Business Insurance & Risk Market Update

Australia | H1 2023

Experts from the Gallagher network offer perspectives on critical trends and changes shaping the Australian insurance and business landscape.

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EXECUTIVE SUMMARY

Mark Oatway
Managing Director Placement

Welcome to the H1 2023 edition of our Business Insurance & Risk Market Update. Our experts provide insight and considerations on key insurance market issues and trends in Australia and globally.

Hard market conditions continue however there is good evidence that the steep pressures over the past two years are levelling out, with premiums as investments in risk management pay off and insurers return to profitability. However for some higher risk industries conditions remain tight.

Geopolitical risks, such as the Russia-Ukraine war, economic instability with rising inflation, stretched supply chains and materials and skills shortages, and the impact of natural catastrophes all loom as perils that could create further market volatility.

Inflation, in particular, is having a significant impact as the risk of underinsurance in the property market rises, and making updated valuations an essential for all businesses.

In this edition, we examine:

- **Placement and market update:** the hard market has continued to level out, but underwriters remain selective, prompting more consideration of risk transfer alternatives.
- **Claims:** the impact of the severe flooding continues to cast a long shadow over short-tail claims and economic risks threaten to drive an uptick in long-tail claims.
- **Financial/professional risks:** rates have stabilised following a return to profitability, new competition and businesses taking control, but regulatory risks loom.
- **Cyber:** new capacity and the evolution of risk at board level have driven a settling of the market, but insurers are increasingly concerned about data caches and supply chain risks.
- **Property:** rising inflation is increasing reinstatement costs so up-to-date valuations are essential, and both cash settlements and short indemnity periods pose risks.
- **Construction:** the contract risks market has stabilised, but significant issues remain in the price and availability of public and product liability and professional indemnity insurance.
- **Workplace risks:** new legislation and the fallout from COVID-19 are forcing businesses to address psychological risks as a work health and safety issue.

Risk management remains key

A focus on risk management remains a common theme across all classes of insurance as underwriters continue to reward businesses with a good story to tell.

To access optimal terms and conditions at a competitive price, businesses need to commit to investing in risk management and dedicate time to helping their broker prepare to take their risk to the market.

Insurance has always been designed to protect against unforeseeable events. If businesses know they have vulnerabilities they should quickly address these issues before seeking cover.

Taking an individual approach to appropriate risk transfer arrangement for each business is required and, in some cases, this may mean thinking beyond the traditional insurance market and considering innovative solutions such as captives and protected cell companies.

Relationships matter

At its heart insurance broking is a relationship business and tri-partite relationships between brokers, insurers and businesses are encouraged. Brokers are in a strong position to facilitate productive partnerships between insurers and businesses, rather than act as gatekeepers.

The return of international travel has been welcomed for its role in solidifying these relationships, with brokers and businesses again able to visit underwriters in London and elsewhere.

Involving businesses directly in their insurance discussions provides underwriters with clear insight into a company's risk management culture. No one can tell the story of a business better than its owners or key employees.

At Gallagher we pride ourselves on our in-house expertise and the strength of our global relationships. We look forward to continuing to help our clients with innovative and customised insurance and risk management solutions.

PLACEMENT AND MARKET UPDATE

Mark Oatway
Managing Director
Placement

Insurance premium increases level out but risk selection remains

Following on from the trend that emerged early in 2022, insurance premium increases in most commercial lines continued to level out during the second half of 2022, which is welcome news for insurance buyers.

The key reasons behind the stabilisation of the hard market are a return to profitability by insurers, following years of hardening rates, and improved risk management by businesses, which has made insurers more comfortable with the risks they are taking.

Higher hazard industries continue to attract premium increases as insurers continue to be selective about the risks they write, but these are smaller than in recent years, with increases in single digits rather than double digits more common.

A return of capacity in the Australian market means that risks that were previously shifted offshore can now be placed with Australian insurers, which has made international capacity more competitive.

The key to this change is that it enables brokers to provide clients with options. In recent years the ball has firmly been in the court of insurers, who were able to dictate terms, but now businesses have more control over how they structure risk. For example, a client may now choose to take a higher deductible because it makes financial sense for them to do so, rather than a higher deductible being foisted upon them by the market.

KEY TRENDS

- **Insurance premiums have continued to level out due to improved risk management by businesses and a return to profitability by insurers.**
- **Alternative risk transfer solutions, such as the use of captives and protected cell companies, are now a common part of mid-market sized businesses' renewal meetings.**
- **Insurers are requesting updated property valuations to avoid potential shortfalls between the sums insured and reinstatement costs.**

The east coast floods that occurred early in 2022 have heightened insurer concern around the potential for losses related to floods and natural catastrophes in general, and businesses with property in these areas are finding obtaining insurance more difficult.

Loss-affected and higher hazard liability risks are also recording larger premium increases and additional cover is continuing to come at an increased price, with more insurers instigating minimum premiums for top-up covers.

Social inflation or the contribution that social factors, such as changing views in society about the role of insurance and what it is designed to cover, is a key factor driving claims costs up in the long-tail liability space.

Focus on alternative risk transfer

Previously the domain of large corporates, discussions about alternative risk transfer solutions, such as the use of captives and protected cell companies, are now a common part of renewal meetings for mid-market sized businesses.

These mechanisms are being considered by companies with risks that continue to be hard to place at an affordable price and with an adequate level of protection, or by businesses that are looking for more control over the volatility of insurance pricing and a better breadth of coverage.

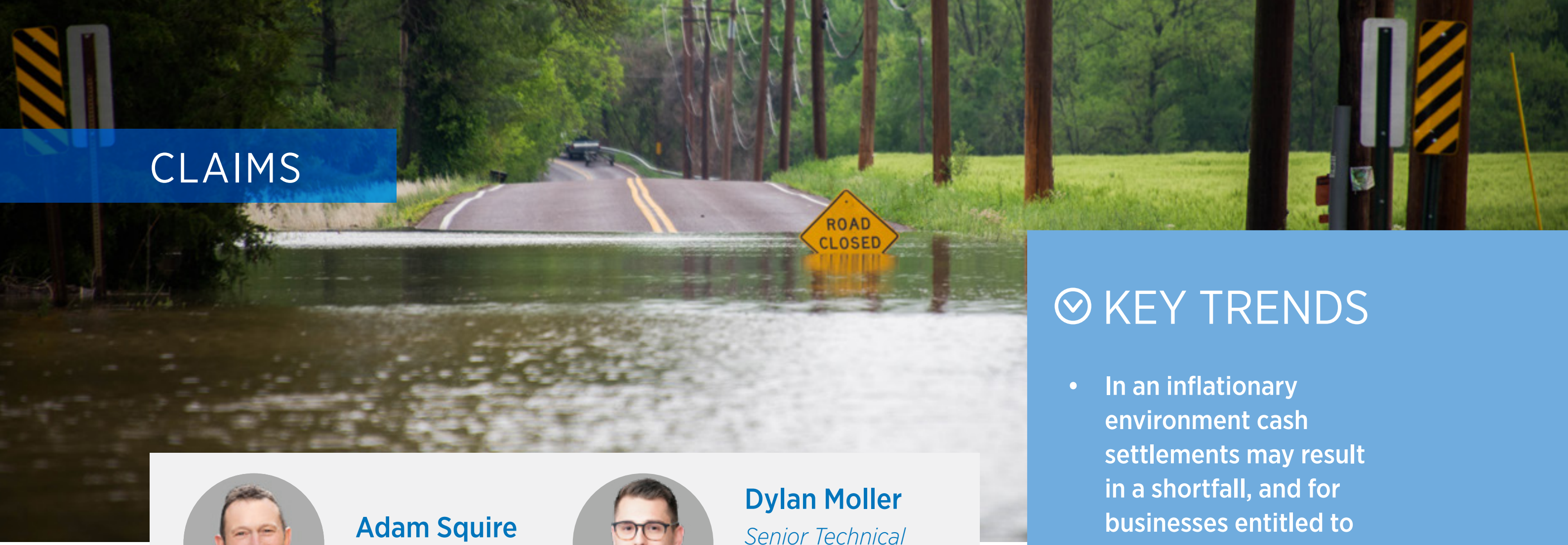
Other forms of alternative insurance, such as parametric covers, are also increasingly on the table for catastrophe-exposed businesses looking for flood or cyclone cover that isn't available to them in the general market.

Risk management pays off

The actions that businesses have taken in addressing risk management in recent years are paying dividends, but this is not a time to rest upon that success as a focus on risk management continues to be a hallmark of the current market.

Insurers are still extremely interested in how companies are managing their risks which means that continuing to get surveys done and acting on risk recommendations remain a vitally important part of getting a good insurance result.

In the current market, with inflation rising significantly in a relatively short period of time, insurers are also asking for updated property valuations for most risks as they are wary of a potential shortfall between the sums insured and remediation, repair or reinstatement costs.



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A maze of obstacles and contradictions confront claims

The current claims environment is one of the most challenging and confusing in recent history. The impact of the severe flooding continues to cast a long shadow on short-tail physical damage claims, with rising costs and shortages both playing a role.

KEY TRENDS

- In an inflationary environment cash settlements may result in a shortfall, and for businesses entitled to a full replacement or repair, patience is required.
- A risk averse approach via both higher sums insured and longer indemnity periods will best serve businesses at claims time in this environment.
- Claims that correlate to economic downturns, such as employment practices, insolvency and employee fraud are yet to significantly increase, but this may still occur.
- Deadlines for climate targets are fast approaching and claims related to greenwashing are expected to increase.

At the same time, long-tail liability claims are confounding traditional wisdom by not spiking in ways expected, although the risk of this looms large, as do new threats from climate-related exposures.

To navigate insurance claims at this time, businesses need to be risk averse, have robust and tested continuity plans and embrace the expertise of their insurance brokers.

Property claims underwater

The devastating floods in February and March 2022 have resulted in insured losses of $5.72 billion[1] (as of January 2023), making it the second natural catastrophe in Australia's history, behind the 1999 Sydney hailstorm that caused insured losses of $5.57 billion[2] (normalised to 2017 values).

But the numbers do not reveal the whole story. Claims closure times are being impacted by both a shortage of experts available to assess and manage them, and labour and materials shortages. Inflation on both materials and labour is pushing up costs. This is also affecting non-flood claims and the situation is set to worsen as the easiest claims are closed first, meaning difficult times lie ahead.

In events such as this insurers offering cash settlements can be common, but in the current environment this may not be in the claimant's best interests, due to rising repair and rebuild costs creating the potential for shortfalls between the settlement offered and the actual cost of reinstatement. For businesses entitled to a full replacement or repair by their insurer patience is required as the process is taking longer, and businesses should consider whether their current business continuity plans take this into account.

How an insurance policy responds to such an event comes back to how it was set up and due to rising inflation cases of underinsurance and limits that aren't high enough in both property and all types of vehicle claims are rising. Insurers make some limited allowances for values increasing, however, it is difficult to argue a claim where a business has knowingly and willingly underinsured.

A similar phenomenon is also playing out with business interruption indemnity periods. Indemnity periods of 36 months are recommended, but this advice is not always taken by businesses and a blow-out in rebuild or repair times can have a severe impact on the ability to recover from a disaster or falling victim to it. Indemnity periods of 12 months, which are common, are simply not long enough in the current environment.

With Australia in the midst of its third successive La Niña, the increased threat of above average rainfall for northern and eastern Australia is still a concern, as any further natural disasters would compound an already difficult claims environment.

COVID-19 provides a silver lining

In an environment of rising inflation and economic pressures, an uptick in long-tail claims would be expected but this is something that is yet to eventuate.

Increased employment practices, insolvency-related and employee fraud claims are all correlated to an economic downturn, however, the typical increases that we have seen in the past are yet to occur.

The flow-on effects of the response to COVID-19 by both government and businesses could also be playing a role here.

Evidence indicates that company procedures and policies, particularly around employee-related responsibilities, improved in response to the changed working conditions brought on by the pandemic. The sustained shift to working from home may also be helping to reduce friction between employees or between employers and employees that might otherwise result in a claim over disagreements at work or about working conditions.

Increasing company insolvencies would be expected in an environment such as this but that is not playing out just yet, except for in the construction industry. Government protections and financial support provided to businesses during the pandemic may have helped, although rising insolvencies and other long-tail risks may still eventuate with these supports ceasing, inflationary pressures and continued economic uncertainty.

It will be important to keep watch on both unemployment and insolvencies as pointers to a rise in long-tail claims.

Risks on the horizon

Over the next two to five years there will be an expectation on boards to stress test the ability to withstand another 'black swan' event, with a likely rise in claims for climate change inaction.

Once (and when targets were set) 2025 or 2030 may have seemed to be in the distant future but they are now just a few years away and companies that have set emissions reduction targets for those years need to be close to delivering on those targets or risk claims from shareholders, regulators or other affected persons.

If businesses are found to have partaken in greenwashing they and their directors will be exposed. The recent passing of legislation by government to reduce emissions by 43% by 2030 only increases the regulatory onus on companies.

Planning prevents poor performance

A robust approach to business continuity and taking a slightly more risk averse view, which equates to buying high limits and longer indemnity periods, will lessen the impact of any potential claim.

Businesses need to consider their broker as a key part of their risk advisory team and notify them in the event of a breach or potential issue, even if they feel it will not amount to a claim. If they're subsequently investigated by a regulator or a claim eventuates it is much harder to help than had the broker and relevant claims teams been involved from the beginning.

[1] Insurance Council of Australia Data Hub – insurancecouncil.com.au/industry-members/data-hub
[2] IInsurance Council of Australia - Flooding disaster declared 'costliest in Australian history' insurancenews.com.au/local/flooding-disaster-declared-costliest-in-australian-history

Michael Herron
National Head Professional & Financial Risks

Rate rises are stabilising but risks remain high for professional and financial lines

The main sentiment being felt by buyers of professional and financial lines insurance is relief, as premiums that had skyrocketed in the past few years have begun to stabilise.

This shift to a levelling out of premium rate rises follows a return to profitability for insurers after 2017, 2018 and 2019 were the worst underwriting years on record, forcing a rapid hardening across the insurance market.

However, significant risks remain for buyers of directors and officers' (D&O) insurance and professional indemnity (PI) insurance in the form of industry-wide threats from global political and economic volatility, along with regulatory risks.

Insurer FOMO sees pricing level out, but uncertainty remains

The hard market over the past few years caused a number of corporates to review their D&O buying patterns. As a result, parts of programs or certain risks were not transferred to the insurance market because of what businesses saw as uncommercial pricing. That took a significant amount of premium out of the market and, at the same time, new capacity entered the market, looking to take advantage of the hard market conditions.

In response, insurers seem to have been struck by a case of fear of missing out (FOMO) and are now looking for ways to recoup lost premium. This coupled with an improvement in underwriting results during 2022, has boosted their confidence and they are more willing to look at risks than they were a year ago. Underwriters

KEY TRENDS

- **Premium rate rises are levelling out following a return to profitability for insurers, new competition and businesses buying less cover.**
- **Class actions have shifted to consumer or government agency claims and away from securities-related claims, although several factors could lead to a reversal of this.**
- **Natural catastrophes, geopolitical events, inflation and volatility all present potential risks to the stabilised rating environment.**
- **Innovation is beginning to re-emerge in the D&O market with the release of the first new wording in years.**

are now operating with fresh vigour, focusing on 'premium adequacy' relative to the risk, rather than a need to pursue excessive premium price increases.

However, professional and financial lines markets remain patchy. Businesses with excellent demonstrable risk management are likely to get a better result in the insurance market than they were able to achieve last year, but cover for businesses with more challenging risks can still be hard to place.

Despite this newfound confidence, global insurance markets remain fragile, with natural catastrophes, geopolitical events, inflation and volatility all presenting potential clouds on the horizon.

Regulatory pressure remains high

The Australian corporate sector has been subjected to Royal Commissions and reviews over a number of years and across a number of industries, and businesses have had to meet the expectations of what is a very sophisticated regulatory environment.

The Australian Securities and Investments Commission (ASIC) has again put directors and officers on notice with the release of its most recent Corporate Plan[1], warning that it "will take strong and targeted enforcement action to protect consumers and investors, and to maintain trust and integrity in the financial system". This requires Australian companies to perform at a very high standard, which is good for overall levels of risk and corporate governance.

However, the risk of regulatory, consumer or shareholder actions remains a key focus for both companies and D&O underwriters as the risks against both businesses and individual directors and officers continues to drive buying patterns for insurance programs.

But while class action filings remain high, the number of actions is trending more towards consumer or government agency claims which are less likely to impact D&O insurance policies, and away from securities-related actions than the previous highs. Uncertainty around reforms to the class action funding environment has played a role here, as has the pandemic.

With the doubt surrounding the financial impact of COVID-19, Australian corporates were given leeway on the issuance of guidance on profits and earnings. This lowered their risk of breaching continuous disclosure requirements and is one factor behind the drop in securities class actions, but with a return to business as usual following the pandemic this could be set for a reversal and is being closely watched.

Another factor being monitored in relation to a potential uptick in securities-related actions is a recent decision by the High Court on the 2016 collapse of listed mining company Arrium. Earlier in 2022 the Court ruled that shareholders can use public examination powers under the *Corporations Act* to investigate personal claims against Arrium's former directors and its auditor. Previously public examinations have been chiefly conducted by ASIC, administrators/liquidators or creditors. The ruling is expected to lead to increased D&O and PI claims against directors and advisors of failed companies.

The issue of environmental, social and governance (ESG) disclosures also continues to loom large in the regulatory environment, with ASIC calling this out as one of four key external priorities in its latest Corporate Plan. The regulator says it "will take action to prevent harms arising from greenwashing and to support effective climate and sustainability governance and disclosure". Insurers are increasingly asking about the veracity of businesses statements on ESG and whether they have been sufficiently audited.

Positive signs of market innovation

Another notable development in the D&O market is the release of the first new/updated wording in recent years. Released by one of the ascendant players in this space, the wording seeks to offer businesses enhanced coverage in return for the higher premiums now being paid.

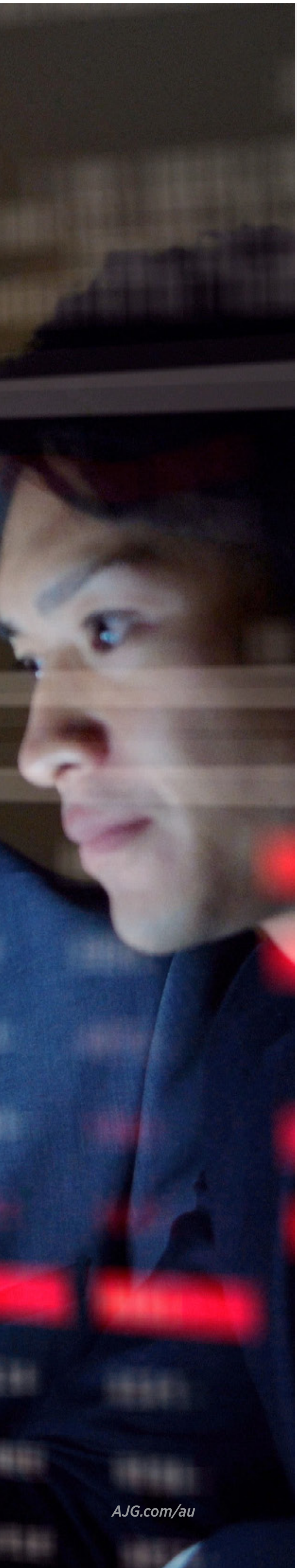
The wording, which addresses claims handling flashpoints by providing for a choice of defence lawyers and predetermined allocation proportions, should lead to fewer claims disputes. There is also a significant change to the approach to continuous cover – which now needs close scrutiny with real variation differentiating insurer offerings.

Product innovation in the D&O market is encouraging as it signals that underwriter confidence is beginning to return to the market, though the details are all important.

[1] Australian Securities and Investments Commision Corporate Plan. asic.gov.au/about-asic/corporate-publications/asic-corporate-plan

CYBER RISKS

Following a difficult two years the market for cyber insurance is shifting again, with new capacity and renewed appetite to underwrite among insurers. This has largely been driven by the gradual shift of responsibility for cyber risk from functional technology teams to company boards, who are now embracing it as part of their wider enterprise and operational risk.



Robyn Adcock
Cyber/Tech Practice Leader

Cyber shifts again as focus on risk management assists companies in the insurance process

Underwriters are remaining very selective in the risks they accept for renewal and terms for new business. If a business cannot demonstrate it has a systematic approach in place for best practice governance, processes, resilience and security controls to reduce overall cyber risk and potential claims activity, it is unlikely to achieve as positive an outcome in the market as a business with the right story to tell.

Insurers need to know that a business has absolute understanding of its risk, has appropriate plans in place to respond to an attack and has a strategy to recover from an attack.

Health, transport, manufacturing and infrastructure remain high cyber risk areas. For businesses in these industries their risk management story must be of the highest quality, and the breadth of coverage that can be achieved will be dependent on their ability to demonstrate a best-in-class approach to their risk management activities.

KEY TRENDS

- **Pricing has stabilised for good cyber risks, with new capacity entering the market and a renewed appetite to underwrite risks.**
- **Risk management is still key to accessing cyber insurance under the optimum possible terms and conditions, and it needs to be sophisticated and driven at board level.**
- **Underwriters are increasingly focusing on data cache and supply chain risks.**
- **Business email compromise attacks are on the rise.**

Not all coverage is created equal and the value of a knowledgeable broker with the ability to represent their client from a position of strength can be a differentiating factor in obtaining fit for purpose protection.

Boards embrace cyber risk management

In response to the market conditions of the past few years, along with increased regulatory scrutiny, businesses have worked hard to improve their risk management capabilities.

Most are able to demonstrate an organisation-wide approach with cyber risk management now embedded in their broader enterprise risk management and business continuity plans, and underwriters increasingly are demanding to see oversight of those activities at board level within audit and risk committees.

Knowledge sharing between businesses in the same industry, and across industries, is a hallmark of this new environment, as collaboration enables businesses to share intelligence and so move faster towards best practice risk management and addressing new risks as they arise.

For businesses yet to invest in effective cyber risk management, many will remain vulnerable to attack and the insurance cover available to them will be restricted. Those with remediation measures outstanding need to act as quickly as possible.

This need for urgency is mirrored by changes in July 2022 to the *Security of Critical Infrastructure Act*, which require the providers of key public services to register their critical infrastructure assets, risk management and continuity plans for protecting them, or they may face governmental intervention under extraordinary powers.

Business email compromise the new battleground

In recent months there has been an increase in business email compromise attacks, with reports of malicious links and suspicious language in emails on the rise as phishing becomes more sophisticated. In this type of attack hackers use email to infiltrate vulnerable systems, with the intent of diverting funds, such as altering banking details on business invoices.

These types of attacks can affect businesses of any size and highlight the importance of all businesses implementing staff email security awareness training, deploying phishing simulations and utilising an inbox protection tool.

Data caches and supply chain risk in focus

Following the recent major cyber attacks, the issue of data controls and data destruction will now be under the spotlight. Questions about how many sensitive records a business holds, how they are secured, whether they include privately identifiable data and how old records are purged will all be increasingly asked by both regulators and underwriters.

Companies need to demonstrate a risk management mentality that confirms their understanding of their risk, that they know where their critical data is, who can access it and that they have adequate and appropriate security controls in place to protect it.

With the proliferation of outsourcing and the use of third-party services, underwriters are also increasingly interested in cyber security in relation to business supply chains.

Asking vendors for a certificate of currency for a business's professional indemnity insurance is no longer adequate, instead cyber insurers are now seeking a detailed understanding of the business's vendor security audit process and how it is embedded in day-to-day operations.

A dynamic, evolving cyber insurance market

Unlike more well-established insurance product classes, cyber insurance has a relatively short history.

As underwriters don't have decades of aggregate claims data to inform their decisions the market tends to be more reactionary to new events and risks as they evolve, and cyber criminals are forever evolving their methods and the sophistication of attacks.

As a result of this dynamic environment it is difficult to predict future market conditions. New market capacity may lead to increased competition, but underwriters will continue to remain reactionary to risks as they emerge.

PROPERTY

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Rising property values create underinsurance headaches

That the cost of living in Australia is rising is no secret, but increasing inflation is also having secondary impacts when it comes to property insurance.

The cost of repairs and replacement is increasing due to inflation on building materials and labour, both of which are in short supply due to other market forces including the disruption to migration flows caused by COVID-19, and to supply chains due to both COVID-19 and the Russia-Ukraine war.

The result is that many property sums insured are no longer reflective of their true reinstatement cost in today's market, putting businesses at risk of being underinsured.

Delays lead to rising cash settlements and indemnity period concerns

Pressure on building works began after the bushfires of 2019–20 and has not let up, with claims processing times and costs escalating. As a result, there may be temptations for businesses to take a cash settlement, however, they should be aware that settlements may not reflect replacement costs.

The risk of a financial shortfall does not only exist in the event of a total loss. If a co-insurance arrangement is in place and is triggered in the event of a partial loss, a business may find itself facing a shortfall if the proportional sum insured doesn't reflect the repair value.

Another flow-on effect of property claims taking longer to resolve is that businesses need to consider whether their business interruption indemnity period

KEY TRENDS

- **Property premiums are expected to continue to harden due to inflation and ongoing supply and demand pressures.**
- **Inflation and other pressures means property sums insured are no longer be reflective of true reinstatement costs, putting businesses at risk of being underinsured.**
- **Detailed valuations by quantity surveyors are recommended to ensure sums insured are adequate, despite the potential for premium uplift.**
- **With temptations to take cash settlements for property claims businesses should be aware that they may not meet replacement costs.**

is sufficient. Indemnity periods of 12 months have been considered something of an industry standard but in today's claims environment this would not be long enough to ensure the survival of most businesses, should their property become uninhabitable.

Detailed and recent valuations are prudent

Against this backdrop there are concerns about up-to-date valuations, with some specialised insurers requesting a new valuation as part of an insurance submission. In instances where a new valuation is not provided, underwriters may add a loading to the premium to address any potential shortfall they believe exists.

But not all valuations are created equal. Where there is outstanding finance on a property a valuation may be obtained by a bank or finance provider, however, this type of valuation is more concerned with the market value of the property in the event of a forced sale, rather than the replacement value from an insurance perspective.

For insurance purposes a valuation should be equal to the amount required to restore a property to the state it was in prior to a claim being made. To best achieve this a detailed valuation conducted by a quantity surveyor is recommended. A quantity surveyor is a qualified construction expert who calculates an estimate of construction costs for buildings, meaning their valuations reflect true replacement value.

Most new property valuations are resulting in an uplift of some magnitude, even if a valuation was last done 12 to 18 months ago, and in instances where a valuation hasn't been undertaken in four or five years increases of 25% are not uncommon.

Rising property values may also present a challenge by pushing properties into new risk categories which may require businesses to upgrade, for example, security or fire protection, or which may no longer fit with an incumbent insurer's risk appetite. For this reason it is important that valuations are undertaken well in advance of renewals.

While a new valuation may result in additional expenditure or an increased insurance premium, the risk of being underinsured and facing a shortfall in the cost of repair or rebuild in the event of a loss is less palatable. Insurers make some limited allowances for values increasing and having an up-to-date valuation makes those allowances more likely to be applied.

Further market hardening expected

From a supply chain perspective it is unlikely the flow of essential materials will return to normal levels until mid-2023, and with regards to inflation it remains to be seen how effective the Reserve Bank's interest rate rises will be on dampening demand to a point where inflation slows or even begins to retreat.

The solvency of construction companies is another potential risk factor that could have a prolonged impact on supply, with several building firms that have overextended failing in recent months.

Insurers are indicating that premium increases are still needed on property risks and the market is expected to continue to harden for another 12 to 18 months. Increases of 10–15% are presently standard, and for loss-affected businesses premium uplift is as high as 20%.

WORKPLACE RISKS

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KEY TRENDS

- **Legislation is being introduced around Australia requiring businesses to address psychosocial risks in the workplace and the fines and penalties for contraventions are increasing.**
- **COVID-19 accelerated both the prevalence of workplace psychological risks and the appetite of businesses to address them, with strong return on investment incentives.**
- **Psychological risk claims cost around 2.5 times more than workers' compensation claims related to physical injury.**
- **Provisions have been introduced in Victoria, NSW, ACT and WA prohibiting businesses from using insurance to fund the payment of work health and safety fines.**

Now is the time to act on psychological risks in the workplace

While psychological risks in the workplace are not new, there has been a significant shift in government, industry and broader public expectations around employers taking a more proactive role in the management of the mental health of workers.

From a government perspective, across Australia regulations are being introduced requiring businesses to identify and mitigate psychological risks in the workplace. In this regard psychological risk is no longer an emerging risk, it has now arrived and any business not paying attention will ignore it at its own peril.

The 2018 Marie Boland-led review into the performance of Australia's Work Health and Safety (WHS) laws has been influential in this shift, with the review recommending changes to the harmonised WHS legislation that directly addresses the introduction of psychological risk regulations. This included recommendations to implement regulations that require a person conducting a business or undertaking (PCBU) to formally identify psychological risks in the workplace and implement risk control measures that eliminate or reduce them as far as is reasonably practicable.

Almost four years since the 2018 review this is beginning to be reflected in the legislative agenda. For example, the NSW government recently enacted the Work Health and Safety Amendment Regulation 2022 that requires a PCBU to manage and control psychosocial risks and took effect on October 1 2022. In Victoria similarly proposed amendments to its WHS legislation are under review, however, the psychosocial risk management legislative agenda being proposed in Victoria is far more prescriptive than that introduced in NSW. Should the Victorian occupational health and safety (OSH) regulations pass, Victorian employers will additionally need to:

- review risk control measures when certain psychological injuries are reported or a health and safety representative requests this;
- prepare a written prevention plan addressing circumstances where serious hazards are identified, namely aggression or violence, bullying, exposure to traumatic content or events, high job demands and sexual harassment, and produce the plan for inspection upon request; and
- require employers with more than 50 employees to periodically report "reportable psychosocial complaints" (pertaining to aggression, violence, bullying and sexual harassment) to WorkSafe every six months.

A large and growing problem

A 2020 report by the Productivity Commission[1] estimated the cost of the loss of participation and productivity in the Australian workforce due to psychological risks at between $12.2 billion and $39.1 billion per year. It found around 2.8 million working Australians have a mental illness requiring time off work to maintain their wellbeing.

When it comes to workers' compensation insurance, while psychological health claims account for only around 6% of all workers' compensation claims, the Productivity Commission found they typically cost about two and a half times as much as physical claims and involve a median time off work of 16 weeks, compared to six weeks for other claims.[1]

In addition to the workers' compensation impacts, employers also need to be mindful of state-by-state legislative developments around increased penalties, industrial manslaughter laws and the banning of insurance to paying for WHS/OHS penalties. This means future psychological risk injuries may lead to an employer's prosecution and insurance won't be able to cover penalties or fines. Currently insurance can no longer pay for WHS fines and penalties in NSW, Victoria, ACT or WA, however, insurance can still be used to fund legal and defence costs.

Beyond the potential for lower workers' compensation insurance premiums and avoiding fines or other statutory penalties, perhaps the biggest incentive for businesses to address their psychological workplace risks lies in the potential to increase productivity.

A 2014 report by PwC[2] found that for every dollar spent on mental health initiatives, businesses will see an average return on investment (ROI) of $2.30. A 2018 report by KPMG and Mental Health Australia considered the ROI across a range of global mental health initiatives. It found a ROI of $1.30 for job control initiatives up to $4.70 for problem solving therapy-based return to work programs.

COVID-19 accelerated both the problem and the solution

In many respects advancements in this area have been driven by COVID-19 as the catalyst that has driven a shift in working arrangements, such as working from home. In acknowledging this shift in the working environment there has been much activity undertaken by employers to implement and resource mental health initiatives that address this shift.

But now that the peak of the pandemic has passed employers may not be retaining the same level of focus on mental health, or undertaking activities that would meet the current legislative agenda on the management of psychological risk in the workplace.

How Gallagher can help

One of the most significant ways Gallagher can help businesses in this space is by educating them on how to understand the psychological risks they face, by identifying their psychosocial risk profile, which then enables the identification of appropriate risk control measures.

A key differentiator between psychological risks and physical risks in the workplace is that psychological risks are often embedded in an organisation's culture. So, while it may be simple to observe an unguarded machine and fit a suitable guard to mitigate the risk, mitigating psychosocial risks often requires extensive enquiry, education, consultation and the co-design with workers of programs to enable a transformation of a workplace culture where mental health is destigmatised, discussed openly and prioritised.

[1] Productivity Commission Inquiry Report
[2] PwC Creating a mentally healthy workplace – Return on investment analysis

INDUSTRY FOCUS

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CONSTRUCTION

Signs of market stabilisation but liability troubles remain for construction industry

There are signs that the construction insurance market is stabilising from a contract works perspective, however, insurance in the civil engineering space remains difficult with little capacity available from Australian insurers for this sector.

For contract works there is an increasing appetite from Australian insurers to underwrite well run construction businesses with good claims histories, particularly those in the building sector. But with the continual rainfall and flooding on the east coast, state government self-insurance agencies such as iCare and VMIA have been tightening their coverage and increasing deductibles for civil engineering, specifically for flood or water damage.

Most civil engineering or hard-to-place construction risks are still finding a home with London and Europe-based underwriters, who did not follow the Australian market down during the previous soft market. By maintaining their underwriting discipline in terms of coverage, deductibles and price – and a preparedness to walk away from some business – they did not suffer the losses that befell Australian insurers as a result of under-pricing risks.

Liability best practice

Containment of worker-to-worker deductibles is the current key battleground when it comes to public and products liability insurance in the construction sector, with both annual and project-specific insurers pushing for higher deductibles to better manage their long-tail risks.

It is often the case that claims come out of the woodwork many years after an event, either in the form of a direct claim or, more commonly, as a subrogation action brought about by the injured party's workers' compensation insurer.

The main problem with long-tail claims such as these is that businesses may have limited records as the project concerned may have been completed many years prior and key employees or witnesses may have moved on, both of which make mounting a defence challenging and present a key risk for insurers in this space.

The construction industry can help to combat this risk by taking a proactive approach to injury management, through both robust occupational health and safety management and strong post-incident risk management measures, such as detailed incident recording procedures, return to work coordination and, if appropriate, precautionary notifications to liability insurers.

Rather than penalise businesses for making precautionary notifications, insurers may reward them at renewal with a lower allowance for incurred but not reported claims, which can result in premium reductions.

Professional indemnity challenges

Placing professional indemnity (PI) cover for construction businesses remains difficult, particularly for engineers, consultants and subcontractors. High-profile issues around the risks associated with combustible building cladding and building defects are well known, but there are also significant claims coming through on civil engineering and infrastructure risks.

However, London is again welcoming business, which has increased competition in the PI space, but businesses with long memories may be reluctant to move quickly back to London. Despite this there are some signs the market for annual PI risks is beginning to level out, a trend that hopefully will continue into the year ahead.

By contrast, the project-specific PI market is suffering from a lack of competition with only a few insurers still active, leading to an escalation of premiums. In some cases these are at 60% to 70% of the policy limit, which is not sustainable. Insurers are also trying to manage their accumulations and if they have written a project-specific PI policy for a contractor, they are reluctant to be on-risk for the annual policy of that same contractor, or even for subcontractors or consultants on the same project. Gallagher is actively working with government, contractors and consultants to find best-for-project outcomes.

Strength in relationships

Across both contract works and liability insurance in the construction sector, the importance of having a long-term relationship with an insurer cannot be overstated. However, taking business to market with a well thought out strategy is still essential for all construction classes to avoid the risk associated with a change in thinking or approach from an incumbent insurer.

Key to this is to start the renewal or placement process early; a late submission is likely to lead to a rushed quote which won't necessarily provide an optimal outcome. Submissions must also be detailed in a way that removes unknowns and positively differentiates a business or project from others. There is power in the way a business tells its story – for example, while underwriters use premium calculation formulas that drive their rating of a risk, there is normally a discretionary element where discounts or other measures can be applied if they believe the business has a good risk management platform.

And finally, like many industries, insurance is a people business, so a client having a direct relationship with underwriters will allow them the underwriters to gain a much better insight into a business, its culture and how it operates. At Gallagher facilitating this tri-partite relationship is a key strategy in gaining the optimum possible outcome for a project or an annual renewal

KEY TRENDS

- **The market is stabilising from a contract works perspective, but civil engineering insurance remains difficult, however, London is offering more capacity than the local market.**
- **Concerns about long-tail risks remain for public and products liability insurance, particularly around the impact of subrogation actions brought by workers' compensation insurers.**
- **London is again welcoming construction professional indemnity risks, which has increased competition and the market for annual risks is beginning to level out.**
- **While it is still important to take risks to market, the value of having a long-term relationship with an insurer cannot be overstated.**

Our commitment: the Gallagher Way

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