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Brighton NEWSLETTER

You insure, We ensure

Editor's Note

As we enter the second wave of COVID-19, many of us are forced to resort to working from home again. We are clearly now living in a brave new world of social distancing, mask wearing, working remotely and economic uncertainties. But as we emerge into a brave new world, lessons will need to be learned and applied. Most importantly, we need to be more prepared for future black swans events.

If there's one common theme that has emerged in this brave new world is that as an industry we must collectively gain new insights and perspectives that would enable us to think more holistically about risk. I hope this newsletter will serve as a useful source of relevant knowledge and as a forum for sharing insights on some of the key issues faced.

While change is inevitable, it's how we respond to that change that matters most. That is why at Brighton, we remain committed in supporting our clients during this time of uncertainty.

Annie Undikai,

Managing Director

How Climate Change Is Changing The Insurance Landscape

It's undeniable that climate change is leading to more frequent and severe disasters. It is no longer deemed as an emerging risk but a crisis of today. Increasingly destructive hurricanes, seemingly unstoppable wildfires and long spells of drought are evidence of climate change.

Global climate change has far-reaching adverse effect on the natural ecosystems and the socio–economic system, which subsequently impact our health, economy, jobs and communities.

The insurance industry has long recognised the increased risk climate change poses and have addressed the climate-related risks in their underwriting, business operations and reserves. But the current pandemic has only sharpened the

focus on climate change related-risks and will continue to be one of the higher-probability, high-impact risks going forward. Since 1980, weather-related natural catastrophes have been responsible for around US$4,200 billion in losses, but only about a third of these losses were insured.[1]

Insurance companies play a crucial role in building analytical capabilities to quantify climate related-risks and in integrating a forward looking view of climate changes in developing a new generation of risk assessment tools. As such, insurers are increasingly considering alternative forms of risk financing, which in turn has driven the market for insurance-linked securities, including catastrophe bonds.

In a number of jurisdictions, insurance companies are now mandated to calculate and report on their exposures to climate change, and how they are managing the financial risks of climate change, including the impact of transition risks as the economy shifts away from carbon assets. Regulatory interest in how insurance companies are preparing for climate change impact will only intensify post COVID-19 as climate change increasingly becomes a balance sheet concern.

The industry is in a prime position to catalyse actions through engagement with clients during the underwriting process and the manner in which insurers invest the trillions of dollars in their portfolios. Hence, the insurance industry can drive behavioural change by putting in place a system of benefits to incentivise climate resilient behaviour and at the same time discourage behaviour that does not mitigate the impact of climate change.

If there is one thing that the pandemic has taught us is that we must take action more rapidly and vigorously to ensure that we are not as unprepared as we were with COVID-19 for risks posed by climate change.

[1] https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2020/2020-09-07-pandemics-climate-change-cyber.html

Captives and the Gig Economy

The rise of the gig economy has fundamentally changed the conventional notions of work in at least 4 ways: the work itself, who does the work, where the work will be done and how the work is done.

Having taken off following the aftermath of the 2008 financial crisis, the gig economy is currently estimated at US$63 billion globally and is poised to grow at exponential rates over the next five years. It is expected to add US$2.7 trillion to the global economy by 2025. In fact, the COVID-19 pandemic has highlighted a long term trend towards gig economy with organisations now forced to become more flexible, agile and streamlined.

Despite huge growth potential, the gig economy has created a significant insurance and protection gap. Due to the nature of the work in the gig economy, there exists a blurring line between business and personal belongings and activities, thus leaving gaps in insurance coverage. So far the insurance industry has been slow to respond to the insurance need of this growing economy.

What is a gig economy?

The gig economy is a free market system that is characterised by companies and workers who engage with one another through short-term, on-demand contracts and freelance work rather than full-time employment. In recent years, on-demand platforms such as ebay, AirBnB, Uber, Grab, Fiverr, TaskRabbit, and Upwork have played an enormous role in expanding this new economy. Although these companies provide different services, they all have one thing in common – they rely on technology platforms to bring together service providers with people needing services.

The gig economy is also finding favour among companies, both large and small. It's now becoming increasingly common for businesses to hire temporary workers for assistance on short-term projects, particularly in the IT sector as more and more companies embark on digital transformation. By embracing on-demand talent, companies are now able to blend full-time employees with short-term consultants and thus, making them productive and efficient.

Coverage Gaps

The nature of the gig economy itself, which is flexible, temporary, and often involving connecting with clients or customers through an online platform; demands for a unique insurance product and pricing methodology. While the types of risk are not unique, the situations that could lead to claims are.

For example, personal insurance will not cover accidents that arise from transporting passengers with your car for commercial use; and the coverage, which some ride-sharing platforms do provide, is not robust enough and might still expose employees to liability.

When the lines between what is personal and what is business become blurry, so does what is and what is not covered under personal and commercial policies.

On top of this, since companies operating in the gig economy are relatively new, there is not enough data observations for underwriters to price policies effectively and accurately. Insurance companies typically utilise large pool of historical data as well as market performance to price risks.

In absence of such data, companies are highly exposed and as underwriters tend to be conservative when there are unknowns, this is often reflected in higher pricing.

Hence, the underwriting challenge for gig economy companies lies in the uncertainties about the risks involved given their short history of observable data.

Given the unfamiliar exposures that these companies face, they are less understood, thus limiting the insurer capacity and translated into higher pricing.

Closing the Gap

The gig economy has created a significant insurance and protection gap for companies and workers involved. However, the flexibility that captives are known for fits well for companies in the gig economy, especially start-up companies.

The flexibility that captives offer on policy wordings and the claims data collected by captives allows these companies to develop coverage tailored to the specific risks as well as to determine their own pricing. Captives also provides these companies access to the reinsurance market, which have a greater appetite for risk as compared to that of retail markets who may offer broader coverage and more competitive pricing.

Gig economy companies can also use captives to offer their providers and clients access to more affordable insurance coverage tailored to their specific risks exposure. Both Uber and Lyft have recently set up their own captives as part of their risk management strategy.

Captives are creating more flexible and cost effective options for the rapidly evolving shared economy sector. Captives give these companies the ability to better protect themselves as they continue to grow and evolve.

A Road Map For A More Sustainable Economic Recovery

Seemingly overnight, the COVID-19 pandemic ushered in a formidable global disruption both in its magnitude and dimension. Many countries were forced to take drastic actions by imposing either a partial or total lockdown in an attempt to contain and prevent the spread of the coronavirus. This brought many social and economic activities to a standstill. But as economies and businesses worldwide gradually recover from the pandemic's fallout, understanding the emerging risks and implementing effective responses are critical to a more sustainable economic recovery.

In the recently published COVID-19 Risks Outlook, the World the World Economic Forum (WEF) identified four emerging risks that will transform the way we we work, socialise, and create economic value: structural changes, stalling progress, social disruptions and abrupt adoption of technology.[1]

According to the report, emerging risks from structural changes will arise as economies attempts to balance between managing the pandemic, managing economic fallouts of lockdown imposed and planning for recovery to reboot their economic engine.

The biggest structural shifts will come from permanent shift in consumer behaviour and buying patterns. The pandemic has accelerated the shift in consumer purchasing habits to e-commerce across all product categories even though stores are opening up again. The strong market demand for e-commerce is expected to persist long after the pandemic is over, with experts predicting that 95% of purchases will be made via e-commerce by 2040.[2] This suggests that substantial investment in such channels is imperative for businesses in building a future proof strategy.

Another structural shift in consumer behaviour is the rise in the so-called conscious consumption and sustainable lifestyles. Consumers are not only making changes to the way they purchase but also what they purchase. Characterised by an emphasis on limiting food waste, shopping more consciously and seeking out more sustainable options; conscious consumption has reached new heights as consumers place more importance on ethical and sustainable issues. This rise in conscious consumption has also transformed the way producers market their products.

1 World Economic Forum. COVID-19 Risks Outlook 2020. Available at http://www3.weforum.org/docs/WEF_COVID_19_Risks_Outlook_Special_Edition_Pages.pdf

2 https://99firms.com/blog/ecommerce-statistics/

The WEF also highlighted that there is a real risk that sustainability and climate change may be a lower priority on the agenda of many countries and businesses. A recent Deloitte Global survey reported that two-thirds of executives surveyed said they anticipate their organisations to make cutbacks in their environmental efforts in the event of an economic downturn.[3]

As governments' fiscal positions are weaken by the pandemic, which the WEF has ranked as among the top risks, lower public investments in sustainability and climate resilience is on the horizon. Some governments have already either relaxed or suspended environmental protection regulations in an attempt to ease industrial activities in their economies.[4]

The circular economy has been hailed as the best way for the world's economy to recover, whilst enabling the transition to a low-carbon economy. In a circular economy, products, services and systems are designed with the end in mind based on 'make, use, remake' as opposed to 'make, use, dispose'.

The resultant economic crisis created by COVID-19 has resulted in sustained unemployment and deeper inequality. The social dimensions of these risks will exacerbate existing inequalities across six key dimensions: social, economic, cultural, knowledge, environmental and political inequalities. If not properly addressed through policy these social crisis may also increase inequality, exclusion, discrimination and global unemployment in the medium and long term.

Digital technologies have never been more important than they are today. Digital technologies have proven to be a key component of the collective efforts to tackle the pandemic and support the new ways of living and working. However, the pandemic has exposed that there remain huge gaps in digital infrastructure, forcing governments to create a policy environment that would enable their economies and societies to prosper in a world that is increasingly digital and data-driven.

[3] https://www2.deloitte.com/global/en/pages/about-deloitte/articles/covid-19/business-climate-check.htm

[4] United States Environmental Protection Agency (EPA), "EPA Announces Enforcement Discretion Policy for COVID-19 Pandemic", Press Release, 26 March 2020, https://www. epa.gov/newsreleases/epa-announcesenforcement-discretion-policy-covid-19- pandemic-0.