A Leap of Faith
The future of the insurance industry

IT'S GOING TO BE A BUMPY RIDE

Over 50 years ago, Robert F. Kennedy said: "Like it or not, we live in interesting times. They are times of danger and uncertainty, but they are also the most creative".

Today, the world is increasingly turbulent and moving at breath-taking velocity. This creates new challenges, new and different risks, often in parallel with new opportunities. Increasingly, organisations are forced to deal with wide-scale, concurrent crises in real time – including mega-trend climate-related disasters, high numbers of employee resignations compounded by a need for the right talent, record-breaking data breaches, supply chain fragilities, the rising cost of living, and geopolitical instability at the highest level since World War II.

As a result, risk professionals are increasingly relied on to help chart a course through a landscape of enterprise-level challenges that were often not on the radar at the beginning of the year. The speed of new, different and emerging risks is unprecedented and changing all aspects of managing risk and insurance. The need for better, more forward-looking data, and an emphasis on 'predict and prevent' insurance solutions, is greater than ever.

THE ROAD TO A SUSTAINABLE INSURANCE INDUSTRY REVOLUTION

Building dynamic approaches to risk and resilience throughout the digital revolution is transforming the way in which organisations – including those which make up the insurance industry – create, deliver and capture value.

The insurance ecosystem is evolving rapidly, and the insurance industry can no longer lean on familiar, old ways, while prevailing technological and strategic clouds gather around them.

As our stormy present opens up towards a brighter future, insurers should embrace technology across the customer journey if they are to have any hope securing the trust and loyalty of tomorrow's Airmic members.

Resilient organisations in the digital age must constantly reinvent their purpose. This involves being aware of opportunities, being willing to commit and recognising that confident forward looking behaviour should rewarded.

But like many industries where digitisation has taken hold, technology shouldn't be adopted for its own sake. Simply following the latest technological trend is not enough to sustain a competitive edge – this is like looking down the technology telescope through the wrong end.

WHAT KEEPS THE INSURANCE INDUSTRY AWAKE AT NIGHT

The Centre for the Study of Financial Innovation (CSFI)-a non-profit think-tank, established to look at future developments in the international financial field, particularly from the point of view of suppliers-has goals which include identifying new areas of business, flagging areas of danger, and provoking a debate about key financial issues. The Centre has no ideological brief, beyond a belief in open markets. It produces a biennial report focusing on the global insurance sector – the most recent of which was published at the end of 2021. This report provides a useful insight into what keeps industry leaders from insurers, reinsurers and brokers awake at night, as their concerns and perceived opportunities will inform their strategy and risk appetite or attitude.

Crime, and particularly cybercrime, was the top risk in this report. This is the first time cyber has come out top. Its rise reflects concerns about both the vulnerability of systems to cybercrime, and the costs of underwriting attacks against policyholders. Regulation, climate change, interest rates and talent all moved up the rankings. Geopolitics was further down the list of concerns.

The risks around the industry's technological modernisation rank high with the focus of concern on the ability of the industry to stay at the forefront of change, and on the operational risks in managing the transition to digitised services. However, technology risk fell, which may be explained by greater confidence in the industry's ability to adapt. The quality of leadership, management, business conduct, and governance of the industry was perceived to be way down the list of concerns.

There were operational risk concerns about industry and policyholders working a hybrid model, and Covid also came up as an underwriting risk in the wake of disputed claims for business interruption and medical care, and as an issue for pricing and wording of contracts. There was further concern that Covid could produce political and regulatory pressure to settle borderline claims, on the other hand it was perceived as creating a boost in demand for pandemic-related insurance products.

As the world begins its recovery from Covid, the impact on economies will be critical in understanding the speed and shape of that recovery. There was a clear view that interest rate risk is higher for the industry than previously, but with a difference in the views between life insurers and others. Life insurers look at the potential benefits of higher yields, with non-life insurers and reinsurers more concerned about the inflationary impacts that might lead to changes in interest rates.

A high ranking risk for a number of years, the increase in virtual working and the increase in the type, volume and success of cyber threats have elevated this risk in the view of insurers. Insurers are also uniquely impacted by the insurance policies which are sold to cover companies when they are hit with cyber attacks, and ransomware in particular. As businesses have introduced new technology, cloud computing and third-party services in longer supply chains, the challenge for insurers has become more complex than ever.

The risk from technology, whilst high, has fallen slightly from the prior report. Linking these two risks – it would seem that whilst the industry is becoming more confident in implementing new digital solutions, and as companies increase the accessibility and usability of technology (particularly remotely), the more they are exposed to cyber risk. This challenge looks set to continue.

The impact of climate change is the fastest rising risk in the survey and moves into the top five for the first time. It is clear that the impact of climate change is a much nearer-term risk than previously perceived, and in many cases, the effects are already being felt. The worldwide focus on climate change as part of the wider ESG agenda is resulting in a step-change for most insurers. Reporting requirements are increasing, and governments and regulators continue to press companies to better articulate and explain how they are quantifying and managing the related risks.

Concerns about industry governance generally centred around a lack of fresh thinking, as boards grapple with challenges with little historical precedent, including climate change and cybercrime.

The insurance industry has been incredibly resilient – both in human and capital terms – and this is borne out in the respondents' increasingly positive view of the industry's preparedness to respond to the risks it faces.

What the CFSI's Banana Skins report does not effectively reflect is the enterprise risk management approach to managing risk, the velocity of changing and emerging risks, the frequency of 'once in a generation' events, and their connectivity.

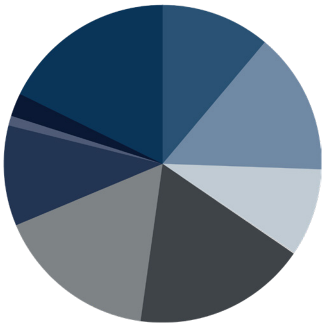
The war in Ukraine and the shock waves it has and continues to create, travel way beyond the two countries at conflict and present yet another challenge for the insurance industry. The question is, what next?

THE VOICE OF AIRMIC MEMBERS

The estimated total annual commercial insurance spend of Airmic members at the first quarter 2022 is around £11 billion (excluding self-retained and captive spend) or an average of £25 million per member organisation.

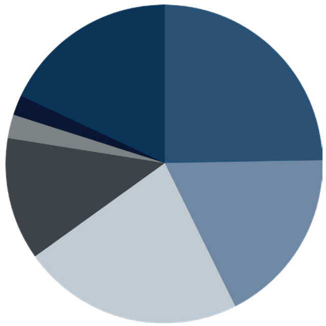
Add to this the spend on broker fees, related professional fees and fees for risk management services, the voice of Airmic members is loud.

ANNUAL WORLDWIDE GENERAL INSURANCE PREMIUM



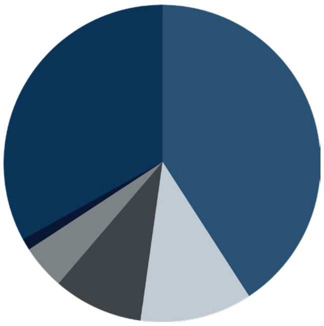
- 17.8% Not applicable/not known
- 11.1% Less than £2 million
- 14.4% £2.1 million - £5 million
- 8.9% 5.1 millon - £10 million
- 17.8% £10.1 million - £20 million
- 16.7% £20.1 million - £50 million
- 10.0% £50.1 million - £100 million
- 1.1% £100.1 million - £200 million
- 2.2% More than £200 million

ANNUAL SPEND ON BROKER FEES



- 2.2% £5.1 million or more
- 18% Not applicable/not known
- 24.7% £250,000 or less
- 18.0% £251,000 to £500,000
- 22.5% £500,000 to £1 million
- 12.4% £1.1 million to £2.5 million
- 2.2% £2.6 million to £5 million

ANNUAL SPEND ON OTHER INSURANCE RELATED SERVICE FEES



- 33.0% Not applicable/not known
- 40.9% £250,000 or less
- 11.4% £251,000 to £500,000
- 9.1% £500,000 to 1 million
- 4.5% £1.1 million to £2.5 million
- 1.1% £2.6 million to £5 million

HEAR OUR VOICE

A continuing theme was the challenge faced by members when seeking relevant cover for their key risk exposures. For all of the top risk concerns other than catastrophe exposures, less than half of members report that they purchase insurance. The main reasons for not purchasing cover for these intangible risks include: high cost of cover, lack of insurance relevant to the risks, and inadequate coverage, suggesting that more work needs to be done between insurers and insureds to really understand the specific risk exposures faced by the organisation.

Lack of innovation has topped the list of market concerns for Airmic members for another year, with 59% of Airmic members marking this as a top three market concern for them.

One could be forgiven for thinking the above extract was from the 2022 Airmic Annual Survey, whereas this was what Airmic members said in 2016 – some messages from members remain the same, and this extract from 2016 continues to be true for many Airmic members.

Since 2019, Airmic has run a pulse survey of members every six months, designed to track the state of the market. For each of these, a spotlight is turned on a specific 'hot topic' identified through exchanges with our members.

Airmic has coined the expression 'harsh market' to distinguish the insurance market of the last few years from the fluctuating nature of the market in the past, which was primarily driven by a hardening or a softening of premium rates at a relatively predictable frequency.

Back in 2016, a number of still familiar concerns featured in the top risks for Airmic members, which reflected a growing shift in concern away from physical risks towards digital and intangible risks. The top risk concerns were cyber risks causing business interruption and cyber risks resulting in the loss or theft of personal data. In the 2022 Annual Airmic survey, cyber risks are at the top of the risk list – just as it is now in the last insurance industry Banana Skins report.

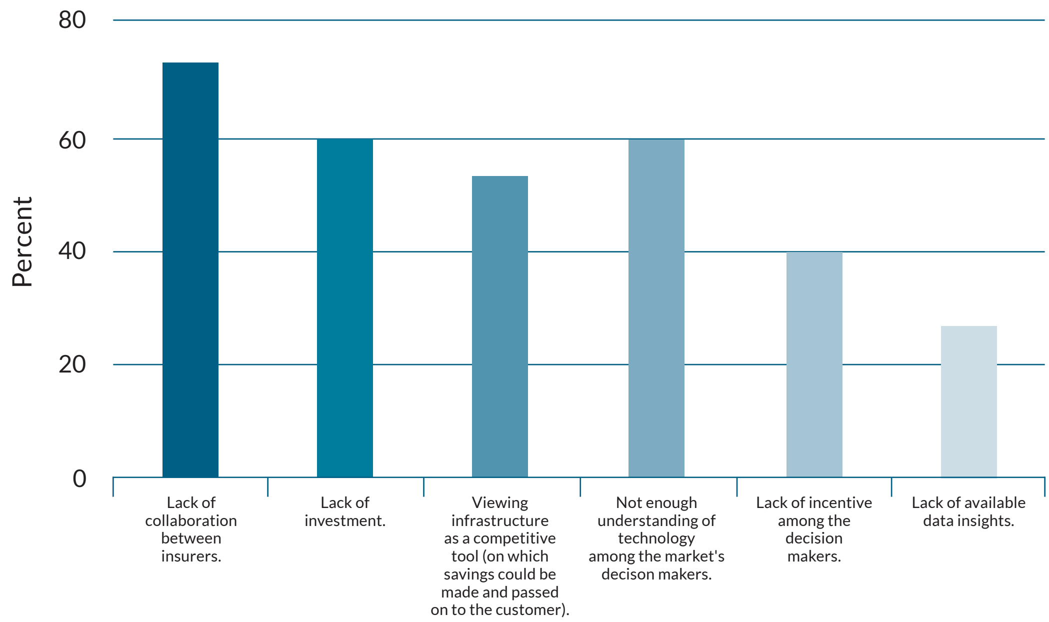
So has the market risen to the challenges of cyber risk? The answer is generally no. When Airmic members were asked about this subject in the second half of 2021, 92% labeled the market 'hard', and reported a continuing deterioration in premium rates and reduced levels of insurer and programme capacity.

Higher premium rates (60%) coupled with an increase in information required by underwriters (52%) featured as the top renewal trends. Airmic members reported an industry that is overzealous in its quest for information, which some challenged might then have little influence on the cover and pricing of their risk. Insurer reduced capacity, cover exclusions and deductibles, and insurer inflexibility were close behind, indicating that this is a class of cover under pressure.

IT'S ALL ABOUT RISK

Will the insurance industry's 300-year legacy hold it back and act as a millstone around its neck? Or will it provide a strong platform for the digital and talent transformation required for industry's post-pandemic growth? The economics of it suggest more buoyant growth. But will the challenges around regulation, talent, sustainability and evolving consumer preferences make this a bumpy ride?

As the insurance industry shifts from a reactive to a preventative model, the future will be more about risk than insurance.



WHAT AIRMIC MEMBERS THINK ARE THE MAIN OBSTACLES TO IMPROVING THE MARKET'S INFRASTRUCTURE

Resilience in the post-pandemic digital age will demand a clear focus on purpose, maximising opportunities presented by technology, and close engagement with all stakeholders. The questions risk professionals need to keep high on their agenda are: how can good risk management make a difference when constructing and presenting insurance programmes? And what types of incentive can risk professionals expect to receive for their organisations, by following evidence of good risk management practice?.

There has been a lot of talk about risk selection and the insurance market rewarding risks that are managed well. This is likely to escalate as policy holders are increasingly incentivised for providing evidence of a culture and associated behaviours that are likely to reduce risk and, on the upside, place them ahead of their competition by releasing more opportunities.

The importance of the upside will increase as the law of diminishing returns kicks in on risk prevention and improvement in the market's performance with lower overheads, and greater sophistication of risk selection and pricing, driven by improved collection, analysis and use of data, by the right talent using the right technology. Whilst this is good news for well-managed risks, this is unattractive news for the more challenging risks with a context and profile that responds less immediately and effectively to some of the risk scenarios above. This will inevitably lead to some polarisation of good and bad risks.

WHAT NEXT, AND WHERE NEXT?

Airmic has faith in the future of the insurance industry – we want to move forward together. We will dive into the unknown and seek ways of collaborating for the benefit of all stakeholders, and especially our members and partners. We will continue to challenge and to question – and we will always be curious!

QUESTIONS ABOUT THE FUTURE

1. How will large 'traditional' insurers avoid losing out to more agile competitors who don't have the burden of legacy systems and legacy data?

2. What technology innovations will best help improve data sharing and collaboration?

3. How can How can Artificial Intelligence be used to help risk professionals better manage risk?

4. Organisations with well-managed risks may be rewarded, or are in a stronger position to negotiate. However, with changing market conditions and risks, what else should Airmic members consider when presenting their risk and demonstrating how they are approaching the management of emerging risks?

5. If boards are struggling to accept that the risk, and the insurance market isn't set up to respond, where do we go from here?

6. What role can commercial insurance play in protecting society from systemic risks like pandemics or very large cyber incidents, which are far beyond the industry's balance sheet?

7. The focus of many business leaders and their boards tends to be on what's in front of them. Are we at risk of failing to look longer term and making dangerous assumptions that the situation will 'just get better?

8. What are some of the main challenges and opportunities for greater public private collaboration in building national resilience and preparing business and society for future crises?

9. What can risk professional be doing about further the continuing velocity in emerging risks?

10. ESG represents one of the greatest opportunities for the insurance industry. What role does the industry need to play in helping to drive the ESG agenda in the UK, both in terms of product and service development, and in helping risk professionals raise awareness of ESG and embed it within their organisations?

11. How do risk professionals demonstrate the value of their role?

12. What knowledge and skills does the risk professional of tomorrow need?

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