Weather Perils and Rising Insurance Premiums: Where To Next?

Snapshot

- Economic and structural drivers are as critical as increased weather peril risk in influencing premium rises. These factors include a shift to risk-based pricing and the hardening of the reinsurance market.
- Risk buyers will need to prove enhanced resilience to achieve cost-effective risk transfer, and this is only possible with robust evidence and data.
- Data also plays a critical role for insurers seeking to accurately price risk, as the need for up to date, accurate insights and information increases.

In recent years, large losses related to weather perils have had a significant impact on premium pricing. However, while the changing nature of weather perils undeniably impact insurance premiums, it is only part of the story. Understanding where to next requires a deeper dive into drivers influencing the market and insights into which trends are here to stay.

Changing nature of weather perils: not the only driver of rising premiums

The changing nature of weather perils is often highlighted as a primary factor in rising insurance premiums across the Pacific region. However, other more localised factors, such as the impact of rising inflation and increases in house prices, also play critical roles. In addition to these shifting economic factors, there are structural drivers influencing premium increases, alongside the impact of the global reinsurance market.

A structural shift: risk-based pricing

In Australia and New Zealand, the shift from community-based pricing to risk-based pricing has been a key influence in rising premiums for some. Previously, the expected costs of extreme weather events were spread across an insurer's portfolio, meaning that all policyholders effectively subsidised those in high-risk locations. Over the past decade, insurers have increasingly reflected the actual risk at individual addresses in premiums. This risk-based pricing can be particularly strong for flood, bushfire, and cyclone perils, where exposure is geographically restricted. For instance, the Brisbane floods of 2011 spurred a significant move toward risk-based pricing in Australia, which has since become the norm. In New Zealand, risk-based pricing has also grown, since its introduction in 2018.

For policyholders, those in high-risk locations face significantly higher premiums, leading to affordability issues. This challenge has prompted some government interventions, such as the Australian Reinsurance Pool Corporation (ARPC) introducing the Cyclone Reinsurance Pool to reduce some of the impact on home and small business premiums for those at risk of tropical cyclones. The ARPC pool is already bringing down premiums in high cyclone risk areas.[1]

Education is another tool for governments looking to support insurance affordability. In New Zealand, the Alpine Fault Magnitude 8 (AF8) initiative combines research, policy and practice to support, build and coordinate readiness and response capability for the next major rupture of the Alpine Fault, across New Zealand's South Island. Education sessions are run as part of AF8 in towns along the Alpine Fault to prepare local communities for future events, given the fault's historical ruptures every approximately 300 years.[2]

[1] Australian Reinsurance Pool Corporation, Cyclone Reinsurance Pool Premium Assessment, April 2024

[2] Alpine Fault Magnitude 8, AF8 Roadshow, 2024

The role of the reinsurance market in rising premiums

The recent string of severe weather events has contributed to a hardening of the reinsurance market, increasing costs for insurers and, consequently, for policyholders. Moreover, reinsurers have been raising the attachment points (the level of loss at which reinsurance coverage kicks in), meaning primary insurers must cover more of the initial losses themselves.

As reinsurers seek to manage their own exposure to increasingly frequent and severe weather events, they have been imposing stricter terms and conditions on the coverage they offer. This includes higher deductibles and more exclusions.

Resilience is a key lever in cost-effective risk transfer

Physical location resilience plays a crucial role in helping risk buyers manage their insurance premiums related to weather perils. By demonstrating the resilience of a property, risk buyers can support their premium discussions with insurers, showing that they have taken proactive steps to mitigate potential risks, for example, through improved construction standards or retrofitting existing structures to withstand extreme weather events.

As insurers and risk buyers focus more on resilience, data will increasingly play a vital role in delivering a credible narrative. By providing robust evidence of a property's resilience, risk buyers can make a compelling case for more competitive premiums.

> "A data-driven approach not only supports more effective premium discussions but also helps in securing better terms by clearly demonstrating the proactive measures taken to reduce risk."
>
> James Knight, Head of View of Risk Advisory, Australia and New Zealand, Aon.

Data must keep pace with climate change

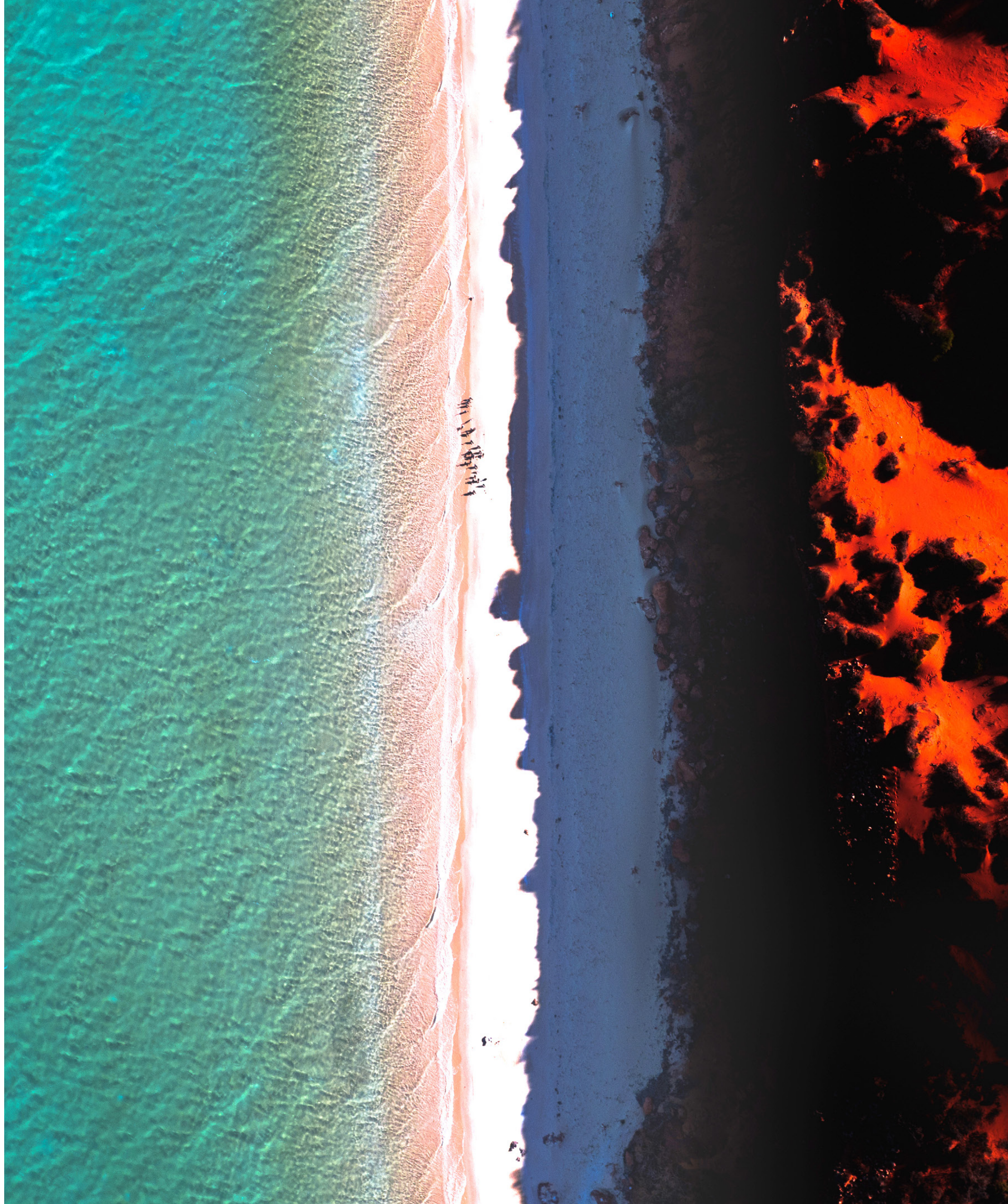
Data also plays a pivotal role in developing credible narratives for insurers in pricing risk. The shift to risk-based pricing has led to a more precise alignment of premiums with actual risk, but it also poses challenges. Risk-based pricing based on individual locations means increasing requirements for weather related data.

The changing behaviour of weather perils will heighten the requirement for insurers to have access to robust and current risk data combined with insights from the local climate science community. Going forward, we anticipate that insurers will also need to take a longer-term view on the frequency and severity of weather perils, to inform extended business strategy and avoid the “boiling frog” phenomenon.

Where to next?

Given these dynamics, where are premiums headed? Premium increases driven by the shift to risk-based pricing are now ‘baked in’ and unlikely to change without further government intervention. Insurers will continue to refine their models to reflect the true risk at individual locations. The reinsurance market’s cyclical nature will have a changing influence over time.

Organisations can help manage rising premiums by focusing on building resilience, leveraging robust and up to date data to demonstrate risk mitigation, and staying informed about market trends and government policies.



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