



**Risk & Insurance
Management in the
Roaring Twenties**

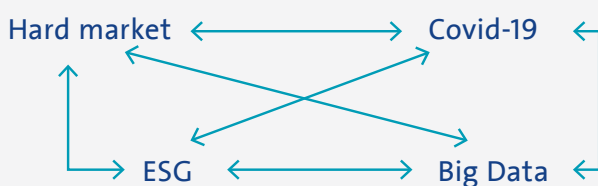


Introduction

After just over a year of pandemic, it is gradually becoming clear to many sectors that many puzzle pieces will be put together in a different way in the third decade of this century. The fact that the *roaring twenties* are beginning, just like a hundred years ago, is really not exclusively related to Covid-19, and the insurance world is an excellent example of this. Insurance is known as an old industry that is also not in the habit of jumping onto a train full of changes too quickly. Nevertheless, more and more actors in our sector are recognising that a series of events has currently brought us to a tipping point. It is certainly not only elements from our sector itself that are shaking up the market, both today and in the near future.

As a market leader, Vanbreda Risk & Benefits is observing from a privileged position how the playing field is expanding. Not only is customer demand evolving towards a broader interpretation, our role as an insurance broker and risk consultant also deserves a broader scope. That is not an evolution that started on the day that our country recorded the first corona infection. We had already left the “soft insurance market” behind us from the end of 2018. Evolutions such as sustainability and digitisation are not completely new either, but will continue in the coming decade.

What are the direct and indirect consequences for our sector of those four major environmental factors (Covid-19, market hardening, ESG (Environmental, Social, and Corporate Governance) and Big Data) that reinforce each other, and how do the market players in the world of risk & insurance management best react to these? We examine this in this whitepaper, and we will examine our starting position at the beginning of the roaring 20’s through the magnifying glass.



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Environmental factor 1.

Market Hardening: the chronicle of a long-announced hard insurance market

For the insurance world, the period from 2003 to 2018 is largely regarded as a soft market. For fifteen years, insurers operated in a market with a lot of (re-)insurance capacity at low prices. This created the opportunity for companies to purchase insurance cover at a good price, with high insured capital, few exclusions and low exemptions. The past two years were characterised by an international hardening of the market, which we can explain in various ways.

Hard cocktail

For the first reason, we have to look at the combined ratio of an insurance company, in which we divide the sum of the claims paid and the operating expenses by the premiums received. If this indicator of profitability exceeds 100%, it means that a certain activity is producing a loss. For a few years now, we have noticed that, in more and more insurance branches, the premium income is insufficient to pay the ever-increasing claims and operating costs, and then still have a margin left. With combined ratios above 100%, insurers can no longer meet their obligations in such a situation.

The second reason consists of the emerging new risks that are associated with “progress”. *Emerging risks*, such as the climate or cybercrime, mean that certain types of coverage from the past are no longer sustainable. Think of a traditional fire or liability policy that used to include a limited cyber coverage almost for free, as an extra. The growing number of cyber risks and incidents has led to the development of separate products, but, in the meantime, loss statistics based on policies from the past are creating an explosive situation for insurers.

Finally, the low investment results of insurers are also contributing to this. The less lucrative investment results of insurers and the (institutional) investors in insurance shares both indicate the uncertainty in the market, which is causing a decrease in working capital and of the possibilities to pay out claims.

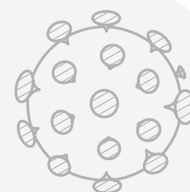
Less capacity

The hard market has a number of very concrete consequences. One direct consequence is that customers have been seeing a declining insurance capacity since the end of 2018, often in combination with higher premiums, deductibles and more exclusions. Indirectly, this means that companies are now faced with proposals for the renewal of their policies that are much more expensive than the year before. This increases the need to create a stronger risk profile in order to sell oneself better to the insurance market as a good risk with adequate prevention measures.

Price war

For many brokers, this hard context is unknown territory after fifteen years of a soft market, and requires a different sales strategy. You can no longer convince customers on the basis of premium reductions, but you need a new arsenal of arguments in order to be able to sell premium increases and exclusions. Moreover, it's by no means enough to only convince the risk and insurance manager, but sometimes also the C-suite as a whole, because, ultimately, it's about the increased total risk cost of the company. At the same time, brokers are seeing that even this hard market is ultimately still strongly price-driven, and that service and coverage conditions are sometimes less important when convincing a client.

Environmental factor 2.



Covid-19

A compulsory closedown, reduced capacity due to the loss of employees, less turnover because products or services are less available or attractive during a lockdown, claims from customers who suffered a Covid-19 infection in the business premises, etc. The causes of damage claims, additional costs and loss of income due to Covid-19 are countless for many companies. Still, little is currently known about the real insured and reimbursable loss impact due to corona, and some insurance branches also have fewer claims. Motor insurance, for example, because less traffic simply means fewer accidents. Other insurance policies are unaffected, because they don't cover the impact of the pandemic, but some dubious cases remain.

Creeping uncertainty

A good example of this is business interruption coverage. A business interruption insurance is an extension of a property damage insurance policy and normally covers the additional consequential loss of a physically covered incident. If a production hall burns down and your company is therefore at a standstill for six months, the extra costs and any loss of income will be borne by the insurer. A pandemic is excluded in most traditional policies, but lawsuits about this are pending in the United Kingdom and the United States and/or the judges of courts of first instance have ruled that the business interruption policy must indeed intervene on the basis of an unclear policy text. For many companies, the so-called *non-damage business interruptions* (NDBI) are an element that has major consequences for the entire supply chain, because of globalization and the Just-in-Time-principle. Operational costs are rising, and the impact on the *business continuity planning* (BCP) can be felt. Seen purely from a risk analysis and risk management perspective, Covid-19 has sometimes caused many companies to become de facto paralysed.

The uncertainty about the impact on their statistics leads to a situation where, in combination with the hard market, insurers decide to no longer underwrite certain insurance branches. In the meantime, for example, the number of insurers that still want to be active in cyber is decreasing, but professional liability, construction and credit insurance are also a bottleneck. The latter is not surprising, given the increased risk of payment arrears at companies. In this way, Covid-19 also seeps into branches that are not directly related to the pandemic, but where insurers are showing more and more caution due to the fallout.



Budget restrictions

In addition to this trend, insurers are increasingly confronted with companies that have had to eat into their financial reserves. As a result, paying premiums is becoming less evident. There is a good chance that companies will disappear, will be unable to pay or will opt for lower premiums for a more limited coverage. In the soft insurance market that existed in recent years, purchasers of business insurance have been able to extend their cover at low cost. Many are now opting for the strict minimum coverage, due to budget constraints. They sometimes prefer to only take the coverage that the company needs and can afford as a minimum. As a result, the focus shifts to a higher self-insured retention, more risk prevention and a good risk presentation to the insurers in order to receive an adjusted insurance proposal without too many surprises. Transparency is important here: ambiguities in the risk profile can cost dearly.

Uninsurable risks

Moreover, after a year, Covid-19 has once again made it clear that more and more critical corporate risks are difficult to insure. International surveys among risk and insurance managers asking what they see as the major risks show that about half the top 10 business risks are traditionally difficult or uninsurable. These are risks such as pandemics, new legislation (e.g. lockdowns) or pure climate risks for which there are currently no traditional insurance products available. This is a new and important schism in the market, because it brings us to the conclusion that brokers can usually only work with most insurers for the more classic products and risks, which cannot offer complete protection for many larger and even medium-sized customers, however, and are only half the solution.

A risk for the authorities

At the heart of the discussion about Covid-19, the question remains whether a pandemic is a risk that the private insurance market should cover. Just like war risks or nuclear risks, a pandemic is, as stated, traditionally excluded in many policies, precisely because no spreading of the risk is possible. The event affects too many policyholders at the same time. The current pandemic, however, provided an extra element due to the associated lockdowns. After all, these ensure that the spread no longer depends solely on the number of infections, but on the legislation in place. If all countries systematically go into lockdown on the basis of government decisions, there is no longer a pure pandemic risk. In that case, there is a certainty of a “systemic risk”, with a “nationwide damage” as a result. The economy is flattening in all countries, with a corresponding impact on customers, their payment capacity and their supply chain. Due to the fact that there is no spreading of the risk, the classic insurance market is ultimately unable to cope with such a situation (anymore). At a time like this, government intervention via *pandemic schemes* could come into play. Covid-19 is a systemic risk that governments must, in principle, resolve, and that is why initiatives are now underway in a number of EU countries to create a sort of a government funded cover scheme. Through a public-private partnership, the government and private bodies could jointly finance the pandemic risk. The idea is still embryonic, and is also geopolitically charged. Each country will want to develop its own initiatives to keep spending within national borders, but that in itself is not completely new. Even now you can see solutions in the market for each country, such as a terrorism “pool” or earthquake funds.



Environmental factor 3.

ESG-risks & -standards

Speaking of risks that are difficult to insure ... The so-called ESG risks encompass the broad group of Environmental, Social and Governance risks. There has been attention to this for quite some time, but it has been on the rise in risk and insurance management for six months, and this development has come from international organisations such as the UNO and the EU. Among other things, the European Union is working on a new directive that will impose rules on companies regarding ESG compliance, including EU standards and reporting.

‘Woke environment’?

The pressure to pay more attention to these risks also arises in parallel at the national level. The debate about nitrogen emissions and rational water consumption is a striking illustration of this, and has a very concrete impact on corporates. Certain (re-)insurers are already announcing that they will no longer underwrite risks related to, for example, the coal industry or shale gas, or that they are no longer investing in such industries. Insuring risks in an ethical manner is becoming more important. The pressure from the media and stakeholders creates a kind of “woke environment”, in which the demand grows for institutional and other investment groups that operate ethically. Everyone can see in the annual reports of larger corporates for 2020 that the attention to ESG is growing enormously.



Sustainability and risk management

The evolution of ESG results in an increased risk profile for companies. From now on, a company is not only operationally and financially impactable because of tangible classics such as property or liability risks, or because of technical risks, such as cyber incidents. Now that social impact and governance are gaining in importance, top-down awareness is growing. Every employee, and certainly also the risk and insurance manager, has to become increasingly aware of the sustainability approach of his company. Sustainability has been a household term for many years, but has recently moved closer to risk management, because the risks will grow if you fail to comply with the ESG reporting standards of the future. ESG will become an enforceable risk, but certainly also a “boardroom risk”, and will therefore also be an important element in the total cost of risk of a corporate, because media pressure will ensure that ESG can significantly impact the corporate reputational risk.

Insurability remains a question mark

In other words, sustainability is no longer a gimmick on the last page of the annual report. It has become an issue for the boards of directors and management, because it has a direct impact on the company's risk profile. Due to the more controlling legislation that is coming, it is no longer just major property or larger liability claims that heavily determine the total cost of risk. Sustainability or the lack of is also a risk that can undermine your company financially. It's perhaps less tangible than a corporate fire incident, but it is still there. Despite the legislation, insurability of ESG risks remains a major question mark. At present, this is largely limited to liability insurance for directors and managers (D&O insurance), resulting in significant price and capacity pressure. In the United States, one of the results of this is that large companies are facing premium increases of 200 to 300% on average. A limited number of insurers offer cover for reputational risks, but, otherwise, very few insurers are on the path of more targeted insurability.

Solvency and compliance

This is an evolution that reminds us of the role of the risk and insurance managers. They must not only be aware of ESG risks, but must also increasingly contribute to the measures that a company takes to be sustainable. These measures affect certain insurance policies and their cost. Sustainability also has additional indirect consequences for the insurers themselves. The own organisation must be ESG-compliant and, as a result, certain insurers will no longer cover a group of risks, as mentioned above. In addition to coal or other elements that negatively influence the climate, social issues such as child labour, for example, are also coming into focus. Caution will increase, and insurers will not hesitate to cancel coverage for certain customers, perhaps even good ones. Moreover, through the set-up of a standardised reporting system, the subscription and operating costs will increase. In addition to solvency, compliance will become a spearhead, and both the insurer and the insured will clearly perceive this. Here too, a hard insurance market, the impact of Covid-19 and other new risks such as ESG go hand-in-hand, and reinforce each other.



Environmental factor 4.



Data management & transparency

The fourth environmental factor is an old well-known one that serves as a catalyst for the other environmental factors. The availability of data is constantly increasing through normalised data flows, and that makes our world a lot more transparent. Just think of how data on social media makes it impossible for a company to play hide-and-seek in the field of sustainability. More data and reporting ensures that the ESG challenges will be clear and equal for all companies. At the same time, the data itself are also an asset in estimating the impact of Covid-19, and as a trigger for further market hardening.

Data-based underwriting

The availability of data will ensure that, in the event of subsequent shocks, insurers will carry out targeted analyses with regard to the risks they still are willing to underwrite. As a result, data will more generally encourage customers to create a clearer risk profile of their organisation. If the data show that you are purchasing raw materials from a supplier who is known for using child labour, or that your supply chain is highly susceptible to a pandemic, this will be part of the *data-based underwriting* of the insurers.

This evolution is also taking place in the traditional insurance branches. We are already seeing that a part of the hard market in property insurance can use big data and 'artificial intelligence' to monitor very clearly which cumulative capital of property risk is insured in one particular location. It allows property insurers to indicate that the financial risk at a particular location has become too high for them. Anyone who says data also says cyber crime. More data indirectly means a greater chance of cyber attacks or incidents, with consequences for both your own environment and that of third parties. Here too, this will lead to selectivity, because insurers identify a certain type of risk (for example, ransomware) too often, and therefore decide to no longer underwrite it.



Action.

Towards a clear risk profile as a cornerstone

The answer to the four key environmental factors described on the previous pages of this whitepaper is a shared responsibility for the actors in the insurance world. For some companies there is a lot of work to be done, but cooperation can yield a lot of added value for certain action points. As a start, many companies can benefit from a more defined risk profile, including the total cost of risk, risk tolerance and risk appetite.

Risk ID

The days when a risk profile consisted of reporting your warehouse and a corresponding liability insurance are behind us. Companies and their brokers must work together to create a fully-fledged Risk ID. This should make it clear what the hard market, Covid-19, ESG and big data have meant for the difficult or uninsurable risks of a company in the past two to three years. You determine your total cost of risk through clear risk profiling, regardless of whether the risks are insurable. As a company, you can thereby also estimate (or have it estimated) exactly how big your risk appetite and risk tolerance are. The risk tolerance is then more of an accounting/mathematical estimate depending on which blow you can take, based on your turnover of, for example, 100 million euro and a net profit of 10 million euro, without getting into problems. The risk appetite, on the other hand, says something about how much you actually want to bear as a function of the management objectives and the available resources. It is possible that your theoretical risk tolerance is an aggressive threshold of 10 million euro, whereas your risk appetite tells you to take a conservative maximum of 2 million euro of own risk.

Cohabitation with the sustainability department

A number of new actions can then be initiated from the defined risk profile. If a company establishes that the profile no longer consists solely of traditional risks, new partnerships will emerge. With the sustainability department in particular, a *cohabitation* will often be necessary in order to be able to make an estimate of risk costs, tolerance and appetite. In many companies, sustainability has long been, above all, a part of marketing, aimed at telling about the initiatives you were taking. The current evolution will require different efforts from the sustainability leaders. In some companies, you can already see job descriptions such as *'Head of Professional Ethics, Risk & Insurance Management'*.

Alternative risk financing

In parallel, the estimation of the risk appetite and tolerance will form the basis for estimating the possibilities for possible alternative risk financing (ARF). This comes to the fore whenever traditional insurance from regular insurers no longer offers a solution, because it is too expensive, too limited or simply not available. Mechanisms for self-financing then come into the picture, such as multi-year contracts with reserves on the insurance balance, a captive company, etc. Alternative markets, such as foreign insurance markets or, for example, parametric insurance (for example, weather insurance) are a possibility for arranging risk financing in a way other than through the classic direct local insurance market. To conclude this whitepaper, we will look at some of these possibilities in more detail.



Captive company

A 'captive' is a regulated (re-)insurance entity. It is a company (subsidiary) that is set up by a parent company/ headquarters to investigate and efficiently manage risk and insurance needs at the group level. Through a captive, companies manage to obtain the best insurance premium on the market. This manner of working also guarantees that the price/quality of the offered cover is adapted to the business activity and the general insurance strategy of the group. Via a captive, companies can determine which risks can best be financed in-house, and which are better placed in the hands of third-party insurers. A captive can be a "direct writing captive" (= an insurance company) or a "reinsurance captive" (= reinsurance company) that reinsures a direct insurer (= fronting insurer). The fronting insurer issues policies and settles claims. The captive, in turn, also issues policies and settles claims, retains part of the risk (if desired) and transfers the remaining part of the risks to the reinsurance market. With an appropriate risk management, a company is able to realise additional financing capacity and a technical profit for the parent company via a captive. A captive thereby provides many advantages, although setting it up is a matter of customisation and the mechanism is not automatically a suitable solution for every company.

Own risk

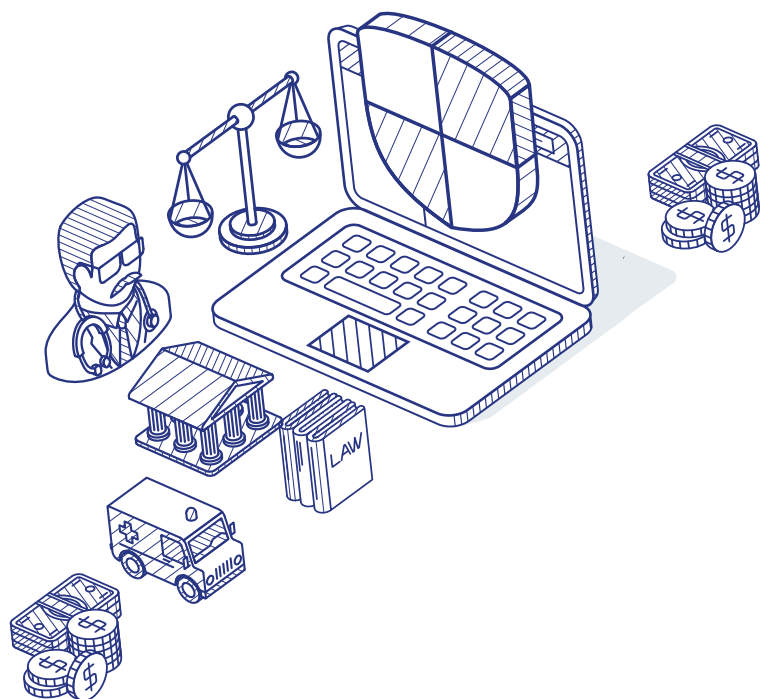
A company that chooses to retain a particular risk itself can opt for self-insured retention (SIR). On the basis of the estimate of the amount of risk and the types of risks, a budget is provided to pay for the losses resulting from these risks. Companies are raising the bar with regard to the franchise, in exchange for a lower premium and better coverage limits. In this way, risk financing products from alternative markets, which were less needed in the soft market in the past fifteen years, come into the picture. This evolution coincides with a race for insurance capacity. The market is shifting from solutions with one or two insurers to programmes with ten insurers at different layers. In addition, there may be room for special reinsurance and alternative capital through other financing instruments.

Parametric insurances

With parametric insurance or index insurance, the pay-out depends on a predetermined index or parameter (e.g. storm of more than 8 Beaufort) being exceeded as a result of an insured event or “trigger” (e.g. a storm). A well-known example of this is weather insurance, in which, for example, it is sufficient for farmers to determine a possible production deficit (index exceedance) due to prolonged drought (trigger event) on the basis of agreed statistics and models. This can be extended, for example, to large construction companies that are impacted by the costs of the delays caused by persistent storms. Traditionally, this is difficult or impossible to insure, but weather insurance can do so in certain forms. In the context of global warming, or, more broadly, the ESG challenges, this type of insurance is on the rise. Another example: the reputation damage or associated negative impact on the listing of listed companies. Based on AI and data on social media, the amount by which certain pre-agreed indexes are exceeded can be clearly measured, and can then be the trigger on the basis of which the insurer pays the claim.

Qualitative and quantitative risk analysis

In this changing market, brokers have the crucial task of keeping all risks covered for their clients. This means that, in practice, the classic brokerage activity is currently focused on ‘*capacity broking*’. Searching for capacity, where necessary through a captive, parametric insurance or other solutions, turns the broker also into a consultant who carries out analyses, for example, about the history of past claims or the financial capacity of a customer. This qualitative and quantitative risk analysis and the creation of a balanced risk profile enable the company and the broker to think along with the insurer regarding the relationship between retained risk and insurance premium. Brokers will draft their submission files to insurers more strongly on this basis, especially for large risks. What is the output of the quantitative and qualitative risk analysis, what do the current coverages and statistics look like, what efforts does the insured want to make in terms of risk management and prevention measures? In the coming period, brokers will have to learn to match this customer data with the benchmarks of the insurers or from their own data systems. This will create an approach that makes it possible to help customers adequately determine their risks and the financing of these, and to manage and reduce the total cost of risk of the company.





How turbulent will the '20s get?

When a pandemic turns our society upside down, it is tempting to quickly talk of a shock effect, a break with the past or a major turning point. But we have not gratuitously chosen the “turbulent twenties” as a description of the era that now presents itself to the insurance market. The third decade of the last century was also quite turbulent, with the starting shot also being given by a virus (the ‘Spanish flu’). In his book *‘Apollo’s Arrow: The Profound and Enduring Impact of Coronavirus on the Way We Live’*, Nicholas Christakis, the American epidemiologist from Yale describes how people respond in much the same way to large-scale epidemics. During the pandemic, we become thrifty, allow ourselves fewer pleasures and take fewer risks.

We are already seeing companies respond in the same way, while, at the same time, climate change and the rise of cybercrime have gained in importance. For the insurers, this has created a new cocktail of an already hardened market and a gentle compulsion to change at a rapid pace. This rapid change feels unusual for this sector, but we are already seeing interesting new recipes emerging in the market to deal with this.

Firstly, the importance of customer support and advice is growing. This will be a *must have* for companies that understand that a good risk profile is indispensable. Secondly, we will see an accelerated degradation of silos. Walls around the risk and insurance manager will disappear, and make way for fairly intensive collaborations with other departments in the company. The sustainability department and IT are thereby seriously on the rise. Thirdly, a new type of creativity is emerging to respond to the realisation that traditional insurance can no longer bring relief to every scenario.




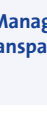
In this combination of creativity, collaboration and more intensive support in assessing risks, we can see the contours of the real face of the roaring twenties in the insurance market. Whether the market will be able to adapt successfully to the prevailing environmental factors in the coming years will therefore depend on the concrete interpretation of these new elements.

Vanbreda Risk & Benefits continues to closely monitor the market development.

If you have any questions or comments about this, your contact person at Vanbreda or Wim Lanclus (wim.lanclus@vanbreda.be) will be happy to help you.

Appendix

Risk & Insurance Management needs to assimilate a rapidly evolving environment. What's cooking nowadays globally?

Environment	Trigger	Direct impact	Indirect impact	Client + Broker Action required	Broker's role
<ul style="list-style-type: none"> • Combined ratio's >100% • Emerging risks • Low investment results 	<p>Hard market</p> 	<ul style="list-style-type: none"> • Lower capacity • Higher premiums • Higher deductibles • More exclusions 	<ul style="list-style-type: none"> • Increased risk management needs • Increased risk profiling 	<ul style="list-style-type: none"> • Review Risk ID: (un) insurable risks • Determine Total Cost of Risk • Determine risk appetite/tolerance • Search for alternative risk financing • Cohabitation RM + Sustainability Dept 	<ul style="list-style-type: none"> • Deploy 'capacity broking' & consultancy capabilities • Define client's 'Risk & Insurance ID' for future submission files • Develop in-house Data Management (quick-reliable-relevant-digital) <p>To control :</p> <ol style="list-style-type: none"> 1. Risk=> 2. Risk Finance=> 3. Risk (Re)Insurance
<ul style="list-style-type: none"> • Evolving worldwide pandemic 	<p>Covid-19</p> 	<ul style="list-style-type: none"> • Loss of markets • Budget constraints • NDBI • Higher operational costs • BCP impact 	<ul style="list-style-type: none"> • Number of uninsurable risks is increasing • Pandemic schemes • Increased interest ARF (captive, SIR,...) • Blurring boundaries between insurance, reinsurance and alternative capital 		
<ul style="list-style-type: none"> • Socio-political pressure (EU-directive,...) • Media pressure • Shareholders • Stock Exchanges 	<p>ESG-risks & -standards</p> 	<ul style="list-style-type: none"> • Increased risk profile • 'Top down awareness' • Sustainability • Reputational risk • Selective u/w/refusals 	<ul style="list-style-type: none"> • Increased total cost of critical risk • Increased standards & reporting requirements • Expanded role of risk/ insurance manager • u/w impact + cost 		
<ul style="list-style-type: none"> • (Big) data availability increases • Globalised data streams 	<p>Data Management & Transparency</p> 	<ul style="list-style-type: none"> • Increased risk profile (buyer) • Databased underwriting (seller) 	<ul style="list-style-type: none"> • Cyber • Selective underwriting (cumul risks) 		



