Australia Pacific business review

Australia Pacific recorded a strong combined operating ratio of 92.8%[1,2] despite the impacts of significantly elevated catastrophe activity in Australia. Industry-wide pricing momentum coupled with benefits from our cell review and Brilliant Basics programs led to a further 1.7%[2,3] improvement in our attritional claims ratio.

Frank Costigan • Interim Managing Director • Australia

Gross written premium (US$M)

4,079

6% from 2019[4]

Net earned premium (US$M)

3,626[2]

3% from 2019[4]

Underwriting result[1] (US$M)

260[2]

98 from 2019

Combined operating ratio[1]

92.8%[2]

2019 90.0%

Insurance profit margin

6.9%[2]

2019 13.6%

2020 overview

The year began with extreme bushfires across much of eastern Australia followed by higher than normal levels of storm activity. As the first quarter drew to a close, COVID-19 took hold and became the pervasive issue of 2020.

COVID-19 significantly impacted our customers, communities and financial results. For the insurance industry, pandemic discussions focused on business interruption policy wording. The industry view is clear: pandemic exclusions apply to infectious disease and prevention of access wordings, and the Insurance Council of Australia (ICA) test case was undertaken to clarify the issue. While the court ruled against the ICA, the industry has now sought leave to appeal the decision. Due to the complex and wide-ranging nature of the issue, COVID-19 related business interruption claims will likely take time to be fully resolved.

Unless otherwise stated, the commentary following refers to the result excluding the impacts of COVID-19.

Operating and financial performance

Underwriting performance

Australia Pacific reported a combined operating ratio of 92.8%[1] compared with 90.0%[1] in 2019.

The underwriting result was impacted by increased catastrophe costs in Australia, coupled with a reduced level of positive prior accident year claims development partly offset by a further improvement in both the attritional and large individual risk claims ratios.

The combined operating ratio of our LMI business increased to 62.3%[1] from 58.3%[1] in 2019. While underlying arrears are broadly stable, more cautious economic assumptions have been incorporated into reserving assumptions through additional risk margin.

The LMI result also included a $60 million provision for COVID-19 which allows for peak unemployment of 8% and average house price declines of 5%.

Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2020	2020 EX-COVID	2019	2018	2017
Gross written premium	US$M	**4,079**	**4,079**	3,920	4,104	4,139
Gross earned premium	US$M	**3,985**	**3,985**	3,885	4,103	4,252
Net earned premium	US$M	**3,625**	**3,626**	3,568	3,758	3,895
Net incurred claims	US$M	**2,479**	**2,316**	2,223	2,310	2,444
Net commission	US$M	**534**	**534**	526	561	548
Expenses	US$M	**572**	**555**	519	542	532
Underwriting result	US$M	**40**	**221**	300	345	371
Net claims ratio	%	**68.4**	**63.9**	62.3	61.5	62.7
Net commission ratio	%	**14.7**	**14.7**	14.8	14.9	14.1
Expense ratio	%	**15.8**	**15.3**	14.5	14.4	13.7
Combined operating ratio	%	**98.9**	**93.9**	91.6	90.8	90.5
Adjusted combined operating ratio[1]	%	**97.8**	**92.8**	90.0	90.3	90.5
Insurance profit margin	%	**2.0**	**6.9**	13.6	13.3	13.8

1 Excludes impact of changes in risk-free rates used to discount net outstanding claims.
2 Excludes impact of COVID-19.
3 Excludes LMI.
4 Constant currency basis and excludes impact of 2019 disposals.

Premium income

Gross written premium increased 6%[1] to $4,079 million. This was despite a moderation in pricing and a deterioration in economic conditions, which led to reduced income on lines of business where premiums adjust to turnover and/or payroll.

Renewal premium rate increases averaged 5.4%[2], down from 7.3%[2] in 2019, due to the temporary suspension of premium rate increases to certain small to medium-sized and personal lines customers in response to COVID-19. Premium rate increases recovered to 6.4%[2] in the final quarter of the year as COVID-19 relief initiatives ceased.

Improved retention, coupled with growth in strata, LMI, home and New Zealand, was offset by a reduction in workers' compensation and CTP, the sale of the travel insurance business and the impact of the economic slowdown on our Pacific Islands business.

In 2020, we launched new home and motor products and re-built our digital front end. Results have surpassed expectations with digital motor and home sales up more than 50% and (nearly) 100% respectively.

Net earned premium increased marginally to $3,626 million, up 3% on a constant currency basis and excluding disposals.

Claims expense

The net claims ratio increased to 62.8%[3] from 60.7%[3] in 2019. A further reduction in the attritional claims ratio was more than offset by an increase in catastrophe claims and a reduced level of positive prior accident year claims development.

The attritional claims ratio improved a further 1.7% to 49.4%[4] as a result of ongoing and targeted pricing increases, coupled with enhanced risk selection and claims management initiatives.

The large individual risk claims ratio improved marginally to 3.5% of net earned premium from 3.7% in 2019, as risk selection and claims management enhancements offset unusual claims severity in CTP.

Net catastrophe costs increased $49 million to 6.7% of net earned premium from 5.4% in 2019, reflecting bushfire, storm and cyclone activity in Australia and flooding in New Zealand.

The underwriting result included $18 million of positive prior accident year claims development or 0.5% of net earned premium compared with $104 million or 2.9% in the prior year. Favourable development, primarily in NSW CTP, commercial property and workers' compensation, was largely offset by modest strengthening in liability lines and minor adverse development in short-tail classes and New Zealand.

Commission and expenses

The net commission ratio reduced slightly to 14.7% from 14.8% in 2019. Growth in strata, which attracts a relatively high commission ratio, was more than offset by lower profit commissions payable as a result of reduced profitability due to higher catastrophe activity.

The expense ratio increased to 15.3% from 14.5% in the prior year. A reduction in staff, project, marketing and travel and entertainment costs was more than offset by higher risk and regulatory costs and a strong performance in NSW CTP, which gave rise to a $61 million profit normalisation charge (transitional excess profits and losses or TEPL).

COVID-19 impact

The 2020 ex-COVID-19 result in the table on the preceding page excludes impacts directly attributable to the COVID-19 pandemic. These impacts include $163 million of net claims spanning business interruption, LMI, trade credit and other classes, partly offset by a $70 million benefit due to a reduction in claims costs across motor, workers' compensation, aviation and commercial packages. Expenses of $17 million included gift cards which were provided to customers due to reduced motor claims frequency during lockdown.

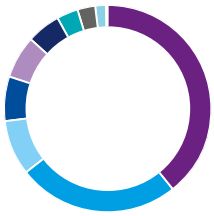
1 Constant currency basis and excludes impact of 2019 disposals.
2 Excludes premium rate changes relating to CTP.
3 Excludes impact of changes in risk-free rates used to discount net outstanding claims.
4 Excludes LMI.

Average renewal premium rate increase[2]

5.4%

1.9% from 2019

Gross written premium by class of business



	2020 %
Commercial & domestic property	39.4
Motor & motor casualty	25.1
Public/product liability	8.8
Financial & credit	6.8
Agriculture	6.6
Workers' compensation	5.5
Marine, energy & aviation	3.3
Professional indemnity	2.6
Accident & health	1.8
Other	0.1

Combined commission and expense ratio

30.0%

0.7% from 2019