Brighton NEWSLETTER

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Editor's Note

Despite the pandemic continuing to dominate the global economic sentiment, outlook remains positive. With vaccinations underway, we can expect to see COVID-19 restrictions be progressively eased and economies to rebound.

But as we look forward to the return of normalcy in a COVID-free world, we need to refocus our attention on how our businesses and lifestyles have impacted our environment and biodiversity. If these issues are not properly addressed, they will have significant implications on the sustainability of our resources.

More focused on driving sustainable practices must be the order of the day. However, new thinking about products, services and organisations is crucial for economic recovery. As Albert Einstein once allegedly said, "We cannot solve our problems with the same thinking we used when we created them."

Although the pandemic may have put some things on hold, but it certainly should not stop us from catalysing new thinking and solutions to build back better and deliver the future we want. If 2020 was a year of disruption and transition for businesses, 2021 will be a year of continued evolution.

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How A Trio of COVID-19 Risks Is Shaping Risk Management Strategies

The COVID-19 pandemic has brought into sharp focus risks on many levels. But more profoundly, the pandemic has revealed to the world what happens when a global risk becomes reality. If anything we have learned in the past year is that a more agile approach to risk management is needed post-pandemic as COVID-19 has cut across traditional risk categories, from supply-chain failures and digital disruption, to workforce shortages, cybersecurity and health.

In their annual risk report, Risk Barometer 2021, Allianz reported that the Covid-19 trio of risks – business interruption, pandemic outbreak and cyber incidents – top business risks for 2021.[1] What does this mean for businesses? How will these risks shape companies risk management strategies?

[1] https://www.agcs.allianz.com/news-and-insights/news/allianz-risk-barometer-2021.html

The report highlighted that the growing interdependency of many industries and processes means businesses are now exposed to an increasing number of disruptive scenarios. And this is evident in the ways the pandemic has exposed that extreme global-scale business interruption events are not just theoretical, but a real possibility. Additionally, the report also noted that the onset of the pandemic did not only create business interruption and cyber risk; it actually heightened their prevalence.

Business interruption risk is not just physical; it can impact a company's reputation and has the potential for liability. This pandemic has underscored the critical need to build business resilience and develop mature yet flexible business continuity plans to address both short- and long-term threats. COVID-19 has also brought non-damage business interruption (NBI) to centre stage. Although the jury is still out there with regards to NBI claims, some jurisdictions have made significant progress in this area with the latest being the UK. In January of this year, the UK Supreme Court handed down its judgment on how NBI insurance policies should respond to claims arising out of the COVID-19 pandemic. Siding with the Financial Conduct Authority (FCA), the Supreme Court ordered insurers to pay out coronavirus-related business interruption losses to thousands of UK businesses.

Cyber risk was ranked third on the 2021 risk barometer. This comes as no surprise as the acceleration towards greater digitalization and remote working driven by the pandemic had further intensified IT vulnerabilities. It has been reported that at the peak of the first lockdown last year, cyber crime was estimated to cost the global economy over $1 trillion, which is an increased of 50% from 2018 figures.[2]

Undoubtedly, COVID-19 is a wake up call for companies to invest in resilience. With the threats of additional pandemic outbreaks on the horizon, businesses must prioritise their risk management practices to prepare for long-term impacts on operations. However, traditional risk management strategies will not be sufficient to tackle pandemics like COVID-19. A digital risk management discipline will be the only way forward.

[2] https://www.agcs.allianz.com/news-and-insights/news/cyber-risk-trends-2020.html

Pandemic Risk Management: Public-Private Pandemic Reinsurance Solutions

The COVID-19 pandemic has been a mega disaster as it continues to fuel a global health crisis and unleash social and economic storms throughout the economies of the world. We have witnessed how measures taken by governments to limit the spread of the pandemic have significantly disrupted economic activities across all sectors, resulting in significant business interruption losses.

Many will agree that the systemic and complex nature of this pandemic risk will unlikely be any different from future pandemic events. Given the deeply interconnected world we live in, COVID-19 won't be the last global pandemic we are going to experience. Although pandemics may differ in magnitude and scale, on thing remains certain – their potential devastating impacts on human lives, economies and business continuity cannot be ignored.

The fallout from the coronavirus pandemic has posed a big question to the insurance industry – what is the industry's role in insuring pandemic risks moving forward? Well, for one thing, a comprehensive approach to pandemic risk management is paramount as insurers prepare their policyholders for future pandemics.

However, such approach calls for collaborations between various stakeholders – insurance industry, policymakers and think tanks; whom should pool their capabilities and resources to address the gap in financial protection for pandemic-related business interruptions.

In a number of countries, solutions to the business interruption protection gap are being explored in light of the many concerns expressed by insurers regarding comprehensive coverage. A number of proposals on the establishment of pandemic risk insurance programmes have been put forward and discussed by various working groups.

In the US, for example, the introduction of the Pandemic Risk Insurance Act of 2020 (PRIA) was aimed at creating a federal reinsurance programme to provide safeguard for businesses against future pandemic-related business interruption losses. Under PRIA, a Pandemic Risk Reinsurance

Programme will be established and funded by both public and private sources, which would then be used to cover business losses arising from pandemics or other public health emergencies.

Similar to the Terrorism Risk Insurance Act (TRIA), which was created after 9/11 terrorist attacks, the federal government would serve as a backstop to maintain marketplace stability and to share the burden alongside private industry.[1] Hence, businesses could purchase pandemic insurance and once a public health emergency occurs, federal government and insurers would share financial responsibility for covering the claims up to US$750 billion.[2]

Chubb, a large US property and casualty insurer, released its Pandemic Business Interruption Programme in July last year. Designed to mitigate economic disruptions and losses in the event of future pandemics, the programme proposes a two-tiered approach: a parametric trigger for small businesses and an indemnity trigger for medium and large businesses.[3] Under this programme, small businesses will be provided with immediate cash infusion when a pandemic is declared. For medium and large businesses, they may voluntary acquire business interruption coverage from private insurers who would cede a proportion of the risk to a government reinsurer.

In the UK, a number of working groups have been formed by industry representatives to look at developing solutions to the business interruption protection gap arising from pandemic risk. One of the proposals being put forward was the establishment of Pandemic Re – a state-backed insurance company that would pay out to cover losses from any future pandemic. Pandemic Re would be modelled after the Pool Re scheme, which is a reinsurer for terrorism risk set up by the insurance industry in cooperation with the UK government.

Lloyd's of London laid out three ways the insurance industry could fast-track global economic and societal recovery from the impacts of COVID-19 and future systemic events. The three frameworks (ReStart, Recover Re, Black Swan Re) address various elements of the pandemic-related business interruption protection gap.

The ReStart framework is for non-damage business interruption resulting from the pandemic. It is aimed at supporting SMEs by providing business coverage and supporting re-opening through the pooled capacity of various Lloyd's market participants. Recover Re, on the other hand, is an after event insurance product framework designed to provide relief and cover for non-damage business interruption in the long-term. While Black Swan Re is a government-backed vehicle to insure against future systemic risks. According to Llyod's, Black Swan Re would provide reinsurance for commercial non-damage business interruption cover for black swan events through industry-pooled capital, backed by a government guarantee to pay out if ever the pool had insufficient funds.[4]

[1] https://associationsnow.com/2020/09/in-congressional-roundtable-association-leaders-push-for-pandemic-risk-insurance-act/

[2] https://www.insurancebusinessmag.com/asia/news/columns/conversations-around-insuring-pandemics-have-to-happen--and-fast-224189.aspx

[3] https://www.lloyds.com/news-and-risk-insight/media-centre/coronavirus-updates-hub/supporting-global-recovery-and-resilience-for-customers-and-economies

[4] https://www.reinsurancene.ws/lloyds-proposes-array-of-covid-19-recovery-solutions/

The Growing Importance of Directors & Officers Insurance Post COVID-19

In the wake of several major economic scandals worldwide in the past decade or so, there has been growing awareness on the importance of the need for Directors and Officers (D&O) insurance coverage.

Such insurance coverage is even more necessary and compelling in light of the COVID-19 pandemic. As businesses face increasing and unique challenges due to the pandemic, directors are coming under closer scrutiny, which subsequently heightens the risk of potential claims and litigation.

Why are directors and officers at an elevated risk? In addition to their day-to-day obligations and duties, directors face increasingly complex responsibilities, including responsibility for the company's governance around risks such as cyber risk, data privacy and securities class actions. In recent years, there has an increasing number of civil actions seeking to hold directors and officers personally liable for failures to detect and prevent corporate wrongdoings.

In such environment, it becomes imperative that directors and officers should be able to make informed managerial decisions without the fear of being held personally liable. The inability to do so would have far reaching consequences. For instance, the lack of effective decision making would not only hamper business development, but could also impact the broader economy negatively. Furthermore, companies are now operating in a multinational environment where their partners, suppliers, investors or even operations are located in multiple jurisdictions across the globe. This has implications for directors and officers as they have to also take into considerations the many compliance regulations, governance and risk management requirements of various jurisdictions.

This is where D&O liability insurance comes into play in the event that a claim is made against company officers. However, there is a misconception that D&O insurance is just for large public companies. On the contrary, it can be an equally valuable risk management tool for smaller businesses as well as non-profit organisations and educational institutions.

D&O insurance plays a critical role in protecting directors and officers from claims arising from decision and actions that are taken within the scope of their managerial duties. It is basically a specific type of liability insurance that covers and promises a pay out to directors and officers, in the event such individuals suffer losses or incur defence costs from a legal suit brought against them for decisions made in their capacity as officers of the company.[1]

Having said that, businesses must not overlook the potentially significant implications of COVID-19 for corporate liability and D&O insurance over the long term. At present much of the attention concerning insurance coverage for COVID-19 issues has understandably been focused on business interruption and operational hardships amid plummeting economic conditions. But in the longer term, companies can expect to deal with a broader range of claim scenarios resulting from the current circumstances as they are being closely scrutinised by shareholders, employees and customers who are all too keen to hold companies to account. [2]

The COVID-19 pandemic has created a highly volatile and uncertain environment for businesses, resulting in a litany of new or heightened risks for D&O. Some of these risks and potential claims that are top of mind include: [3]

- The adequacy and accuracy of disclosures in a financial/business environment with so much in flux, including many businesses trying to cope with shutdowns and other unprecedented pressures.
- Civil liability surrounding alleged breaches of contract involving major customers or suppliers.
- Event-driven litigation caused by different triggers such as poor sustainability performance, or underestimating or misrepresenting COVID-19-related risks.
- Regulatory and compliance uncertainty in facing unparalleled events and responses by authorities.
- Liability arising from cyber security and employee privacy issues as businesses manage remote workforce.
- Inadequate disclosures to capital markets about supply chain or operational resilience.
- Reputation risk arising from perceptions of how management has responded to the pandemic.

As the spread of COVID-19 continues to impact businesses' bottom lines, directors and officers will continue to have broad liability exposure to shareholders, stakeholders, employees and the government. Companies and their directors and officers should be mindful of the claims that may arise from the management of these risks, and note how their insurance policies may respond to provide protection.

[1] https://dnh.com.my/directors-officers-do-insurance-protecting-the-captains-from-the-storm/

[2] https://www.dandodiary.com/2020/04/articles/d-o-insurance/guest-post-do-insurance-issues-arising-from-the-covid-19-crisis/

[3] https://www.willistowerswatson.com/en-GB/Insights/2020/04/covid-19-and-executive-risk

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Brighton wishes you Happy Chinese New Year 2021!

May the year of the Ox bring you a safe, happy and bright new year.