Brighton You insure, We ensure **NEWSLETTER**

Editor's Note

It was one year ago that we went into lockdown to slow the spread of the coronavirus. A lot as happened since then.

But one of the many lessons we have learned from the pandemic is that we are more resilience than we know and it's not until we are faced with the biggest of hurdles that we come to learn this about ourselves. We also learned that we are completely inept and ill-prepared for a pandemic outbreak. This Black Swan COVID catastrophe shows us just how fragile our world is.

As we rebuild a post pandemic world, we must also take stock of the looming potentially new Black Swan events such as climate change and cyber attacks. It's no longer a matter of if, but when, the next unpredictable event will hit. While we cannot predict when the next black swan event will happen, we can be better prepared to deal with it.

The COVID-19 pandemic has given us permission to change. We now have the opportunity to create a better, stronger, more sustainable, resilient and inclusive future for all. The insurance industry has a pivotal role to play in building this future. We are all in this together. So let's do our part and make a difference.

Annie Undikai,
Managing Director

Double Black Swan Looms Over Insurance Industry

The COVID-19 pandemic has been referred to many as the "Black Swan", a term coined by Nassim Nicholas Taleb to describe a rare, unforeseen event that has extreme consequences. But just as September 11 had forever changed air travel, COVID-19 has radically transformed every aspect of the global business landscape far into the future. This has caused many of us to ask, "What's next?"

As the insurance industry emerges from the pandemic, the threat of a double Black Swan – climate change and cyber security – looms over the industry. Climate change and cyber security are real and fast-increasing threats that are expected to accelerate further post pandemic. But in order to tackle these pressing issues, the insurance industry needs a fresh approach to address the multi-dimensional disruptions that these threats can potentially cause.

The threats of climate change have become strikingly apparent in recent years. 2016 was the hottest year in recorded history.[1] The Greenland ice sheet lost a record amount of ice in 2019, which was equivalent to a million tonnes per minute throughout the year.[2] The years 2019 and 2020 broke all sorts of unwelcome weather records and natural disasters from hurricanes, earthquakes and massive floods to devastating fires in the Amazon forest as well as the Australian bushfires.

The threats of climate change "Black Swan" on the global economy have reached new heights and ushered in a new urgency. Hurricane Harvey caused an estimated $125 billion in economic damages whilst the Australian bushfires not only killed more than a billion animals but resulted in damages worth more than $4.4 billions.[3] However, the economic costs of climate change losses are likely to be far higher due to its systemic effects.

With future economic costs of climate change amounting to about 5 to 10% of the world's GDP, as estimated by the World Bank, insurers can no longer avoid or postpone addressing the impact of future systemic 'Black Swan' climate catastrophes on their underwriting, pricing, investment decisions as well as their bottom lines. Against this background, the insurance industry needs to become more resilient against climate change through better risk awareness and innovative risk mitigation tools that can help to build a more sustainable industry, and ultimately a more climate-resilient society. The industry should also incorporate environmental factors in insurance pricing in addition to traditional insurance pricing factors. For instance, scenario-based analysis can be used to project future claim experience under multiple climate conditions.

COVID-19 has also shone the spotlight on the potential catastrophic effect of cyber incidents 'Black Swan'. The acceleration of digitalisation during and post pandemic has heavily increased the threat of business interruptions due to ransomware attacks, technical failure or via the supply chain as well as the severity of consequences from data breaches, phishing and hacking.

Although it may not possible to predict all plausible Black Swan-type cybersecurity incidents, it is critical for insurers to have a crisis management approach to effectively manage the situation. This involves adopting a strong cyber security discipline and ensuring that the security systems are up to date to protect themselves more effectively from cyber attacks. As cybersecurity is a business issue, not an IT issue, insurers must look into developing a comprehensive risk management programme to promote cyber resiliency.

THE WORLD'S BIGGEST RISKS FOR 2021

Top 5 Risks By Impact

1. Infectious diseases
2. Climate action failure
3. Weapons of mass destruction
4. Biodiversity loss
5. Natural resource crises

Top 5 Risks By Likelihood

1. Extreme weather
2. Climate action failure
3. Human environmental damage
4. Infectious diseases
5. Biodiversity loss

Source: World Economic Forum

[1] https://medium.com/@350/on-paris-its-trump-and-the-fossil-fuel-industry-versus-everyone-else-on-earth-8ef9caf9eebe

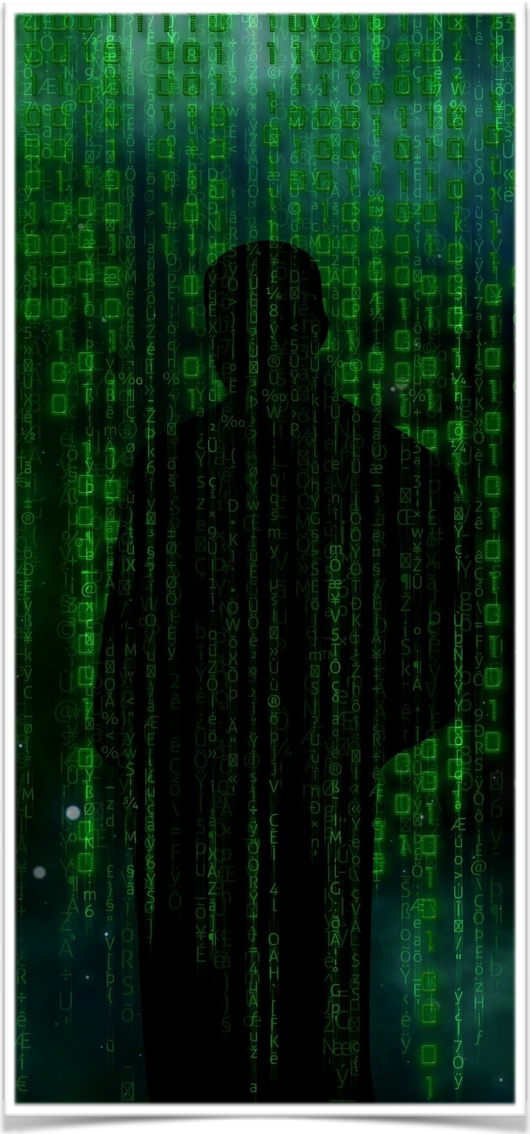
[2] https://www.theguardian.com/environment/2020/aug/20/greenland-ice-sheet-lost-a-record-1m-tonnes-of-ice-per-minute-in-2019

[3] https://www.mckinsey.com/industries/financial-services/our-insights/climate-change-and-p-and-c-insurance-the-threat-and-opportunity

The Captive Immunity

Traditionally, captives are formed when the market is facing a 'triple crunch': hard market, shortage of capacity and price increase. Over the past three decades, the captive market has matured to reflect changing risk management practices. A growing number of companies – large corporations, midsize companies , family businesses – are utilising captives as an important risk management and risk transfer tool.

According to Marsh's 2020 Captive Landscape Report, captive premium growth continued to accelerate in 2020, with a current total of around $54 billion in premium across all industries and captive domiciles.[1] The report also revealed that due to COVID-19 and the tightening insurance market, the industry can expect to see an increase in the formation of captive insurance companies and utilisation of existing captive structures mainly for financial flexibility and protection.



For one, the pandemic has made companies more aware of additional risk exposures that their traditional insurance programme do not provide coverage for, such as losses associated with a pandemic.

Secondly, the overall increased in the awareness on the many benefits of captives will drive the new captive formations, especially in the areas of cyber insurance coverage, employee benefits and environmental liability.

As cyber risks grow and organisations have a better understanding of the extent of their exposures and the need to protect themselves against cyber-related risks, the role of captive insurance in addressing the exposure will continue to grow as well. According to Aon's Cyber Captive Survey 2019 report, an estimated 34% of all captives will be writing cyber in 5 years' time, with the healthcare and energy industries leading the way in utilising captives for cyber coverage.[2]

In the current business environment and the continuation of the hardening market this year, we can expect to see increased exploration in the use of captives to help solve a variety of risk management challenges.

[1] https://www.marsh.com/us/insights/research/captive-landscape-report-2020.html

[2] https://www.aon.com/captives/insights/cyber-captive-survey-2019.jsp

Green Is The New Black

Never before has sustainability been more important. If anything, COVID-19 has placed sustainability at the centre of business resilience. For those companies that had integrated sustainability into their business operations prior to the pandemic, they are putting an even stronger focus on it now during the crisis. They realised that they were much more agile in responding to the pandemic crisis as their sustainability programmes had better prepared them for such unexpected events.

For insurance companies, sustainability has a direct impact on their balance sheet including from regulatory, investment and underwriting perspectives. Of late, there has been a strong push from regulators for insurers to prioritise sustainability in their agenda and integrate environmental, social and governance (ESG) principles into their business models.

The first guide for the global insurance industry to ESG risks (also referred to as sustainability risks) was developed by UN Environment Programme's Principles for Sustainable Insurance initiative (PSI). This guideline, launched in June 2020; outlines eight areas for insurers to manage ESG risks in non-life insurance transactions with a focus on risk assessment and insurance underwriting.

For financial firms operating in the EU, they will now have to comply with the EU regulation on sustainability-related disclosures in the financial services sector (SFDR), effective from 10 March 2021.

Under the SFDR, European financial firms are required to identify sustainability risks of their investment (financial risk) and consider how such risks are incorporated into their investment decision-making processes, as well as the extent to which their financial sector remuneration practices are consistent with sustainability concerns. In short, manufacturers of financial products and financial advisers need to consider and adapt how they operate their business before they can make the disclosures required under the SFDR.[1]

Last December, the Monetary Authority of Singapore (MAS) published Guidelines on Environmental Risk Management for Insurers, which cover governance and strategy, risk management, underwriting, investment and disclosure of environmental risk information. Concerned with financial and reputational implications arising from environmental risk, MAS adjudged it crucial for insurers to build resilience against its impact as part of their business and risk management strategies.

[1] https://www.clearygottlieb.com/news-and-insights/publication-listing/sustainable-finance-2021-brings-significant-new-esg-disclosure-obligations-for-financial-services

There has been a strong interest in ESG by insurers and the COVID-19 crisis has further accelerated their focus on integrating ESG considerations into their investment strategies. The pandemic crisis exposed just how sustainability risks may significantly impact insurers' underwriting, investment and even operational activities. ESG investing has been shown to deliver better risk-adjusted returns in the longer term, but also provide downside protection during periods of high volatility as was the case in the first half of 2020 amid the COVID-19 storm.[2]

Insurers have also realised that they risk a lack of demand for their products if they do not keep up with the demand for ESG fund options. Clearly, there is a reputational risk that an insurer is not seen as environmentally and socially conscious. Post pandemic, we can expect to see a growing number of insurers looking at how best to align their investment strategies with the Paris Accord objectives. This could take the form of reducing carbon intensity of existing investment portfolios or undertaking thematic and impact investing. According to the 2020 Global Sustainable Investing Report by BlackRock, about 54% of respondents consider sustainable investing to be fundamental to investment processes and outcomes, primarily amongst investors in the EMEA region.[3] When asked to rank their focus on ESG factors, 88% of respondents ranked 'environment' as the priority, reflecting the urgency that is present by climate change.

Although ESG considerations have now featured prominently on the asset side of their balance sheet, how insurers factor these in their underwriting decisions is less clear. In a report by AM Best published in November last year, the rating agency emphasised that insurers and reinsurers that ignore ESG in their underwriting and investment decisions face serious reputational risks.[4] The pandemic will reinforce the involvement of the insurance industry with ESG. AM Best expects this to continue significantly as regulators, rating agencies, investors and other stakeholders refine definitions of ESG and adjust their approach to integrating ESG.

[2] https://www.asiainsurancereview.com/Magazine/ReadMagazineArticle/aid/44395/Preparing-for-a-green-future-in-insurance

[3] https://www.blackrock.com/corporate/literature/publication/blackrock-sustainability-survey.pdf

[4] https://www.insurercio.com/images/Ignoring%20ESG%20factors%20poses%20reputational%20risk.pdf

A Busy 2021 For Cat Bonds

The year 2020 was a landmark year for the catastrophe (cat) bond market as well as the insurance-linked securities (ILS) funds. There was a surge in investors' interest in the aftermath of COVID-19, with issuance expected to grow in 2021.

The rising interest was in part due to their performance and robustness during the pandemic, with new issuance reaching a record high of $11.3 billion by the end of last year.

Positive cat bonds forecast for this year reflects both investors demand for more liquid and transparent investments and strong returns. The expected strong growth in cat bonds will also be fuelled by renewals of existing cat bonds as well as new activity from sponsors including corporates, insurers and reinsurers.

Other positive developments include Hong Kong's proposed regulatory framework for ILS, in its bid to establish itself as a new location for the issuance of cat bonds and other reinsurance linked instruments.

Cyber Insurance Goes Mainstream

As cyber attacks continue to surge with the coronavirus pandemic serving as a catalyst, cyber security has emerged as a growing concern for businesses given the increasing risk of falling victim to a data breach or other cyber attack.

The World Economic Forum reports that cyber attacks are ranked as the 6th most likely global risk over the next decade. In a research conducted by Cybersecurity Ventures, it is reported that cybercrime is expected to cost the global economy $6.1 trillion annually by 2021 as compared to $3 trillion in 2015.[1]

With the growing number of companies taking precautionary measures against cyber attacks, the global market for cyber security insurance is set to grow 21% to reach $9.5 billion in 2021. By 2025, the cyber insurance market is expected to exceed $20 billion.

As the cyber insurance market evolves and matures, 2021 will usher in a wave of transformation for cyber insurance – greater standardisation in cyber insurance coverage as well as in language and risk impact assessments. The broad consensus is that steps towards harmonisation and standardisation will increase trust and understanding of cyber insurance.

[1] https://securityboulevard.com/2020/12/cybercrime-expected-to-rise-at-an-unprecedented-rate-in-2021/