Mactavish
Expert insurance buyers

Mactavish Report

Managing risk and safeguarding business resilience in a time of crisis

Building corporate resilience.

The war in the Ukraine, and its global repercussions, is undoubtedly one of the major crises of our times. Now, more than ever, businesses across the world are looking to the insurance market to limit and recover their losses. But, for an industry already rocked by a series of unprecedented crisis events, resulting in one of the toughest markets in insurance history, delivering against the promise to safeguard these organisations, is challenging.

As events continue to develop, with their inevitable impact on supply chains already compromised by COVID-19 and Brexit, our survey aims to evaluate the risk impact of the war on UK businesses and the role of risk placement in preserving business resilience during these difficult times.

Past crisis events have only served to expose the limitations of the traditional insurance model and its ability to understand and protect against new risks, as they emerge. There is now a growing pressure on policyholders to take a more active role in ensuring the reliability of their risk placement programmes.

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Understanding emerging risks

An unprecedented series of disruptive events, including a financial crisis, Brexit, a global pandemic, ongoing climate change and Russia's war with the Ukraine, have significantly altered and increased the risks to which companies are now exposed. The challenges of the current climate are testing the resilience of all businesses, and causing many to re-evaluate.

90% **of companies expect the Ukraine/ Russia crisis to impact their business resilience**

Just as businesses were beginning to recover from the pandemic, increased operating costs and supply chain disruptions have been squeezing profits since the Russian invasion of the Ukraine. The rising price of commodities, as a result of the downturn and uncertainty of Russian and Ukrainian exports, has become a serious issue for producers. And, those that have not been able to pass on increased operating costs have become less profitable as a result. The price of raw materials, combined with the strength of the labour market, has eroded the headroom and capital capacity of many businesses to deal with any more unforeseen events.

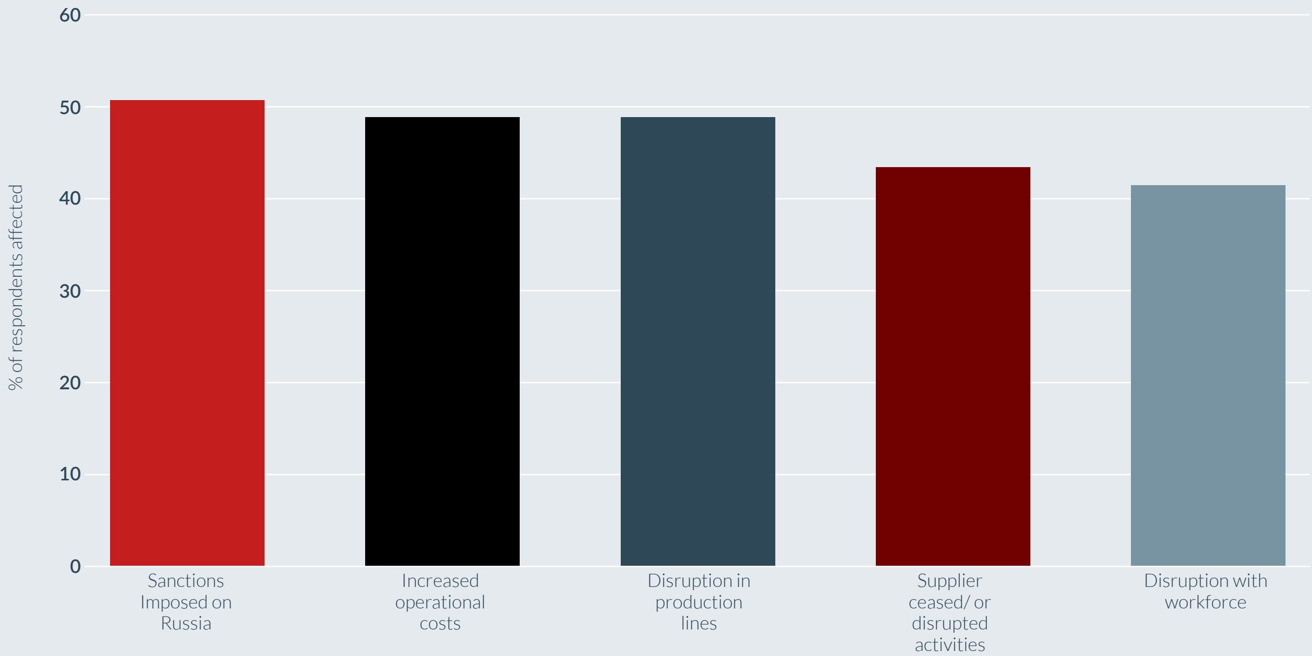
Furthermore, nearly every business has felt the impact of rising energy prices. The price of oil, natural gas and coal have all risen sharply since the start of the conflict, which has had a global economic impact and prompted countries to examine their energy security. Europe, in particular, is actively trying to decrease its reliance on Russian oil and gas, but the infrastructure needed to make this change will take time to build. As larger companies come to the end of their energy hedges, they will see sudden and sharp price rises. Energy costs, combined with rising inflation, will have a substantial impact on consumers and their spending power, which has a knock-on effect for businesses.

With much manufacturing outsourced to the far east, the current economy is reliant on functioning supply chains. The COVID-19 pandemic first highlighted the dangers of over-reliance on China for manufacture. Realising this, many companies began a process of on-shoring and moving production closer to home. However, this process is some way from completion and the subsequent lockdowns of the world's largest port, Shanghai, has further crippled global supply chains. The World Bank estimates that the lack of reliability in supply chains has knocked 1% off global GDP growth.[1]

77%

of businesses surveyed have had to make changes around their supply chain as a consequence of the war in Ukraine.

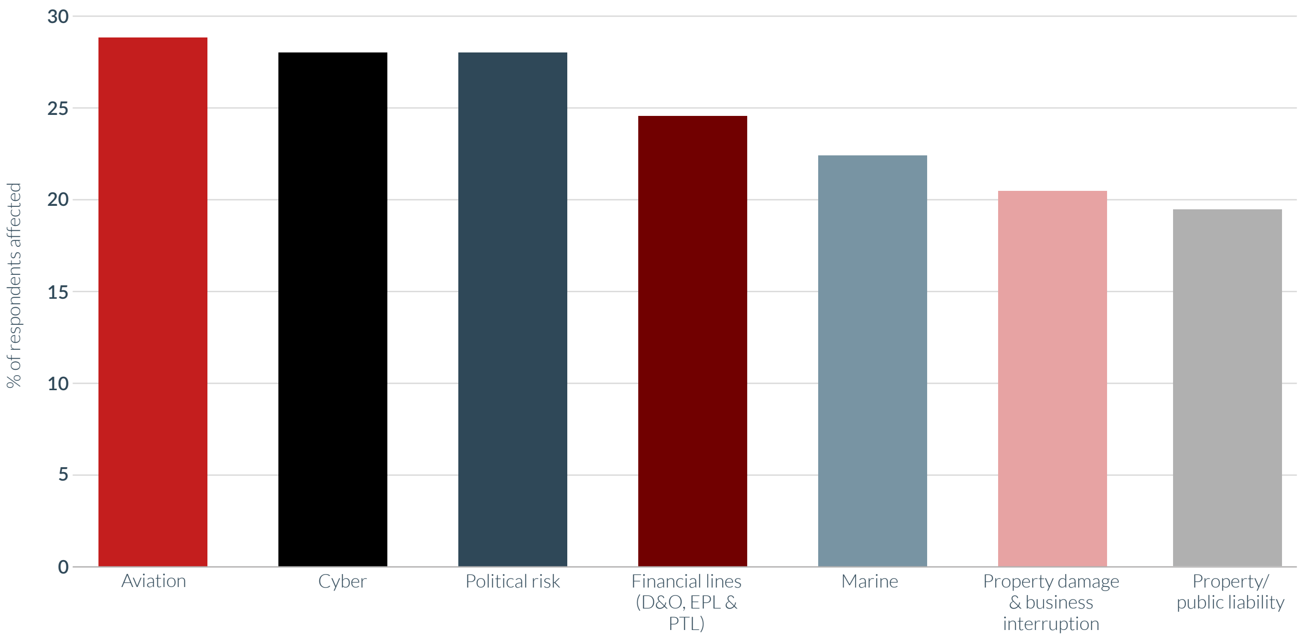
Principal causes of operational disruption arising from the Ukraine/ Russia crisis



These operational disruptions have many effects on the risks companies face, some of which aren't always obvious; from new suppliers and transport routes, hurried product redesign, distribution centre and packaging changes, to slower supply and unrelated property losses when rebuild materials and IT equipment can't be sourced at the expected cost or in the timeframes predicted in loss recovery plans. All of these incremental shifts change risk, surprise insurers and invariably cost more when it comes to recovering from insurable events.

This also has knock-on effects for other types of financial risk such as Directors & Officers' insurance, where senior management are themselves more exposed to allegations of financial mismanagement or failure to oversee business operations adequately at a time of stress and rapid change.

Main insurance lines affected by disruptions caused by the war in Ukraine.



Business use case

At Mactavish, we've seen these in full effect. For example, a worldwide charity received an exclusion detailed in such broad language that it would exclude any loss indirectly involving a Russian dual citizen, even if that individual was living outside the country and the claim had nothing to do with Russia. Exclusions such as these, which specify that they will not pay out on any claim involving a 'Russian Person', were designed to exclude claims arising from an organisation's activity in Russia but the wording can have a more far-reaching impact.

The financial risk of the crisis

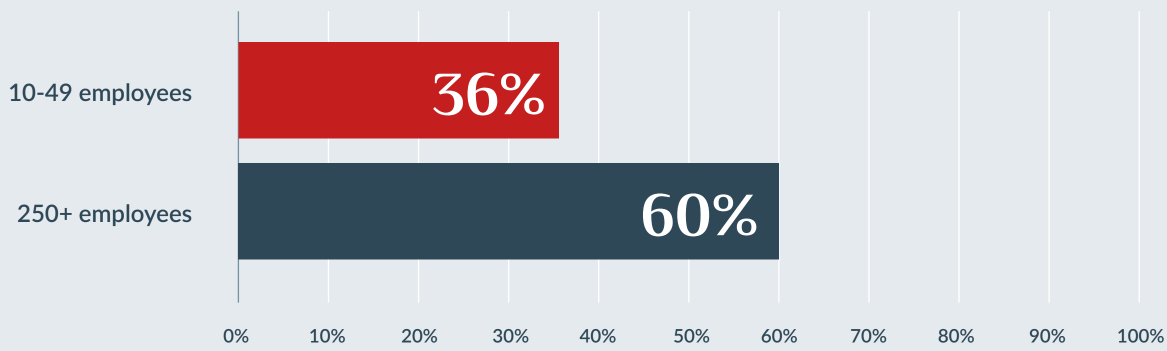
Global insurers have announced $1.3 billion in direct losses from the Ukraine crisis in the first quarter of 2022 but some estimate that eventual losses could exceed $20 billion, therefore many insurers and reinsurers are putting aside large sums for this eventuality; Hiscox for example, has already put aside $40 million for possible future claims.[2]

Incidentally, commercial insurance pricing in the UK increased 20% in the first quarter of 2022, coming on top of more than 3 years of uninterrupted price increases with UK companies on average paying up to three times more for their premiums than they did in 2019. This comes at a time when companies are more exposed to risk and require more accessible support.

Nearly 60% of businesses have reported an insurance loss due to the crisis

Sample of businesses reporting of insurance losses experienced due to the crisis

Larger corporations have reported losses in larger proportions than smaller businesses. This was observed both based on company size and company turnover.



Sectors of the industry most exposed to losses

84% Aviation

64% Marine

67% Oil & Gas

1. Consequences of war exclusions

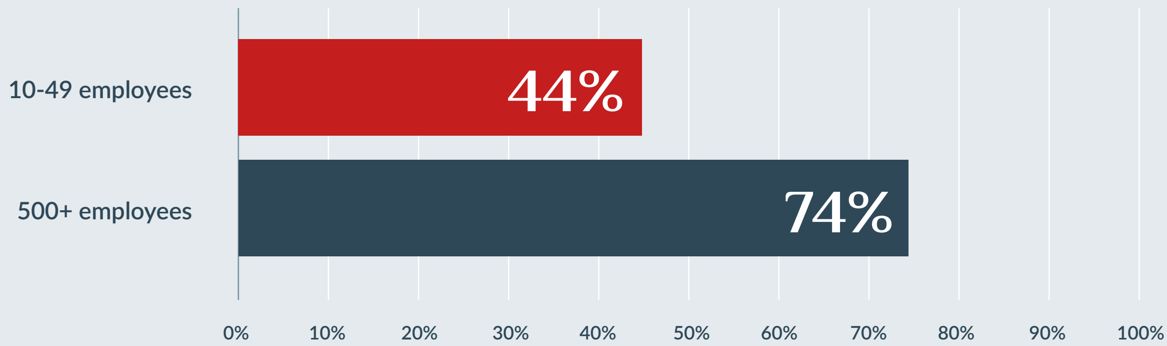
The war and its associated disruptions have already resulted in direct losses for certain insurance classes, such as political risk, marine and aviation. However, its secondary effects will increase both the probability and cost of losses for almost every other class of insurance.

Additionally, war and sanction exclusions, which exist in most commercial insurance policies, can have far-reaching impacts, restricting cover beyond simply trading with sanctioned entities or governments, and must be reviewed very carefully.

71% of businesses surveyed have had assets impacted by sanctions placed on Russia and Belarus.

Sample of businesses reporting assets impacted by sanctions placed on Russia and Belarus

Small and large businesses have been unequally impacted by sanctions with 74% of companies over 500+ employees reporting impact on assets against 44% of businesses under 50 employees.



Sectors of the industry with assets most impacted by the sanctions

92% Finance

84% Aviation

77% Technology

2. Prediction on claims and businesses' losses

It is inevitable that larger 'man-made' losses will occur as a result of the operational changes detailed above and that both 'man-made' and 'natural catastrophe' losses will cost more and recovery will take longer.

1 in 5

business are not aware of what newly imposed exclusions, stemming from the Ukraine crisis, mean for their business.

48%

Many of these structural risk changes will take time for the full impact on insurance claims to be felt; many respondents felt however, they were already suffering more claims as a result, with 48% reporting having suffered a related insurance claim since the onset of the crisis

It is inevitable that larger 'man-made' losses will occur as a result of on-going operational changes and that both 'man-made' and 'natural catastrophe' losses will cost more, and recovery will take longer.

The introduction of new exclusions on cover in response to the Ukraine crisis narrows protection and consequently increase the risk of claims falling outside of cover.

Claims that are currently live and unrelated to the war can also be affected by supply chain disruptions which make it harder and longer for businesses to recover, increasing the risk of significant costs falling outside the indemnity period once the cover expires.

The acceleration of inflation and rising costs of materials for reinstatement and manufacturing parts among others, also makes under insurance a real threat for insureds. Values must be updated but the pandemic caused widespread delays and backlogs to the availability of revaluations. Insureds could end up, in the event of a claim, with a considerable gap between declared and reinstatement values.

The role of risk placement in preserving business resilience

Traditional insurance cover is often no longer suitable in light of new emerging risks. As a consequence, there's growing pressure on policyholders to step-up and build in-house expertise to ensure the viability of their insurance programmes.

1. How well-equipped are businesses to mitigate their risk exposure?

In addition to new emerging operational risks, inflationary trends are also exposing businesses to drastically increased risk of under insurance.

If the value of assets is understated when placing insurance (much more likely in a high inflation environment with asset categories affected unevenly), it is likely to lead to a reduction in insurance claim recovery, or even outright dispute of the entire claim. This effect not only relates to assets values but a myriad of other costs of recovery will be higher in today's environment; via supply chain delays, materials and personnel shortages, and contingency plans being rendered obsolete.

Companies less able to pass on price increases to consumers are already struggling in this environment and will not find it easy to absorb such a shortfall in insurance recovery if they suffer a major loss: they need to consider this at any upcoming insurance renewal.

The cost of getting it wrong can be irremediable for businesses already stretched by hard economic conditions, increased operating costs, and loss of profitability.

1 in 5

of businesses do not feel confident that they have disclosed all new emerging risks properly to comply with fair presentation obligations

On top of this, there are systemic issues to contend with, such as the erosion of quality in cover caused by standardised policies and a lack of accountability and market expertise to effectively understand both new emerging risks and evolving known risks. The instances of cover being withdrawn, the out-pricing of high-demand products and exacerbated broker conflicts of interest, all constitute major blockers to business resilience.

2. Building business resilience via risk placement

In light of recent events, business resilience is becoming a higher priority item on a Board's agenda. The nature and prevalence of major crises have forced organisations to focus more strategically and concentrate resource on issues of crisis management and preparedness.

In this high-risk operating environment, there's simply no excuse for any Board to either skimp on risk management or to view insurance as a commodity purchase. Insurance is a key financial component of a company's capital mix, and one which has tremendous value but it also requires attention to structure properly and ensure reliability.

There is a pressing need for more diligence around risk placement processes to tackle high-impact risks; There are key areas that businesses need to focus on to help stress test their risk placements:

- Understanding the new risk landscape facing the business and how this affects both operational and contractual exposures the business faces

- Scenario analysis to ensure clear disclosure of known or non-standard risks, and stress testing of available cover.

- Accurately disclosing new operational risks and the measures being taken to address and manage them to ensure credit is received for proactive risk management.

- Taking extra vigilance around renewal (often an opportunity for insurers to introduce new coverage restrictions, some of which may be buried in small print and definitions)

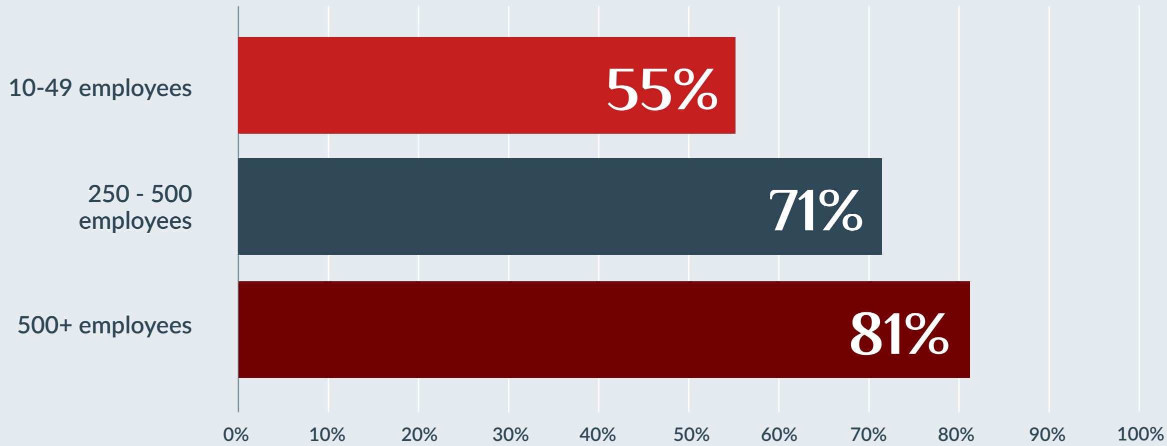
- Consider alternative options to current cover, perhaps even going beyond traditional insurance. This might include increased retentions for known risks, potentially using a captive to retain more risk efficiently, alternative risk transfer 'ART' options to fund or spread the cost of risk over time, parametric insurance options to reduce uncertainty around payout for more quantifiable risks, etc. This is an evolving and complex landscape but one which is no longer the exclusive preserve of the largest or most sophisticated policyholders.

- Consider alternative insurance tender options appropriate to a hard market environment, such as a costed / 'written lines' approach which caters for the conflicts in play, boosts competition and fosters greater innovation.

- Adopt a 'sell your risk and its management' mindset, don't just buy insurance!

70% of companies have reinforced their Business Continuity Plan (BCP) in response to the crisis

Smaller enterprises have been less proactive in making changes to their BCPs than larger corporations



Sectors most inclined to reinforce their BCPs

Finance

Aviation

Marine

Over 50% of companies have bought extra insurance cover because of the crisis

Over half of the businesses surveyed expect their insurance programmes to be negatively impacted by the crisis

The top causes for concern being:

1. Rises in premium costs
2. Reduced capacity
3. Less support and accountability from the insurance market

3. The Role of insurance in times of crisis

The primary role of insurance is to provide protection against financial loss from unforeseeable or unlikely events. However, past crisis events have exposed the limitations of this model. Current insurance practices have been put under the microscope, exposing the industry's self-serving approach and failure to support its clients in times of crisis. The industry's response has been characterised by a lack of understanding and withdrawal of capacity, by more cover restrictions and disputes and by higher prices; creating enduring hardship for policyholders rather than building understanding of clients' risk and working together to manage and reduce it. This testing time may well result in an unprecedented **loss in confidence** in the insurance market as a whole.

At the root cause is an insurance system that has prioritised low transaction costs above risk understanding and reliable insurance policies. This approach is not fit for purpose and at odds with the environment we now find ourselves in. In light of the increased risk exposure organisations are facing, policyholders can no longer consider insurance as a commodity and must fully embed risk placements within their strategic plans to effectively protect their organisations against losses from unforeseen events.

The insurance market must, in turn, accelerate its transformation to propose adaptable and viable solutions to increasingly volatile risks; demonstrating genuine understanding and a partnership approach that helps protect against the unpredictable and reduces client risk over time. The more partnership-oriented brokers and insurers are, the greater the opportunity for differentiation and the greater the challenge to the status quo.

1 in 5 businesses

do not feel confident their insurance will cover their business given the risks and operational shifts arising from the crisis

Traditionally, the insurance industry has moved quickly to protect itself but, in prolonged times of crisis such as now, the industry is under more scrutiny than ever before. In a letter sent to all London market intermediaries and MGAs in May 2022, the Financial Conduct Authority (FCA) asked for better controls to be put in place to ensure firms could meet conduct requirements, sharing its concerns that they have not seen any real change.

The FCA also called out on London market brokers over 'poor culture' and 'poor value' for buyers, supporting the view that little optimisation has been observed in market over the past few years.

Trust and reputation are paramount, and this period of uncertainty must be used to rebuild and refocus. If not, the irreparable reputational damage will continue to be felt for many decades to come.

References

1 Source: Ruta,Michele World Bank, The Impact of the War in Ukraine on Global Trade and Investment (English). Trade, Investment and Competitiveness; Equitable Growth, Finance and Institutions Insight Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/099750104252216595/IDU0008eed66007300452c0beb208e8903183c39

2 Source : $1.3 billion in losses https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/global-insurers-take-1-3b-in-losses-from-russia-ukraine-war-in-q1-70379363 ; estimate of $20 billion https://www.reinsurancene.ws/ukraine-conflict-insurance-industry-loss-pcs/ ; Hiscox reserve of $40 million https://www.reuters.com/business/insurer-hiscox-sets-aside-40-mln-potential-losses-ukraine-crisis-2022-05-05/

3 Source: Global Insurance Market Update Q1 2022 published by Marsh in May 2022: https://www.marsh.com/us/services/international-placement-services/insights/uk-gimi-q1-2022.html

4 63% of surveyed businesses with 50-99 employees experienced a loss and 53% of surveyed businesses with 100-249 employees experienced a loss

5 53% of surveyed businesses with a turnover of £100m-£499.99m experienced a loss. Research conducted with 203 respondents (aged 18+) from organizations across all sectors of the UK industry.

Find out more

Contact the Mactavish team

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A member of our technical team will be delighted to talk you through any of the issues we have mentioned here or any other concerns you may have about your insurance programme.

If you'd like to find out more about our mission to create a fairer market for policyholders, visit **www.mactavishgroup.com**. In times of uncertainties and change, planning for the future and building resilient risk transfer is more important than ever.

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