

# Navigating a changing insurance market

A European perspective

*June 2019*



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# Foreword

During my thirty-year career in the insurance industry, I've experienced the highs and lows of the market cycle. Over the past decade this has bumped along at the bottom, producing generally favourable conditions for commercial insurance buyers across the EMEA region.



We are now working through a tougher period where the market is in transition – although it is not yet a hardening market. I'd prefer to call it a firming environment, where rates are increasing for specific lines of business and industries, some of which also feel a contraction in capacity. However, this differs by country and it is important to understand the complete landscape to make the right decisions.

## Response is critical

How we respond to the shift as an industry is critical. Some think this period will blow over and the market will return to soft market conditions. This scepticism is hardly surprising given there have been instances over the last decade where a hardening market was anticipated, but little actually changed. The market is firming – as our insurance market heat map reveals (pages 10-11) – and buyers need to re-think their approach. Insurers now have a focused strategy on their portfolio to deliver profitability with obvious consequences for clients and brokers.

During the last year, we started to see challenges in industry sectors like food, and waste-to-energy. While many thought it was simply brinkmanship on behalf of insurers and were prepared to push their renewal to the wire without alternatives to avoid rate increases, most insurers held firm.

## A first time for many

A concern for me is that many people in the industry may have never experienced conditions like these before and are not sure how to react and sell risk into the market; not only when negotiating premiums, but also when discussing risk in a broader sense.

What is important in this transitional environment is not to overreact, but to ensure there is a regular exchange of information and views between all parties throughout the year to avoid surprises at the time of renewal.

At Aon, we continue to work closely with the markets to help ensure that buyers are not locked out, perhaps caused by insurers no longer having an appetite for distressed sectors. We understand the pressures insurers are under, but we try to identify how we can help make a client insurable – not necessarily under the current terms or risk management – but in an alternative, evolving way.

## Bringing our expertise together

In this kind of market – where the challenges are growing for buyer and insurers alike – our Aon United way of working aims to bring together our expertise and the full power of Aon to deliver results for our clients. Information is key at this time; our investment in the Aon Client Treaty, data and analytics, EMEA-wide bench of risk consulting expertise, and ability to work in the insurance and reinsurance markets, helps us to partner with our clients to develop a well thought through and proactive strategy.

The process starts by providing clients with a realistic assessment of what is happening in the market and I hope this report does exactly that, as well as providing invaluable advice on how organisations can navigate this changing insurance market and deliver optimal results.

**Hugo Wegbrans**  
Chief Broking Officer Europe, Middle East & Africa  
Aon

# Executive summary

## **Change is coming to the European insurance market.**

Unprecedented loss levels, coupled with other factors such as evolving buyer demands, changing exposures, reinsurance pressures and an increase in the cost of doing business, are pushing insurers into a reassessment of their business models.

For commercial insurance buyers across Europe, the impact is starting to be felt in terms of rate increases, capacity constraints, tightening terms and conditions, and growing insurer scrutiny on risk management practices.

While the market cannot yet be called a hard market across all lines, it is entering a transitional phase. The extent to which this transition impacts buyers will vary country to country, and by line of business, and for some buyers it will already be making its presence felt.

### **Insurers' attitudes shift**

There is now an apparent change in the attitudes of insurers, demonstrated through the examination of rates, terms and conditions, capacity they're willing to deploy, expectations of insureds' risk management standards, programme attachment points, and even the risks they're prepared to continue insuring.

### **Capacity issues**

Capacity constraints, insurer withdrawals and consolidation are creating challenges in certain lines/sectors such as professional indemnity in the technology sector, international construction, and commercial crime.

### **Rates – firming in some lines, flat in others**

As our insurance market heat map reveals (pages 10-11), it would be wrong to infer that insurers are simply pushing through significant rate rises across every line and every client in every country. In practice, the spread of average property/casualty rate changes range from -5% to +10%<sup>1</sup> depending on the sector, geography, and client risk profile. Some lines of insurance, like D&O for example, are seeing a general firming of rates – with sectors such as life science or companies with US listings experiencing more focused and consistent rate increases.

1. Aon's Market Update, March 2019

## What this means for buyers

### Cover

Some companies in distressed sectors – notable examples in Europe include property cover for waste-to-energy and the food sector – may struggle to get the desired level of cover at an acceptable price.

### Cost

Buyers are potentially being asked to pay more for risk transfer, as well as taking higher retentions and refocusing on the quality of their risk.

### Stakeholder management

The risk management function may need to help the C-suite in their organisations to understand how this shift might affect the business from a cost and volatility perspective.

### Justify the approach to risk

Companies will have to increasingly reconsider and justify their approach to risk and the degree of insurance cover that they have in place.

### Work smarter

Risk managers will need to work differently to get an outcome that is even remotely similar to prior years.

### Ask the big questions

Organisations will need to ask – and answer – big questions such as “does insurance continue to represent value for money?”

## How buyers can manage and mitigate the impact

### Start preparing now

Time is critical. Renewal timeframes are generally becoming longer which means the whole process must start much earlier and with more preparation and detail.

### Challenge your broker

Buyers must work with their broker to proactively assist their risk financing strategy and navigation of the market so that they are ‘positively differentiated’.

### Refresh risk assessment processes

Bring the insurance buying function and enterprise risk management (ERM) team more closely together to better inform perspectives on risk profile and the control environment.

### Explore alternative risk financing options

The trend towards increased retentions will almost certainly lead to more extensive utilisation of captives, even from organisations that may have previously discounted this approach due to a lack of scale.

### Review policy wordings

As insurers focus on the breadth of policy wordings, buyers need to carefully review the relevance of their wordings. When were wordings last reviewed? Is cover still relevant to the risk profile?

### Improve risk marketability

The quality of the risk submission will become more important to ensure optimal renewal terms. Organisations will need to articulate to the insurance market how their risk is better managed than their peers.

## Threat or opportunity?

**The message is clear:** as the market becomes more selective, organisations must proactively take control of their risk financing approach and renewal process, and prepare a clear strategy for their next renewal and beyond, or potentially pay the price.

# Insurance in transition

While the European insurance market is a broad and diverse ecosystem, there are some increasingly common themes across the region that suggest the market is entering a transitional phase.

This transition is being driven by insurers responding to continuing high levels of man-made and natural catastrophe losses, the legacy of a lengthy soft market, the well running dry on historical reserves, and a surfeit of capital that has stoked competition, but cloaked systemic profitability issues.

The extent to which this transition impacts commercial insurance buyers will vary by country and by line of business, but change is coming, and for some buyers it will already be making its presence felt.

## As claims grow

From a claims perspective, 2017 alone saw three of the top ten costliest insured losses ever in hurricanes Harvey, Irma, and Maria, at a combined insured loss of some USD 90 billion<sup>2</sup>.

While insured catastrophe losses from 2018 are estimated to be 36% down compared to 2017<sup>2</sup>, they continue to run at 26% above the 10-year average<sup>3</sup>.

2018 was still the fourth most costly year on record for insurers with the combined cost of the California wildfires standing out as one of the biggest industry events at nearly USD 16 billion. In the last two years California has faced a total of USD 31.2 billion<sup>2</sup> in losses for this peril alone. In total, global natural catastrophe insured losses reached USD 247 billion for 2017 and 2018<sup>2</sup>.

From a European perspective, clients with catastrophe property exposed risks in the US, Latin America and the Caribbean will be feeling the direct consequences of a changing insurance market.

For example, our insurance property heat map reflects some of the challenges facing Spanish buyers with property exposures in these territories, especially for those who have experienced losses.

For others, the catastrophe losses might not be quite the headline grabber offered by the hurricanes and wildfire across the Atlantic, but January 2018's Windstorm Friederike in Western and Central Europe still inflicted a USD 2.1 billion<sup>2</sup> loss on insurers – making it the fifth costliest European windstorm of this century.

It is not just catastrophe losses that are hurting insurers, there has been an increase in loss activity across many insurance lines from motor, construction and marine to crime, professional indemnity, and directors' and officers'.

2. Aon's Weather, Climate & Catastrophe Insight, 2018 Annual Report (Updated May 2019)

3. Aon's Market Update, March 2019

## Profits tumble

Lloyd's market results for 2018<sup>4</sup> revealed an aggregated market loss of GBP 1 billion – a 50% improvement on the previous year's GBP 2 billion loss, but still a figure that demands urgent action from the market. Lloyd's is not alone, with other insurers posting combined ratios in excess of 100% for consecutive years.

This poor performance has not been confined to two heavy loss years; it is a sobering reflection on the industry that some insurers have made limited underwriting returns on commercial insurance for over a decade.

**What impact has the costly claim environment had on insurers' profitability?**

## Reinsurance landscape

Another trend and potential impact on insurers' profitability relates to the reinsurance picture. On the treaty side, 2019's January reinsurance renewals saw some territories less impacted than others when it comes to rate rises, and there was perhaps, in general, less of a flow through to the direct market than initially expected.

In recent years, some direct insurers have consolidated their treaties and taken higher net retentions to reduce their reinsurance costs. This has hit their profitability in the face of the high levels of losses they've had to carry without reinsurance recoverables.

## Facultative challenges

There has, however, been a more pronounced and immediate change on the facultative side. Lloyd's provides a significant amount of facultative support to global insurers and, given syndicates' performance over the last two years, the focus on improving lower quartile business is directly flowing through to direct insurers. In some cases – for example, food property risks – the facultative market has become more constrained.

## Pressure from evolving buyer demands

Insurers are also being challenged to demonstrate the relevance of their products. As insureds' risk profiles evolve through changes in their business, the launch of new services and M&A activity, it raises the question, are traditional insurance products keeping pace?

[Aon's 2019 Global Risk Management Survey](#) – which canvassed the opinions of over 2,600 risk leaders in organisations around the world – reveals a climate in which risk managers feel less in control than ever before; in part as a result of a rapidly changing political, economic and technological landscape and a proliferation of risk issues such as accelerated changes in market factors.

## Changing exposures

Key business risks are evolving towards brand, reputation, intellectual property, crypto currency, cyber, and non-damage business interruption – introducing the challenge to insurers of developing products for some intangible exposures, despite the limitations posed by a lack of market experience and the paucity of loss data.

People risks are also evolving as overall declining health patterns<sup>5</sup> lead to an increasing prevalence of non-communicable diseases and chronic conditions. There is a greater expectation from employees around health support and a challenge to insurers to play a role here and shift from a reactive, claims led approach to a more proactive health and wellness led proposition.

4. Lloyd's press release, March 2019

5. Aon's 2019 Global Medical Trend Rates Report

This presents an opportunity for the industry to align with the needs of its clients and actively support them through more business enabling solutions and better risk management strategies, such as products to support the M&A process and those which promote a healthy workforce and absenteeism. It does however, create a shorter-term challenge to the relevance of the services that the market is in general able to provide.

The growing pressure of Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) factors have also had an impact on the industry and resulted in some increasingly 'ethical' underwriting behaviour. For example, some insurers have ceased writing thermal power and coal risks.

### The cost of doing business

There is a universal recognition that a change to insurers' business models is imperative; all insurers are looking at their channels of distribution and how they can reduce costs whilst modernising their operations. The rush for the holy grail of updating and maximising the efficiency of working processes and leveraging data to innovate products, improve services and speed up claims settlements has started. Lloyd's is the latest to comment on its vision through a recently released prospectus focused on improving the ease of doing business and being a viable marketplace for the long term<sup>6</sup>.

### Insurers' attitudes shift

It is no surprise that against this challenging backdrop of increased claims, reinsurance changes, insufficient pricing, evolving client demands, increased CSR pressure and poor profitability, there is now an apparent change in the attitudes of insurers. This is demonstrated through the examination of rates; terms and conditions; capacity they're willing to deploy; expectations of insureds' risk management standards, programme attachment points; and even the risks they're prepared to continue insuring. The market is at the beginning of perhaps its most consistent shift in a number of years.

### Bottom line trumps top line

With cost and expense ratios too high, insurers are thinking less about market share – a common theme of recent years – and moving to a much clearer, focused conversation on profitability. There is a shift in their business plans with 'in-scope' appetite more clearly articulated and difficult decisions being made around remediating or rebalancing portfolios. Some insurers are openly discussing that it is not a need, but an absolute requirement, to deliver strong bottom line performance in 2019.

### Policy wordings tighten

There is more focus on terms and conditions across the market. In distressed markets, insurers are trying to introduce changes – higher deductibles or reduced cover – for insureds that have not properly adhered to risk management requirements. However, coverage extensions are still available in certain areas, and there is more dialogue around relevance of cover to evolving risk profiles.

There is also a more pronounced focus from insurers on identifying their silent cyber exposures – where non-specific policies potentially offer some 'inadvertent' element of cyber cover. Some insurers, increasingly under pressure from regulators, are reviewing lines of insurance to identify where there might be cyber cover – intended or otherwise – and what they intend to do about the exposure. Insurance buyers should expect to see greater clarification around policy extensions related to cyber risk.

6. *The Future at Lloyd's, 2019*



Ultimately, this should be a healthy process both for the market and buyers to ensure that where cyber cover is provided, it is clear and understood; making the market for this emerging risk more sustainable in the longer-term.

### Pricing changes are more nuanced

As our insurance market heat map demonstrates, it would be wrong to infer that insurers are simply pushing through significant rate rises across every class and every client in every country to combat their profitability challenge; the market in Europe is too nuanced to reach the conclusion that rates are firming across the board.

In practice, the spread of average property/casualty rate changes range from -5% to +10%<sup>7</sup> depending on the sector, geography, and client risk profile. Some lines of insurance, like D&O for example, are seeing a general firming of rates – with sectors such as life science or companies with US listings experiencing more focused and consistent rate increases.

However, it is not a hard market; more a return to technical pricing designed to improve rates and combined ratios; it is perhaps better characterised as a ‘firming environment’. The Netherlands for example, as our heat map highlights, has experienced some of the most material recent changes in the local market and is seeing a much stronger focus on the quality of the risk and the delivery of technical underwriting. Commercial insurance buyers should expect insurers to seek rate increases in some classes for their next renewals.

### Capacity remains broadly available but with some pockets of challenge

For well managed risks, capacity is not yet a problem, although pricing may be under focus. However, where there has been a desire for some insurers to grow their market share as quickly as possible, they have now effectively reversed this strategy as the capacity deployed has exposed them to significant shares of large losses. Syndication of risk is back on the agenda.

Capacity constrictions, insurer withdrawals and consolidation are creating challenges in certain lines and sectors, such as professional indemnity in the technology sector, international construction, and commercial crime. Countries across Europe are feeling the impact in different ways; in Sweden for example, as our heat map illustrates, automotive product recall and professional indemnity for financial institutions are proving more challenging to place.

In France, marine could see a shift to hardening, depending on claims activity and insurer expectations; and in Spain, some local insurers have left the motor market leading to rate increases. Lines of business such as D&O are making their impact felt more consistently across the region.

Should the remediation activity of insurers addressing rate adequacy, risk quality and attachment point not improve combined ratios in the next 12-18 months, then more dramatic action could be on the horizon as insurers choose to exit sectors and/or lines of business.

**More dramatic action could be on the horizon as insurers choose to exit sectors and/or lines of business.**

# Insurance market heat map

The impact of shifting market conditions and what this means for insurance buyers.

## Key

- Low**  
Rates flat to down with capacity available. Continued insurer appetite with some flexibility on coverage and deductibles.
- Moderate**  
Rates are firming (5-10%) with capacity generally available. A level of underwriting scrutiny on coverage with a focus on deductible adequacy.
- High**  
Rates increasing at +10% with capacity potentially contracting. Increased likelihood of underwriting referrals and detailed review of cover, limits and deductibles.

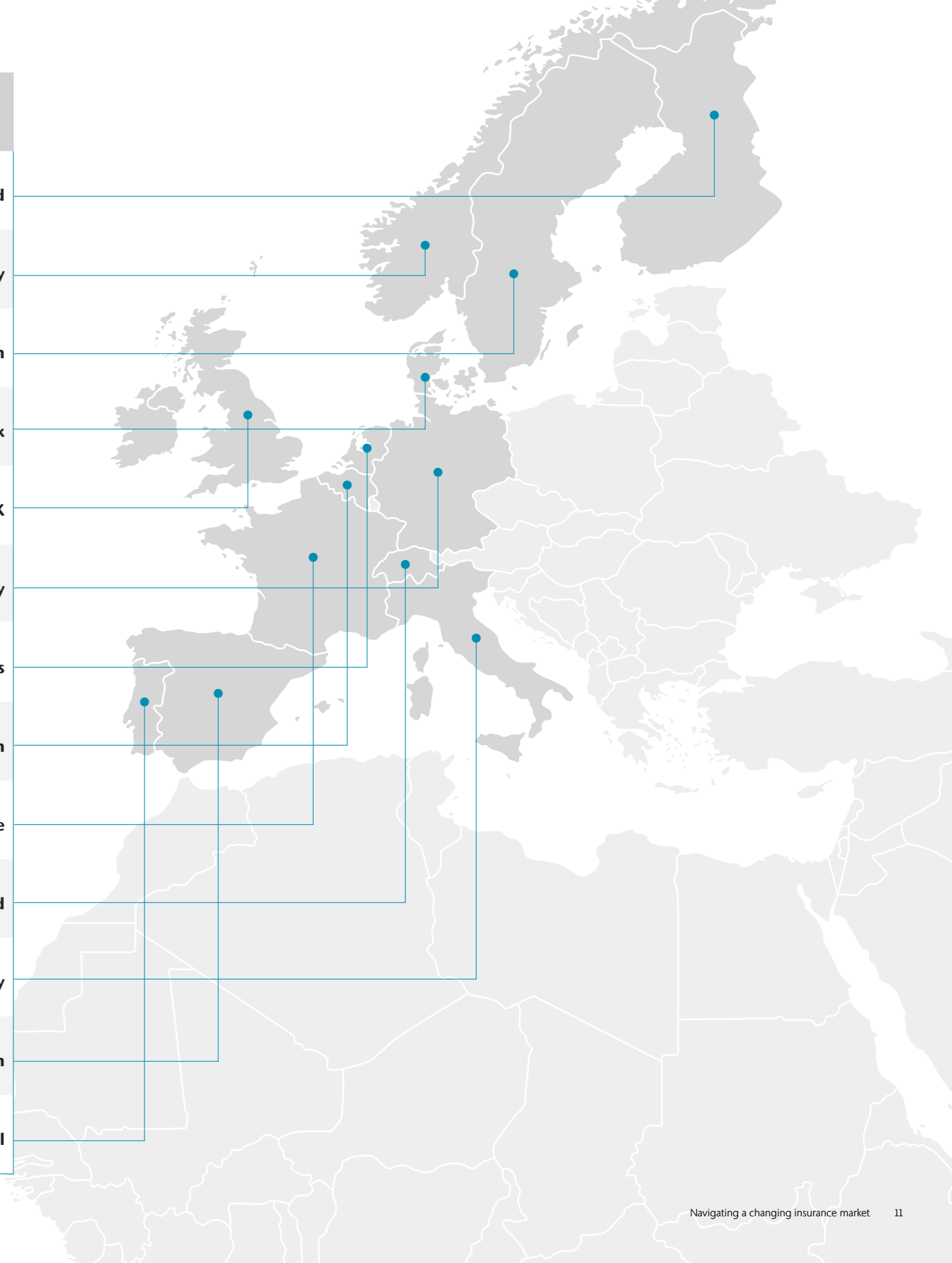
Note: The heat map rating definitions are representative of Aon's Insurance Market Update and our analysis of trends and opinions based on our proprietary data and analytics and engagement with key insurance markets. As at time of report publish date - June 2019

## Line of business

- C** Cyber
- DO** Directors' & Officers'
- GL** General Liability
- MC** Marine Cargo
- ML** Marine Liability
- MF** Motor Fleet
- PI** Professional Indemnity
- PBI** Property & Business Interruption

Country summary	Country highlights	Line of business								Country
		C	DO	GL	MC	ML	MF	PI	PBI	
Where domestic insurers have a strong presence, there is little market change. Conversely, where international insurers are stronger, there are more signs of a changing market.	<ul style="list-style-type: none"> <li>Domestic market remains competitive</li> <li>Underwriters are scrutinising property risks in certain sectors such as food, meat production and recycling</li> <li>Accumulation concerns affecting cyber placements for financial institutions and tech companies</li> </ul>	Low	Low	Low	Low	Low	Low	Low	Low	Finland
Market remains competitive as domestic insurers are strong. However, some international insurers are pushing for rate increases and de-risking their portfolio. There is an expectation that rates will firm across most lines.	<ul style="list-style-type: none"> <li>Certain property risks are challenging to place, especially for waste treatment and food production sectors</li> <li>D&amp;O is slightly firming</li> <li>Cyber is a developing market and rates are relatively competitive</li> </ul>	Low	Low	Low	Low	Low	Low	Low	Norway	
For multi-national buyers accessing the global market, there are signs of firming. The picture is generally different for large and mid-sized national organisations where the domestic market is still quite competitive.	<ul style="list-style-type: none"> <li>Motor is showing significant rate increases for some buyers</li> <li>Capacity challenges for property in steel, mining, waste and food sectors</li> <li>Placement challenges for product recall (automotive) and PI (financial institutions)</li> </ul>	Low	Low	Low	Low	Low	Low	Low	Sweden	
As with other Nordic countries, the market is stable across most lines, with rates flat or even down for general liability, marine liability, marine cargo and motor fleet.	<ul style="list-style-type: none"> <li>Cyber is tightening as underwriters better understand the risk</li> <li>Capacity challenges remain for life sciences general liability</li> <li>Some D&amp;O insurers have increased rates and reduced their capacity</li> </ul>	Low	Low	Low	Low	Low	Low	Low	Denmark	
Market is entering a more disciplined phase. Key areas of focus include providing sufficient risk information and allowing enough time for renewals.	<ul style="list-style-type: none"> <li>Specific areas of concern include D&amp;O, marine cargo and professional indemnity</li> <li>Professional indemnity challenges triggered by the Grenfell Tower block fire leading to rate rises in construction, design and other related professions</li> <li>Food and waste are challenging sectors for PBI with insurer focus on risk management quality</li> </ul>	Moderate	High	Low	High	Low	High	Low	UK	
Clients with poor loss records and/or limited risk management investment are seeing premium increases and facing capacity constraints. The market is firming.	<ul style="list-style-type: none"> <li>A rising number of cyber claims has led to insurers increasing premiums</li> <li>Rate increases in PBI, especially for international risks (chemicals, pulp &amp; paper and wood)</li> <li>Higher rates are being enforced for D&amp;O, although capacity is currently adequate</li> </ul>	High	Low	Low	Low	Low	Low	High	Germany	
Insurers are focused on profitability and re-underwriting their portfolios with a stronger focus on the quality of risk management to deliver bottom line results.	<ul style="list-style-type: none"> <li>Property sectors have become distressed (cold storage, food and areas of real estate with attritional losses)</li> <li>There is reluctance to write primary liability on international risks</li> <li>Markets have pushed strongly for rate increases in commercial D&amp;O</li> </ul>	Low	High	Low	Low	High	High	High	Netherlands	
Market is experiencing an overall firming with some lines and sectors impacted more strongly than others.	<ul style="list-style-type: none"> <li>General liability is challenging for large, international clients, particularly for the automotive sector, or buyers with US exposures</li> <li>Motor fleet rates have increased with more restrictive terms and conditions</li> <li>Limited insurer appetite for construction professional indemnity given prior loss history</li> </ul>	Low	Low	High	Low	Low	Low	Low	Belgium	
Market is flat to firming, with changes in some lines. Renewals are taking longer with limited markets to lead the largest global programmes.	<ul style="list-style-type: none"> <li>Agriculture, pharma and automotive sectors are showing signs of firming for GL</li> <li>D&amp;O market is firming for organisations with US exposures</li> <li>Broad trends include programme layering and challenges for long-term arrangements</li> </ul>	Low	Low	Low	Low	High	Low	Low	France	
There is capacity in the market and a continuing appetite for risks with a good loss record, and where enterprise risk is well managed.	<ul style="list-style-type: none"> <li>A stable to slightly firming market trend following 15 years of softening property rates</li> <li>Few cyber claims translate to a good market for buyers</li> <li>Liability is seeing premium decreases and flexibility</li> </ul>	Low	Low	Low	Low	Low	Low	Low	Switzerland	
Market experiencing some changes although it is too early to assess whether this will be a progressively firming environment.	<ul style="list-style-type: none"> <li>Property &amp; business interruption has been particularly affected by rate rises</li> <li>Lack of property &amp; business interruption capacity available for waste treatment</li> <li>Financial institutions and the public sector are becoming more disciplined</li> </ul>	Low	Low	Low	Low	Low	Low	High	Italy	
Local insurers are competing for mid-market buyers, global clients have fewer insurer options, meaning some sectors are seeking London or international capacity.	<ul style="list-style-type: none"> <li>Some firming of rates in property, construction, marine &amp; liability with reduced lead capacity in energy and liability lines</li> <li>Some insurers leaving the motor market, leading to capacity constraints and rate increases</li> <li>Rate increases for D&amp;O, especially for accounts with large losses</li> </ul>	Low	Low	Low	Low	High	Low	Low	Spain	
Natural catastrophe exposure - such as earthquake and wildfire - has caused some challenges due to limited ongoing insurer appetite.	<ul style="list-style-type: none"> <li>Limited local capacity for professional indemnity along with rate rises</li> <li>Awareness of cyber risk is still low with many viewing this as an IT issue</li> <li>Motor is under pressure particularly in sectors such as car rental</li> </ul>	Low	Low	Low	Low	Low	High	Low	Portugal	

Note: Findings included in the insurance market heat map for 13 specified European countries and eight lines of business come from Aon's analysis of trends and opinions based on our proprietary data and analytics, engagement with clients and/or key insurance markets. As at time of report publish date - June 2019



# Client focus

## Capacity crunch



A large pharmaceutical manufacturer with a US securities listing was struggling to renew its D&O programme. Looking for EUR 180 million capacity, its existing broker had managed to secure only EUR 54 million, with premium indications running 750% higher than 2018 levels. Having secured a transfer mandate, Aon had just 14 working days to unravel the previous negotiations and secure the full capacity needed by the client.



Following immediate deployment of Aon's D&O placement expertise in Dublin and the Global Broking Centre in London, the teams quickly determined the content and extent of negotiations carried out by the previous broker's market representatives; discovering that the EUR 54 million capacity may not have been fully secured. Aon's brokers then set about designing and filling a new EUR 180 million tower, making extensive use of Aon's Client Treaty and Structured Portfolio Solution facilities. The final line was placed on a complex programme with thirty five attachment points; a testament to the perseverance, expertise, and market penetration of Aon's placement team.



EUR 180 million D&O capacity was secured for a relieved client and at a more 'reasonable' premium level, leading to a two-year appointment with Aon, a cyber resilience project and insurance placement, as well as an opportunity to secure the balance of the client's programme.

# Why the changing insurance market is a priority

## As the insurance market goes through this transitional phase, what are the ramifications for the commercial insurance buyer?

### Cover

At its most drastic, some companies in distressed sectors – notable examples in Europe include property cover for waste-to-energy and the food sector – may struggle to get the desired level of cover at an acceptable price. That is, of course, the most extreme scenario, but it is important to emphasise that a more disciplined insurance market is likely to impact all organisations and how they prepare and allocate budget to their risk.

### Cost

Since the financial crash of 2008, and the subsequent recessionary burdens, insurance has been a relatively low-cost form of capital. In fact, for some companies, certain risk transfer arrangements represented a break-even or profit centre scenario.

With the negative performance of the European commercial market for the last couple of years and a consistent insurer focus on rate adequacy and profitability, buyers are now potentially being asked to pay more for risk transfer as well as take higher retentions and refocus on the quality of their risk.

### Stakeholder management

Given the developing market situation, the risk management function may need to help ensure the C-suite in their organisations understand how this shift might affect the organisation from a cost and volatility perspective. Also, with a shift in risk profiles and evolving intangible exposures such as reputation management and a change in people risk, risk managers will need to have different conversations to those in the past.

### A new experience for many risk managers

The risk management function has been able to demonstrate its value over recent years, in part due to competitive market conditions. Historically, the internal dialogue was often simple with treasury functions and CFOs asking the insurance team for savings - now the situation could be reversed.

Given the changing market dynamic for some risk managers, this may be the first time that insurance purchasing decisions are scrutinised by the CFO. Why are we buying? What are we buying? Who are we buying from? What risks are emerging? Why are rates going up in this area? What are the implications of taking higher deductibles or lower limits?

Risk managers will need to work differently to produce an outcome similar to prior years. This is coupled with the task of having to justify their approach and purchasing decisions to an increasingly challenging C-suite, generally facing testing commercial conditions, greater regulatory pressures, and unparalleled levels of change to their business models.

The risk management function may also find new issues hitting their radar. From a people perspective, the financial implications of poor employee health, as well as insurance premium challenges relating to medical and other health related benefits, shows no real sign of abating.

Coupled with factors such as an ageing population, multi-generational workforces and employees increasingly working into their latter years due to lack of retirement savings, it is not surprising that the transition in the health arena is now much more focused on wellbeing, improving behavioural health and preventing disease. As many employers look for ways to improve the health and engagement of their employee population, it is anticipated that the risk management function will increasingly need to scrutinise their people risk approach in collaboration with their HR colleagues.

### Commerciality hit by insurance costs

Overall, companies and their boards will have to increasingly justify their approach to risk and the degree of insurance cover that they have in place. If that's not complete or turns out to be insufficient – leaving the business exposed – there are ramifications for the C-suite as they come under the spotlight from customers, regulators and other stakeholders.

For some sectors, insurance is not only a cost of doing business and a way of reducing volatility, it is also a commercial lever in their overall business models. In the property owners and construction sectors for example, significant hikes in insurance costs may need to be passed on to tenants, customers, and suppliers, which may impact the overall commercial proposition; leading the C-suite to sit up and take notice of the growing cost of risk.

There are ramifications for the C-suite as they come under the spotlight from customers, regulators and other stakeholders.

### A rebalancing of the buyer to seller market dynamic

With distinct themes emerging, buyers will have to navigate the market far more carefully than perhaps many have been used to over the last decade. This will necessitate a reprioritisation of buyers' approaches to risk financing and the need for the changing conditions to be understood by stakeholders at every level of their organisation.

# Client focus

## An upfront solution



After three major losses amounting to a total over EUR 75 million in the same year, plus a poor loss record in previous years, the existing insurer of a Dutch multinational engineering company refused to renew at any price.

Underwriting data was limited and Aon faced a firming Dutch market to place the client's risk which included many locations with low total values, a large global footprint, and a need for local policies with low deductibles to keep subsidiaries satisfied.



Presenting an Aon United approach with our Global Broking Centre and Commercial Risk Solutions teams, a solution was developed working with both the direct and reinsurance markets, in combination with the Aon Client Treaty to maximise impact.



The lead insurer ultimately delivered a policy backed by reinsurance. The pricing was mitigated by multiple structures in the reinsurance market. Our client benefited from a 30% reduction of the initially proposed renewal premium, and importantly the solution enabled them to continue their trading activities as usual.

## Three key questions

There are three key questions for risk managers and the C-suites they serve resulting from the evolving dynamic in the insurance industry:

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1. *Does insurance continue to represent value for money?*
  2. *How relevant is the financing strategy – has it evolved with the organisation, should the organisation revisit its risk appetite and risk retention?*
  3. *How should the organisation manage the extra volatility if it takes more risk?*
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### Taking on the challenge

For every organisation, it is now more challenging to anticipate exactly what will happen at the next renewal. There are examples of markets withdrawing from geographies, lines of business and reducing appetite in others as they drive through their more focused strategies.

There is no sign of these trends abating in the near term, which is why the changing insurance market and its ramifications must be a strong focus for every organisation.

This leads to the next question: How can buyers work to manage and mitigate the impact that a changing insurance market will have on their organisation?

# How to get ahead

Given how the market is trending, it is about taking control. Buyers need to be ready, not just for the next renewal, but for the years that follow, asking themselves what levers they have to help them manage their total cost of risk across a three to five-year period.

A key component in doing this is understanding the risk maturity of the organisation. In particular, how it identifies and manages the interconnected nature of risks and develops effective governance and processes to encourage improved risk-based decision making.

[Aon's Risk Maturity Index](#), based on the analysis of the financial results and stock performance of circa 400 publicly traded companies, reveals the direct relationship between the risk maturity of an organisation and its ability to deal with uncertainty and the associated shocks.

By understanding risk maturity now, organisations can take steps to ensure that they are appropriately positioned to navigate the changing insurance market conditions.

Gathering the data to put the organisation in an informed position around feasible risk financing alternatives and having the right risk maturity to make informed decisions, should be a priority now and in the future.

## Be prepared

Preparation is everything. It is critical for businesses to define a clearly articulated risk strategy and closely manage expectations with all its stakeholders. There could be extra cost coming from a budgetary perspective which needs to be communicated.

This means working closely with the CFO and the treasury team in terms of defining acceptable levels of retention and risk appetite, which also goes hand in hand with having assurance on the control of the organisation's risk and volatility profile and its insured values and exposures.

When insurance capacity is competitive, it doesn't make a significant cost difference whether an organisation buys EUR 100 million or EUR 150 million of limit. As rates increase, the differential cost can be pronounced, particularly for exposures like

contingent business interruption. As such, having the information available to understand what risks to keep, mitigate, or transfer and how much insurance limit to buy has become more important.

### Start now

Time is critical. Renewal timeframes are generally becoming longer which means the whole process must start much earlier and with much more preparation and detail. The action that businesses take now will not only impact their 2020 renewal, but also their 2021 renewals and the years beyond.



# Client focus

## Insurance programme efficiency



A large food and beverage client was renewing their multi-line programme. Aon were asked to review whether their insurance structure was efficient and if the premium paid to the insurance market was appropriate. The client has two captives.



We undertook an analytical perspective of the renewal and a risk appetite review was performed. An actuarial review of the loss and volatility distributions for each line of business was conducted using our Risk Financing Decision Platform. On this basis, an assessment of different programme structures was undertaken to identify how the expected losses and cost of capital would change for the client, helping to determine the most efficient programme structure.



The programme structure was confirmed to be efficient and a premium saving of 4% was applied over the term. Post-renewal the risk retention was increased in line with risk appetite, resulting in a reduction of annual premium outflow of a further 13%.

## Partner with your insurer and broker

A response to the challenging market should be a strengthening of relationships between insurance buyers, their broker, and their insurers. Buyers, working closely with their broker, should be prepared to lead the discussion with insurers, rather than allowing the strategy to be determined by what the insurers will insure.

**Working smartly as to how the organisation aligns risk and insurance is critical**

Buyers need to challenge their broker to proactively assist their risk financing strategy and navigation of the market so that they are 'positively differentiated'. This includes available data and analytics to support the organisation in better understanding and quantifying its risks and exposures, enabling more informed discussions both internally and with insurers.

### **Refresh risk assessment and enterprise risk assessment processes**

Working smartly as to how the organisation aligns risk and insurance is critical. In a multi-national organisation, there is often a separation between the insurance buying function and the enterprise risk management (ERM) team. There is considerable value in bringing the two more closely together. This value includes delivering better quality risk insights to ensure that insurance cover is relevant; identifying and responding to gaps or limitations; and better informing perspectives on the organisation's risk profile and control environment.

For example, some organisations may conclude that a risk is not material at an ERM level because they assume that insurance will respond; however, they may not have drilled into the complexities of when and how it will respond. Cyber is a good example. Some organisations may believe that cyber no longer presents a material threat because they have bought insurance to cover the risk. However, without a clear understanding of their most critical systems and significant cyber scenarios, the quality of the current controls, and financial exposure, they may find that the existing policy may not fully cover them from either a coverage or limit perspective. A different conclusion may be reached if they bring together their ERM, insurance and IT teams to collectively assess the implications of a potential cyber attack.

**It is crucial to look at the broader spectrum of risk to make informed decisions**

### **Arbitrage risk**

Organisations may need to rethink their approach to renewing on a single line-by-line insurance basis. It may be necessary to arbitrage across their risks to deliver a more optimal outcome from a cost and coverage perspective. Some organisations will have a certain amount of retention and volatility they are prepared to assume, but will need to arbitrage, for example, between their liability programme and their property programme. With insurance costs rising, making informed decisions about where to carry more retention cannot be done if the property renewal is treated separately from the liability renewal. It is crucial to look at the broader spectrum of risk to make informed decisions.

### **Explore alternative risk financing options**

Market conditions are also prompting more discussions around alternative risk financing. The trend towards increased retentions will almost certainly lead to more extensive utilisation of captives, even by businesses that may have previously discounted this approach due to a lack of scale.

A captive solution is particularly relevant in situations where individual business units retain risk on their balance sheet, or are looking to diversify their portfolio, for example, in respect of insurable employee benefits. The risk bearing capacity of business units is often less than the risk tolerance of the overall group and increasing retentions for the business unit can introduce levels of volatility which the operating unit's balance sheet is unable to bear. A captive can help to bridge the gap between the levels of risk that the group wishes to retain and the levels that the business unit is comfortable taking.

The use of 'cell' captives, where individual cell companies within a facility owned by a third-party provider can be used as a retention vehicle, reduces the barrier to entry for organisations that might not normally consider a captive solution, as cells generally have a lower cost profile when compared to a stand-alone captive at lower retention levels.

Exploring alternative approaches to risk financing is happening. Data from [Aon's 2019 Global Risk Management Survey](#) indicates significant growth in captive and Protected Cell Company (PCC) usage from companies with revenues below USD 5 billion.

Organisations with existing captives should be lining up fronting capacity and be prepared to pay more for that capacity – we are seeing increased insurer pricing in this space which is sometimes a less focused on aspect of a market where rates are beginning to firm.

#### **Test limits**

When buyers look at the limits of their programme, it is critical to understand the business's loss scenarios and to know if it did go wrong, how much it would cost. Key questions to answer in considering limits include: When did we last test the adequacy of our limits? Does the business get cover more cost effectively from insurers or by utilising its own capital base? How much volatility is the business prepared to accept?

As these can be worked out mathematically, it is incumbent upon all risk managers to 'run the numbers' to facilitate informed decision making and limit their organisation's exposure to shock. This approach should go beyond the 'classic' property and business interruption limits review as tools also exist to support the quantification of cyber and liability limits.

#### **Undertake claims scenario exercises**

Having a better understanding of key claims scenarios and how much they could cost the organisation will help in terms of deciding where an organisation should be setting its limits.

For example, if an organisation is over insuring on its general liability cover, there may be an opportunity to reduce the limit and use the 'freed up' premium to buy more tailored cover elsewhere across its risk profile.

#### **Take advantage of risk management bursaries**

Buyers should capitalise on the willingness of some insurers to partner and make investments in risk management programmes through bursaries.

This can result in a 'win win' through a deeper understanding of risk and driving risk management activity that can ultimately lead to a longer-term partnership with an insurer. Proactively identifying areas to review can add real value for the organisation and insurer partners.

#### **Long-term arrangements**

If there are options to lock in to long-term arrangements (LTAs), these should also be seriously considered as it presents an opportunity to align the interests of the buyer and insurer to reduce volatility in a relationship.

Structured correctly, LTAs can reinforce the partnership approach and help define a buyer's relationship with their insurer around areas such as renewal information. LTAs can also create a strong risk control approach as it can be built into the agreement to enable a clear understanding between risk control spend and subsequent premium where the expected impact on actual claims is in line with expectations. Typically, the market's desire to offer LTAs in a firming environment dries up, so again, an organisation positively differentiating its risk within the market will help.

#### **Review policy wordings**

As insurers focus on the breadth of policy wordings, buyers need to carefully review the relevance of their wordings. When were wordings last reviewed? Is cover still relevant to their risk profile? It is also important to review the dovetailing of cover between hitherto separately placed policies, especially as perils such as cyber transcend numerous lines of insurance.

# Client focus

## Vodafone dials up higher limits



With an existing captive-led approach, Vodafone, a multinational telecommunications firm, was looking for a fresh approach to risk financing that could reduce captive financial exposure across their portfolio to a single captive retention, while building significant limits to reflect their evolving risk profile, upgrading and updating the basis of cover, and achieving premium savings.



Aon's Strategic Account Broker developed a strategy across 16 lines of business that included expertise from across the organisation; including actuarial analysis, cyber quantification, programme limit reviews, reinsurance support, global benefits, and specialty broking in areas like tech/E&O, political violence/terrorism, aviation and cyber. We carefully managed the market process, working closely with the insurers' teams across multiple disciplines.



Significant limits were placed as part of a long-term multi-line programme and additional total cost of risk savings.

*"An outstanding reinsurance programme that is structured in a way that responds to the complexity of Vodafone's evolving risk profile and can be simply articulated to the Group Executive. This has been driven in a true partnership approach between Vodafone, Aon and the (re)insurance market, and has established a strong platform for future development and growth."*

**Phil Clark**

Director of Insurance, Vodafone.

## Improve risk marketability

In a more disciplined market, insurers will place a greater emphasis on the quality of the risks that they deem as high exposures. In Germany, for example, we have seen clients with poor loss records, largely driven by limited risk management, being among the first to see premium increases and face capacity challenges. Insurers may agree to underwrite the risk, but on the condition that they are able to undertake a programme of visits and provide a view of the risk.

Organisations need to articulate to the insurance market how their risk is better managed than that of their peers

An insurer is then likely to impose a list of risk management recommendations – sometimes linking those recommendations directly to the insured’s ability to secure similar terms in the future. If an organisation already has a well-documented risk engineering programme, it will help to create confidence around the risk for the insurer and is another way of proactively taking control.

### **Better claims management**

Organisations need to focus on areas where there might be frequent claims running through their insurance programme. Can the organisation take better control and understand what’s driving claims and how to better manage them?

Remedial work on claims trends has two positive impacts – there is the potential to reduce the residual costs surrounding the claim itself, and there is also the improved line of sight a business has on its claims, which helps to paint a more confident picture with insurers.

### **My risk is better than yours**

The quality of the risk submission will become more important to ensure optimal renewal terms. Organisations will need to articulate to the insurance market how their risk is better managed

than that of their peers. Our insurance market heat map demonstrates that in the UK, there can be greater challenges among smaller companies, where buyers are providing insufficient underwriting information or not committing enough time to their renewal process. Buyers will have to consider what data they will provide in addition to their traditional submission.

For example, buyers should be prepared to provide information in areas where they may not previously have been questioned, such as exposure in their supply chains or risk management work they are deploying to address deteriorating claims experience. Providing insurers with access to specialists who can articulate risk control measures and strategies can also positively differentiate an organisation in the market.

# Threat or opportunity?

Today's changing insurance market is a potential challenge to organisations, both as the cost of risk transfer increases and their ability to adequately protect themselves against risk becomes more challenging, particularly as the time demands associated with renewal grow.

However, it also presents an opportunity to refresh and reconsider how risk is managed and financed across the enterprise. Although the pressures of potential premium penalties or coverage constraints could be a challenge for an organisation, doubling down on risk management efforts will help to address this as well as deliver wider business benefits.

**The message is clear:** as the market becomes more selective, organisations must proactively take control of their risk financing approach and renewal process, and prepare a clear strategy for their next renewal and beyond, or potentially pay the price.

## Top five levers in a changing insurance market

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- 1. Prepare, prepare, prepare** – allow more time for renewal

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- 2. Invest in relationships and develop a strong partnership with both broker and insurer**

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- 3. Challenge practices and approaches:**
  - a. Consider** the organisation's evolving risk profile
  - b. Review** wordings, retentions and limits
  - c. Explore** alternative risk financing options

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- 4. Use data and analytics** to make informed recommendations and decisions, particularly around programme design and where to invest in risk control

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- 5. Positively differentiate** – improve risk marketability

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## About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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