitive insurance policies to customers based on their individual risk profiles.
2. **Fraud Detection and Prevention:** AI can identify patterns of fraudulent behavior by analyzing large datasets and detecting anomalies. In the insurance industry, AI can help in identifying potentially fraudulent claims by cross-referencing information and highlighting suspicious activities, which helps insurers reduce fraudulent payouts.
3. **Customer Service and Engagement:** AI-powered chatbots and virtual assistants can provide immediate and personalized customer support. They can answer routine queries, guide customers through policy information, and facilitate claims processing, improving customer satisfaction and reducing response times.
4. **Claims Processing and Settlement:** AI can streamline the claims process by automating tasks such as claims intake, document processing, and verification. This reduces the time taken to settle claims and enhances the overall customer experience.
5. **Predictive Analytics:** AI algorithms can analyze historical data to predict trends and outcomes, helping insurers make informed decisions. For instance, predictive analytics can be used to anticipate changes in customer preferences, market dynamics, and risk factors.
6. **Telematics and Usage-Based Insurance:** AI-powered telematics devices can track driving behavior and collect data on factors like speed, braking. and mileage. This data can be used to offer usage-based insurance policies, where premiums are based on actual driving habits, promoting safer driving and potentially lowering insurance costs for customers.
7. **Portfolio Management and Investment:** AI can assist insurers in optimizing their investment portfolios by analyzing market trends, economic indicators, and risk factors, helping them make more informed investment decisions.
8. **Regulatory Compliance:** AI can aid insurers in ensuring compliance with complex regulatory requirements by analyzing and interpreting regulatory changes and assisting in data reporting and documentation.
9. **Market Insights and Competitive Analysis:** AI can analyze market trends, customer preferences, and competitive landscapes to provide insurers with valuable insights that inform product development, pricing strategies, and marketing efforts.

Figure 4.1: An illustration of the power of ChatGPT. Source: ChatGPT.

AI brings concerns, but opportunities abound

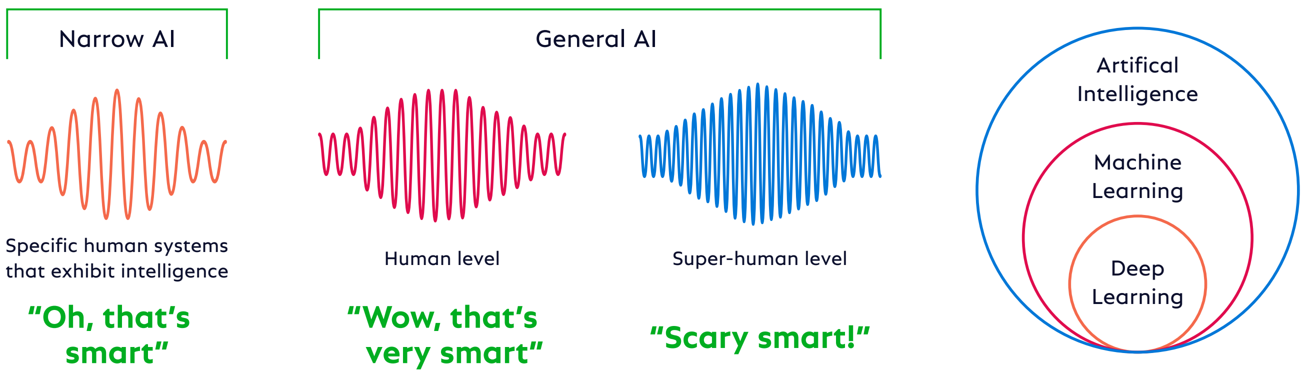
The fear the public has regarding AI is understandable. Stories often emerge suggesting that AI will take everyone's jobs, and that a world in which humans are unemployable is just around the corner. But the truth is that all rapid technological advances, though disruptive, have typically been beneficial for workers and for economies. This is because it is through technological innovation that economies become more productive and prosperous.

Productivity in Australia has been lagging for many years. Productivity is a formal measurement of how much output is generated from each hour worked, and in recent times, it has flatlined. Productivity is not only good for businesses, but it is also essential for increasing living standards in any economy. A productive economy creates more for the same number of hours worked, providing increasing quality and quantity of goods and services for cheaper prices.

As productivity has stalled in Australia, there have been fears that living standards will also go backwards. While there is no panacea to the productivity challenge, innovative technology, such as AI and machine learning, promises to help businesses and individuals become more productive – producing more for less – to the overall improvement of the economy.

With many businesses now looking to AI to streamline their operations and increase productivity, focusing

Fig. 4.2 **What is AI?**



It is important to consider Artificial Intelligence by its literal meaning. As humans we can have good ideas that are small and simple, and occasionally we come up with large-scale complex solutions that require R&D and testing. Regardless, if the idea solves a problem, is processed by a machine, and mimics the human equivalent, then it is AI. You can define three main categories of AI, starting with those that have narrow focus, through to the purely futuristic.

1 Narrow AI
This would be the most understood and highly used level today. This could be automation, statistical and machine learning modelling, predictive text, language translations etc or specific tasks that have hardware and/or software methods applied to aid processes that come near to human level.

2 Human level AI
While we can't really point to an application of AI that has quite achieved this as yet, there are aspects that are coming close - ChatGPT, medical image diagnoses, for example - but they still have a long way to go.

3 Super-human level AI
Could be a while until we get there - think *I, Robot*.

Figure 4.2: Optima Finity report – Tech transformation and the path to AI and analytics 2023.

on making administrative processes more efficient is a clear win-win for brokers and their clients. The fact is, that embracing AI technology is no longer a choice for the insurance industry, it is a strategic necessity. For brokers, the automation of data collection and transfer will be a critical enabler, allowing them to focus on personal interactions that deliver value as trusted business advisors. For insurers, the application of AI and machine learning to policy administration systems and its ability to deliver insights from enormous databases presents significant opportunity to improve broker and customer experience and free up capacity to focus on strategic innovation.

There is no doubt that in a more complex, rapidly changing world, the role of insurance brokers has risen to the fore. Increasing numbers of customers are engaging their services to help them understand and mitigate risk and navigate rising insurance premiums. Automation of back-end systems and clunky processes will create further opportunities for brokers to invest in their professional development, equipping them with the skills to guide their clients through this uncertainty.

"Fundamentally we are an industry driven by relationships. Empathy for clients and understanding their challenges is critical. By combining these skills with professional qualifications, and leveraging advancements in technology to improve processes, people are better positioned to service their client's needs."

– Tim Mathieson, CEO, QIB Group

There have always been fears that emerging technology will cost people jobs. But economies are always evolving. Just as we rarely see typists working in secretarial pools today, in decades to come, many of the daily functions of the worker of 2024 may be replaced by advanced technology. This will lead to change but also result in new occupations and opportunities we cannot yet imagine, potentially redefining industries.

There are many upsides to AI in the insurance space

Of all the industries that stand to benefit from the widespread adoption of advanced technologies such as AI, insurance is certainly among them. Insurance relies on advanced risk analysis performed by actuaries and has a direct customer relations function with large numbers of customers and claimants.

There are boundless opportunities in the insurance industry for AI to positively disrupt the status quo. From a risk assessment perspective, advanced modelling backed up by machine learning and AI promises hyper-localised risk assessments based on real world big data analysis. From a customer service perspective, AI tools such as chatbots, or image recognition, can expedite the claims process, potentially making claiming insurance easier, quicker, and more accurate.

"This technology creates a paradigm shift for our people, enabling high-speed innovation, away from previous tech and process dependencies."

– Timothy Rafton, EGM, CGU Claims

The potential to radically transform claims experience and processes is now a reality within CGU, with AI technology already deployed to rapidly assess and consolidate complex information (such as builder's reports and policy wordings), efficiently execute high volume document loads, and better inform decision-making by staff. Manual Quality Assurance processes that sit behind higher than acceptable leakage rates will soon be a process of the past. Audit teams empowered with AI technology at their fingertips can expand claims and supply chain audit samples from about 1% to as much as 80% – 90% once Smart Audit AI technology is fully implemented.

Why does improving claims leakage matter?

Solving high leakage rates benefits insurers, brokers, and customers by reducing higher than optimal claims settlements, which in turn can have an impact on premiums, and avoiding compliance breaches, improving customer experience outcomes. The implementation of Smart Audit AI has the potential to address three major leakage categories that account for 90% of settlement errors in home, landlords, and motor policies:

1. Insufficient validation to confirm policy coverage.
2. Insufficient claims assessments.
3. Incorrect claims settlements.

By closing the most significant leakage gaps, AI can help insurers to save millions of dollars in costs across many payouts.

One of CGU's most exciting claims simplification initiatives is the trial implementation of CASI, an AI chatbot that can instantly search, retrieve, and read PDS (Product Disclosure Statements) documents to help claims consultants to interpret policy wording sections and apply them to a claim. Completion rates that once were a lengthy, time-consuming process for claims consultants are now largely finalised within thirty minutes for more simple claims, not only preventing claims leakage but also enabling staff to efficiently manage high claims volumes.

The implementation of total loss prediction tools driven by AI presents significant upsides for customers' motor claims. AI can quickly scan lodgement data and uses predictors to identify if the vehicle is a likely totally loss. If flagged by the AI tool as a total loss, the claims consultant is instantly notified, enabling them to rapidly engage the assessor and salvage yard to finalise the process. In some cases, AI has reduced the motor total loss process by up to nine days, simply by cutting out the wait time for assessments. The business benefits to improve process efficiencies and reduce leakage are obvious, but the human value of implementing AI technology within claims is its ability to positively support human beings' ways of working. By providing and training AI tools as co-pilots, claims consultants are relieved of highly administrative, time-consuming tasks to focus on more meaningful interactions that deliver value to customers and brokers as consistent, high-quality results. Essential to an insurers' promise to pay its customer's claims is the consultant who offers a listening ear, empathising with the customer's unique and often stressful situation. Yes, AI can exponentially improve processes and help to reduce operating costs, but it cannot replace our essential need for human connection during some of life's most challenging moments.

Brokers are also adopting AI technology to streamline their business operations and bolster customer engagement. In discussion with broking leaders, the benefits of implementing AI solutions as an enabler in their operations are numerous. The ability to streamline and personalise customer communication presents significant productivity gains, allowing brokers to reach customers at more frequent intervals throughout their policy periods with informative updates about risk management, sums insured, the impact of reinsurance, and the risk of underinsurance.

"I do not see AI as a threat. I see it as a piece of technology that we can use to enhance our relationships moving forwards."

– Shaun Standfield, Managing Director, Insurance Advisernet Australia

With Open AI literally 'open' to anyone with Internet access, the risk of brokers providing the same advice as what AI can generate for customers has the potential to erode their value proposition. The elevation of the role of brokers as a trusted insurance advisors is more important than ever. Brokers have a clear opportunity to demonstrate AI's limitations in replacing the unique human-to-human relationship they share with their clients because it cannot replace the empathy and emotional intelligence required to understand the nuances of each client's business and the unique risks they face.

More customers than ever are gravitating towards brokers for professional advice, seeking personalised service experiences throughout their policy journey. The value of a broker to support customers at the point of a claim, when they are at their most vulnerable, is a distinct point of differentiation. This is the moment when brokers shine as trusted insurance advisors whose service offering extends beyond products and price.

"AI will enable us to get a much more granular understanding of claims and to give feedback into products and pricing."

– Willem Paling, Director of Consumer & Growth Analytics, IAG

But it is still early days. The adoption of AI by insurers and brokers presents genuine challenges. As with the widespread, unregulated proliferation of any innovative technology, the countless downsides and upsides for the Australian insurance market will continue to emerge as these technologies evolve.

Leaders and decision-makers must identify, address, and manage these downsides carefully. The utilisation of AI for decision-making has the potential to yield unlawful, immoral, and discriminatory results due to the obscured and untraceable nature of the decision processes. To regulate the risks associated with the use of AI, policymakers around the world have acted to implement policy responses and make recommendations. Unlike human beings who can exercise common sense and navigate moral and ethical contexts, machines operate in narrow domains. They will work relentlessly at a scale impossible to humans, but as an immature technology that is yet to be fully tested and completely understood, governance and guard rails are a necessary safeguard against adverse outcomes for the humans they are designed to support.

For insurers and brokers, understanding the difference between the human and AI decision-making flow of authority when implementing AI technology can help to identify control gaps, so effective monitoring mechanisms can be implemented as part of their overall governance framework.

Fig. 4.3

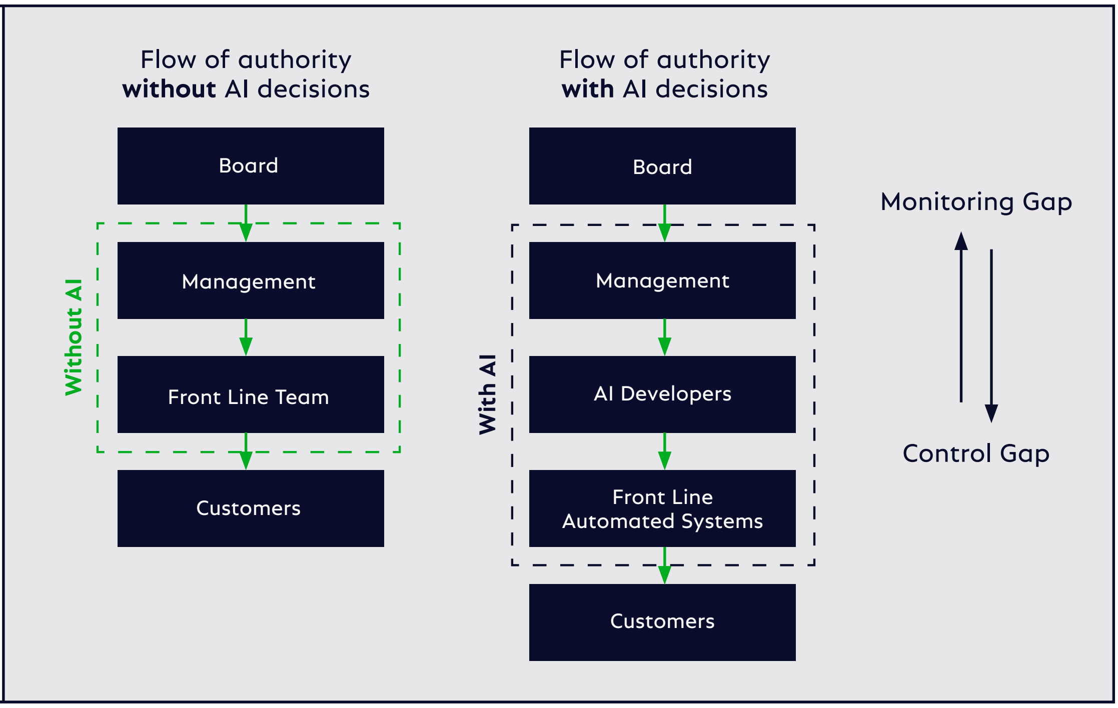


Figure 4.3 The Gradient Institute. De-Risking Automated Decisions. A practical guide for AI Governance.

PART 5

How 2023
came to a close

In 2022, the third La Niña year in a row led to extraordinary weather events across much of Australia. Intense rainfall events affected many parts of Eastern Australia throughout the year. Rivers swelled. Catchments became inundated. And community after community became subject to flooding so severe that entire communities became cut off from each other. Roads and infrastructure failed, and thousands of properties across Australia sustained considerable damage.

KEY POINTS

1. **2022 was a volatile climate year, with major flood events across the East Coast affecting dozens of communities.**
2. **The start of calendar year 2023 was more benign in Australia, but not globally.**
3. **The underlying risk due to more climate volatility is now higher than it ever has been before in Australia, and the scale and frequency of natural perils is higher.**

The flooding in 2022 was unlike any recent weather events Australia had seen. Even the devastating 2019-20 bushfires, which scarred much of Eastern Australia, were a smaller insurance event than the 2022 floods. As this report has noted, this intense flooding came at the tail end of a three-year period of turmoil and turbulence afflicting Australians.

There was fire. There was a pandemic. There were floods. And this new normal saw the lives of innumerable Australians deeply impacted.

2023 had a quiet start – but did not finish that way

In contrast to a tumultuous 2022, the start of 2023 was much more benign. Intense rain, hail, and fire events were rare. Major cyclones only affected sparsely populated areas in northern Australia. In fact, 2023 felt like a remarkable return to normal. The pandemic restrictions were a thing of the past, and the extreme weather events seemed to have skipped Australia for most of 2023, offering a welcome reprieve. December, however, saw some significant weather events, including Tropical Cyclone Jasper and catastrophic storms.

"Usually, El Niño means drier and warmer weather. However, there are other climate drivers influencing the Australian weather. The end result is a mixed bag this season - starting with very dry and hot weather in Spring, flipping to a very active thunderstorm season in Summer."

- Peter Chan, Manager for Modelling, Governance and Major Events at IAG

Globally, 2023 was the hottest year ever recorded

While fewer weather-related events were observed in Australia in 2023, the effects of a changing climate have been felt worldwide. The average global temperatures in 2023 were the highest on record.

There were unusual winter heatwaves in South America and deadly heat events in the Middle East, southern Europe, and Africa. These heat events carried with them other natural disasters — bushfires, droughts, and crop damage. Nature's unpredictability presented an early surprise with Tropical Cyclone Lola severely impacting Vanuatu in October 2023. As a Category 5 system, Lola's fury devastated infrastructure and communities still recovering from twin cyclones Judy and Kevin from earlier in the year.

Lola was the earliest Category 5 system ever recorded in any cyclone season in the southern hemisphere.

And while these events can seem a world away to Australians enjoying a relatively mild and calm year, the truth is, these significant weather events abroad are intrinsically connected to the climatic systems that are impacting Australia, too.

Australia's summer has been hotter than previous years

For many, the extreme weather of the northern hemisphere summer has sparked concern over what dangerous weather conditions Australians can expect for the remainder of this summer, especially considering the high probability of temperatures reaching the top 20% quintile of temperatures Australia-wide. After three years of La Niña, where Australian summers are comparably cooler and wetter than usual, the declaration of an El Niño in September 2023 did nothing to soothe those concerns.

In Spring 2023, this strong El Niño pattern operated concurrently with a positive Indian Ocean Dipole to generate very hot and dry conditions across many parts of Australia. This led to dozens of homes damaged or destroyed by bushfires in northern NSW, southeast QLD and southwest WA. Periodic rainfall and residual forest moisture from past years' rainfall (except for Western Australia and South Australia) have prevented us from seeing conditions like those in the Black Summer of 2019-20.

The duo of El Niño and positive Indian Ocean Dipole lost its grip on influencing the Australian weather in early Summer as warmer than average ocean temperatures developed and almost engulfed the entire nation's coastline in December 2023. The extra warmth in the ocean provided moisture and fuel for tropical cyclones and thunderstorms, giving the annual storm season a forceful kick.

While tropical cyclones tend to be more infrequent during El Niño's, they can still occur any season, as proven by Tropical Cyclone Jasper making an unwelcome visit in early December 2023 as a Category 2 storm. Crossing the coast north of Cairns, Jasper delivered flash flooding and four days of record-breaking amounts of rainfall to parts of the north tropical coast and Tablelands districts, isolating communities from Cairns north to Cooktown, triggering evacuations in many communities. Some rain gauges on the Barron River reported totals of up to 2,200mm – more than Cairns' rainfall in an average year. Flood waters flowed over Cairns airport for the first time, closing it down. As the flood waters receded, the full extent of the damage to infrastructure, homes, and businesses was revealed, with the number of claims exceeding 6,300 as of mid January.

Throughout December 2023, atmospheric conditions were ripe for multiple severe thunderstorm outbreaks due to a warm and humid airmass interacting with a cool upper atmosphere and low-pressure troughs. The thunderstorms brought giant hailstones, damaging winds, heavy downpours and flash flooding across many communities in QLD, NSW, VIC, SA and the ACT, most of which occurred on Christmas and Boxing Day.

Overall, Australia's weather outlook can be best summarised as a 'little bit of everything' and remains with a recommendation for customers to follow risk management and mitigation advice from brokers, insurers, and governments to avoid substantial losses.

The underlying risk due to climate has changed in Australia

The frequency and intensity of major natural peril events in Australia in recent years have fundamentally changed the underlying risk profile of the country at large. This means that insurers must consider this evolving paradigm when it comes to accurately pricing risk, as described in this report. For consumers, this new reality is a genuine challenge. It means premiums are likely to continue rising for some time to come. To alter the overall risk profile of Australia in a changing climate, there needs to be a systemic investment in mitigation to address risk in existing high-risk areas, and changes to land planning and building codes to ensure the resilience of our communities into the future.

CONCLUSION

While 2023 was a calmer year after a challenging 2022, major forces of economic and environmental change persist

Persistent inflation in the first half of 2023 saw interest rates rise, increasing living costs and challenges for Australian households.

While climate events were fewer in 2023, the underlying risk Australian insurers face due to an increasingly volatile natural environment have fundamentally altered Australia's insurance landscape.

This higher risk environment has increased the cost of reinsurance, which alongside inflation and supply chain issues, has resulted in an unavoidable spike in premiums.

"It is the new normal to expect uncertainty. Our focus is that our people have the support, training, and technology to be prepared and resilient to what could come next."
– Tim Mathieson, CEO, QIB Group

2023 also saw new, challenging, and exciting technologies begin to disrupt the economy. The proliferation of generative AI and new AI language models caused fears among some that the world would be dominated by runaway artificial intelligence. But these recent technologies also offer hope for a more productive economy that creates more for more people and improves living standards.

In the insurance sector, incorporating these modern technologies also provides a chance to enhance existing customer services, streamlining how people interact with insurers.

The reality is that Australia will continue to face considerable forces of economic, environmental, and technological change. Progress and evolution are inevitable.

The challenge is not avoiding this change but communicating it accurately to consumers and ensuring that the forces of change and their impact on insurers and insurance costs are well understood.

The natural optimism of the Australian spirit remains a constant. In the face of continuing uncertainty, many acknowledge that people are more resilient and resourceful than ever before, occupying their 'new normal' with wisdom gained from adapting to the disruptions of the past.

Progress and evolution are inevitable. The challenge is not avoiding this change, but communicating it accurately to consumers, and ensuring that the forces of change, and their impact on insurers and insurance costs, are well understood.

This concludes the second instalment of the CGU STRIVE Report, providing insights to support brokers and customers with increasingly complex insurance conversations in an ever-changing world.

We hope the information presented within helps empower our audience with greater awareness of the economic, environmental, socio-political, and technological drivers that sit behind their insurance program, powering them towards realising their ambition.

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