Brighton NEWSLETTER

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Editor's Note

2022 is not an easy time to look back on. If this year has taught us anything, it is that we should expect the unexpected and the unpredictable.

The economic shock waves from the unexpected Russia's invasion of Ukraine have dimmed prospects of a post-pandemic economic recovery. As highlighted in the article on "Time To Focus On The New 'G' in ESG", it is timely that we now focus on geopolitics when integrating ESG into corporate strategies.

A combination of crises – COVID-19 pandemic, climate change and geopolitical tensions; are putting the world at risk of passing multiple climate tipping points. How can the insurance industry be at the forefront in building resilience? Read the article on pages 5 and 6 to find out.

The final article in this issue delves into innovation in captives as the industry poised to fill the capacity gap left by the hardening market.

Looking ahead at 2023, there is no question that the list of uncertainties is long and growing. But when there is uncertainty, there is always room for possibilities and opportunities.

Finally, as I write this last editorial note of the year, on behalf of the team at Brighton, I would like to wish you a happy, healthy holiday season, and the best for the year to come.

Happy reading and Happy New Year!

Annie Undikai,
Managing Director

Time To Focus On The New 'G' in ESG

The term ESG – Environmental, Social & Governance – has been around for almost two decades since it was first coined in 2004. But it only gained prominence ten years later when the risks from ESG started impacting investments. Today ESG issues are considered as mainstream concerns and are at the forefront of the corporate agenda.

Several factors have contributed to the rise in ESG including change in global focus, shift in the value system, and the realisation that a strong ESG proposition improves business performance and adds long-term value.

But the rise in geopolitical tensions in recent years have reshaped risks and underlined the importance of supply chain resilience for businesses world over. At a time when

the global economy was grappling with growing inflationary pressures and supply chain disruptions caused by the pandemic; the fallout from Russia's invasion of Ukraine and subsequent economic sanctions imposed have added fuel to the fire.

The ongoing Ukraine-Russia conflict has shattered previous assumptions that geopolitical shocks are localised with limited impact on business in other parts of the world. For companies to stay resilience, they must now consider a new "G" on their corporate agendas in order to meet their ESG objectives: GEOPOLITICS.

The energy crisis sparked by the war clearly demonstrated that green energy sources are not yet able to fulfil the energy gap left by Russia. In fact, it had fuelled a global demand for coal – the most polluting of all fossil fuels, to a record high in 2022 as countries switched back to coal and seek to reduce their dependent on Russian supply of gas.[1]

The International Energy Agency reported that global demand for coal is forecasted to grow by 1.2% in 2022 and to surpass 8 billion tonne for the first time.[2] The usage of fossil fuels inevitably increases carbon emissions and other pollutants.

With Europe bracing winter amid an energy crisis, the spike in the demand for coal as natural gas becomes scarce and expensive could seriously derail its ambition to achieve net zero by 2050.

The energy crisis reveals the challenging task for governments and companies to find the delicate balance between energy security and net-zero goals.

As companies pursue and expand their ESG footprints, it is becoming increasingly necessary that climate actions be considered within the broader geopolitical risk landscape and that geopolitics be recognised as the new "G" of ESG.

[1] https://edition.cnn.com/2022/12/16/world/coal-use-record-high-climate-intl/index.html

[2] https://www.tradingview.com/news/moneycontrol:96b6f122e094b:0/

Innovation In Captives As An Alternative Risk Transfer Mechanism

The huge growth in captives in terms of the numbers of new captives being formed and the expansion of scope of existing captives have been primarily driven by the hardening market and emerging risks that are difficult to insure.

Traditionally, captives have been a hard-market strategy for Fortune 500 companies, especially when capacity is scarce and prices are high. But a growing percentage of the middle market companies are using innovative ways to set up captives.

As companies continue to grapple with a complex risk landscape, captives are increasingly being used to cover non-traditional risks such as cyber risk and climate change risks. These emerging risks, which are not well-modelled and where claims data is less available, make captives an attractive method of alternative risk transfer.

Global economic uncertainty arising from runaway inflation, geopolitical conflicts, disrupted supply chains and looming global recession have impacted businesses' risk portfolio and their bottom lines. This has prompted more companies to set up captives or ramp up the use of existing captives to reduce the cost of risk and to fill any gaps in their coverage.

Captives are also being utilised in response to companies' commitments to ESG. With ESG top of the corporate agenda, there are several

ways in which captives can embed ESG into its strategy:[1]

- Incorporate ESG-related metrics into the assessment and measurement of risks to have better visibility of the scale and gravity of the specific risk.

- Align captive's investments with the parent's ESG goals by utilising its profits to invest in sustainable investment funds.

The growing interest in captives as an alternative risk transfer mechanism has spurred innovation in this space with the recent being the virtual captive concept pioneered by Swiss Re Corporate Solutions.

Unlike regular captives, virtual captives are not formal legal entities but a multi-year insurance agreement between a customer and an insurer. Under this structure, the insurer handles the set-up and the administration of the supporting balance sheet and thus, virtually taking it off the customer's balance sheet.[2]

A recent addition that was borne out of the cyber protection gap is the creation of mega captives such as the Miris Insurance. Created by several European companies including Airbus, BASF, Michelin and Veolia; Miris is a mutual cyber insurer aimed at providing its members with insurance coverage against cyber risks.

During the first two years, the new insurer will allocate up to $24.3 million of capacity to each members. Pending the approval of the supervisory authorities, Miris Insurance is expected to commence activities on 1 January 2023.

As the industry enters 2023, captive insurance market has an opportunity to dive into new business and create innovation in a bid to fill the capacity gap left by the hardening market.

[1] https://www.lexology.com/library/detail.aspx?g=04bc274c-5a7a-4189-b544-be6784f14bb6ml

[2] https://corporatesolutions.swissre.com/dam/jcr:807a22a1-8046-49c0-8af8-082fdf45e5a0/virtual-captive-solutions.pdf

The World At Risk: Climate Change And The Future Of Insurance

In spite of laudable commitments by governments, multilateral institutions and organisations to tackle climate change, build resilience and create sustainable development pathways; recent political and economic developments are doing the reverse.

A combination of crises – pandemic, climate change and geopolitical conflicts; are not only putting the UN's 2030 Agenda for Sustainable Development in grave danger but are also hindering progress towards the Paris Agreement goals and reaching net zero by 2050.

Events during the last two decades have dramatically changed the risk landscape as risks takes on new forms and assume ever greater significance. The triple crisis have demonstrated that the impact of disasters cascade across sectors and geographies.

According to the UN, based on current trends, the world is projected to soon face 560 disasters each year. In short, the world we live in today is more at risk than it was ever before.

As highlighted by the Global Assessment Report on Global Disaster Risk Reduction (GAR 2022), keys to building resilience and accelerating sustainable development are measuring what we value, and designing systems around the way we make decisions on risk.[1]

So, what is needed is a shift from making commitments towards taking actions. This is where the insurance industry can play a leading role in building resilience against current and emerging risks. As an industry that has a reputation of being risk-averse, slow to change and is not typically considered a bastion of innovation, it must now harness the

[1] https://www.undrr.org/gar2022-our-world-risk#container-downloads

transformation momentum gained from the fallout of COVID-19 to reassess its future and reimagine its place in a world where the only constant is rapid change.

One of the biggest challenge of our times is climate change. In the transition to a green economy and towards a net zero world, the insurance industry has a critical role in helping stakeholders manage and mitigate the risks associated with climate change.

But innovation in the industry will be essential for insurers in taking this leading role. New products and new ways of sharing risk must be developed. These include incentivising climate mitigation and supporting the growth of low carbon solutions in the design and pricing of policies, claims as well as in the provision of risk advisory services.[2]

The global energy crisis triggered by the conflict in Ukraine underscored the huge capacity gap in renewable energy as renewables have not yet reached a scalable level as replacement for fossil fuels. Despite its commitment to switch away from fossil fuels, much of Europe is still heavily reliant on these heavy pollutants as an energy source. The industry will need to reassess how it is supporting the energy market transition.

In a bold measure, global insurers such as Swiss Re, Aviva, Allianz, and Zurich; have decided to discontinue underwriting for some thermal coal-dependent industries to support emissions reduction while others are scaling back or discontinuing investment in industries dependent on fossil fuels.

With the world at risk of passing multiple climate tipping points, the insurance industry now needs to reflect on how best to be at the forefront in developing new strategies to respond to climate change and the energy transition. But climate change is a shared phenomenon. Hence, mitigating it cannot be done in silo. A multi-stakeholder approach is essential for implementing change at scale and for ensuring that these changes stick.

[2] https://www.cisl.cam.ac.uk/files/climatewise_climate_product_innovation.pdf

[3] https://www.forbes.com/sites/christopherhelman/2021/10/19/energy-crisis-2021-how-bad-is-it-and-how-long-will-it-last/sh=70a6aa594c63