Risk & Resilience

Spotlight on business risk

beazley

Introduction

As the world dares to look forward to COVID-19 becoming endemic, rather than a pandemic, institutional burnout remains a real threat in the health sector and many other aspects of critical infrastructure – travel, education, retail – to name just some of the worst affected.

As companies continue to face having high proportions of their workforce off sick or isolating as we move into 2022[1], insurers are starting to ask what might be the possible impact of 'resilience fatigue' on our customers across every sector in 2022.

Although most organisations have leveraged the pandemic to improve operations from the ground up and the vast majority (84%) of business leaders believed they would be more resilient in 2022 as a result, high levels of optimism do not mean that business risks have gone away.

Business risks top concern in 2022

Indeed, over a third (34%) of business leaders in the US and UK believe that risks in this grouping – which include supply chain, business interruption, boardroom (director failure), reputation, employer risk (looking after staff through and post COVID-19) – will be their top concern in 2022.

We are already seeing supply chain issues impacting property claims, with a possible overspill into technology product liability claims if companies are forced to substitute missing parts that could lead to loss and problems further down the line.

We also see scope for COVID-19 issues driving Directors' & Officers' liability (D&O) and employment liability claims this year as COVID-19 positive employees or their families bring injury and manslaughter claims or raise issues around vaccine mandates – with potential for class actions from those required to vaccinate as well as from those who caught COVID-19 from unvaccinated employees.

Social inflation, already a scourge on casualty markets, could become super-charged by such concerns, as pandemic pressures encourage jury members to believe ever more extreme financial redress measures are warranted.

Against this backdrop, there can be little doubt that the complex and highly integrated risk environment will drive a sharp rise in claims severity, with settlement amounts far exceeding previous levels. And as this threat grows, clients will likely demand improved granularity around how insurance will respond - the industry will want to be clear it is not inadvertently including COVID-19 risk in policies.

As the liability landscape continues to shift and expectations of our industry rise, the value of closer and more responsive insurance partnerships that focus as much on risk management and mitigation as on traditional risk transfer, will become increasingly evident.

Bethany Greenwood
Group Head of Cyber
& Executive Risks
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[1] Covid: Workplaces told to plan for absences of up to 25% - BBC News

Which business risks are predicted to dominate in 2022?

Business risks dominate in the high risk – low resilience quadrant of our risk-resilience matrix – more than any other category of risk.

Risk-Resilience Matrix

How resilient do business leaders feel to business risks in 2022?

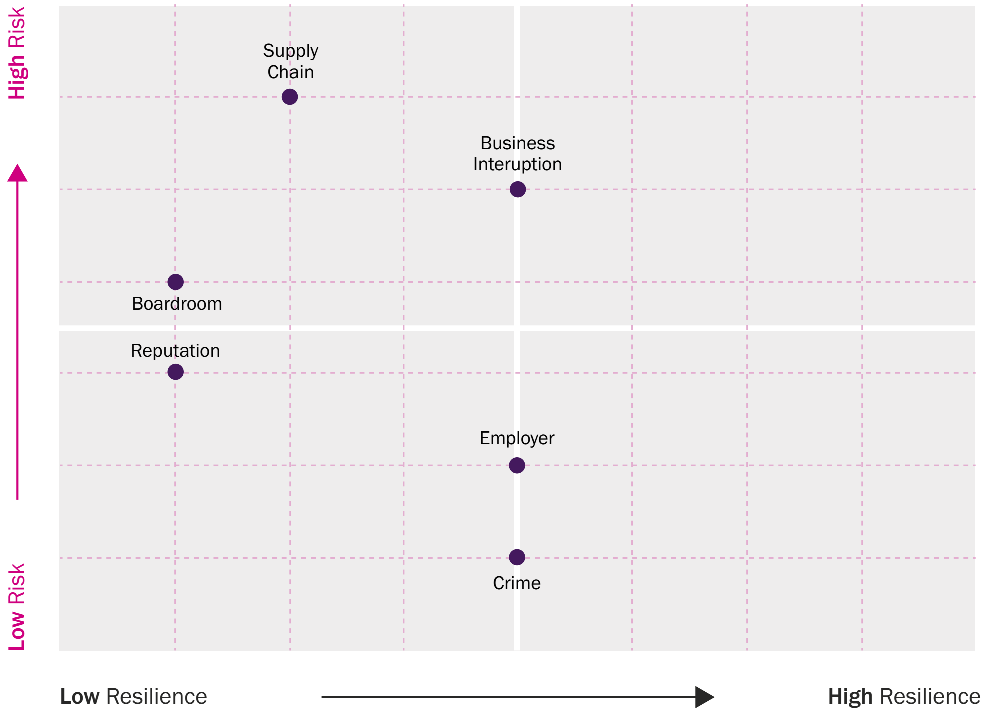

Chart scales are based on the percentage of companies ranking a risk as their leading concern and on the percentage of companies feeling 'very prepared' to anticipate and respond to each risk.

Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to business risks

Key takeaways

- 2022 may be the year in which supply chain, D&O, reputation and employment liability concerns 'leak' across insurance classes, creating ever more complex, integrated risks with no obvious or traditional insurance solution.
- US businesses feel notably more resilient than their UK counterparts to supply chain and business interruption risk, but reputation risk is something of a blind spot for companies in both territories.
- Addressing the impact of COVID-19 and social inflation on claims for complex integrated business risks will be a priority for 2022.
- Business leaders are likely to look to their insurance providers for greater granularity and transparency on wordings. This will present an increasing challenge for the industry going forward.
- It will be more important than ever for insureds to pick a long-term insurance partner with the expertise and insight required to help them navigate the complex business risk landscape.

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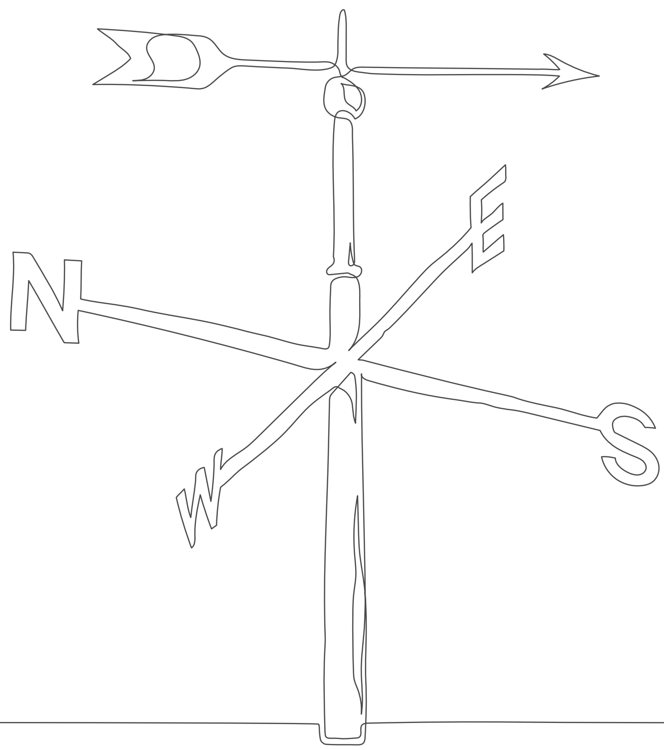


Will supply chain issues make or break reputations this year?

Business leaders say supply chain is their area of greatest concern and least resilience. Could tackling this be a shortcut to improved business continuity, better customer relations and reduced reputation and D&O risk?

Throughout 2021 we saw the widespread impact of supply chain failure play out in the inability to manufacture and supply goods and services at the same speed and scale as pre-pandemic.

What drove the supply chain problem?

Consumer demand recovered fast from the initial COVID-19 impact but as movement restrictions and labour shortages caused factories to slow down, so supply faltered, with shortages in some areas like semiconductor chips impacting everything from manufacturing through gaming, telecoms and medical devices.

- **How challenging is business continuity?**
- **What's the solution?**
- **Is the supply chain re-set an opportunity to add value?**
- **How can the industry innovate and tailor cover?**

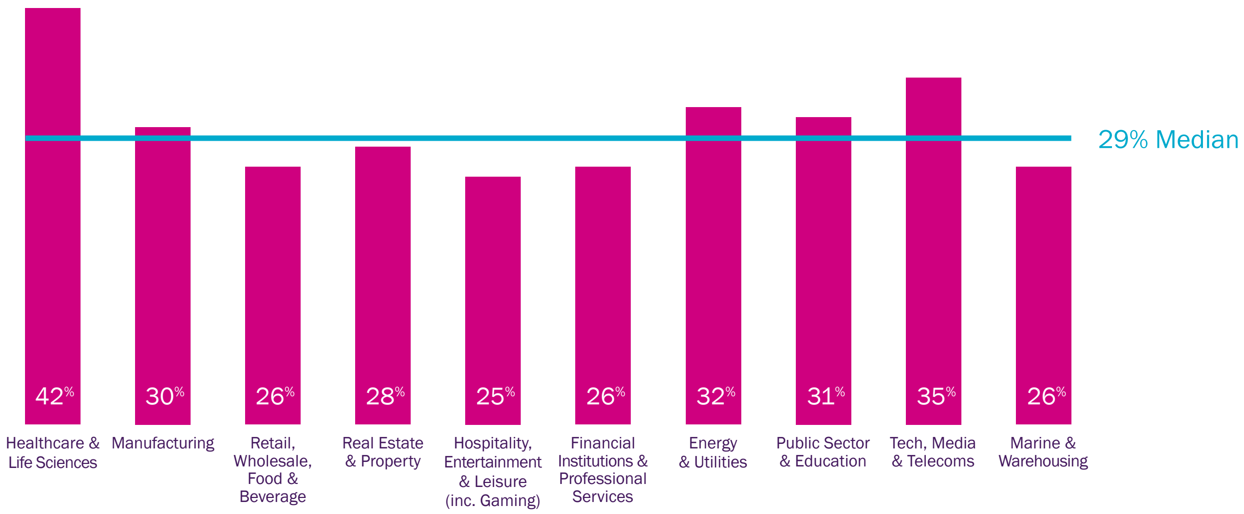
What began as local supply issues fast compounded into a global demand-supply dislocation. This situation was exacerbated further by cyber-attacks on infrastructure and floods that disrupted manufacturing and severed railway links in China and Europe.

Some 42% of Healthcare and Life Sciences businesses in the US and UK predicted supply chain risk would be their primary concern in this risk category this year – more than any other sector we surveyed – with concern particularly elevated in the US.

> Supply chain challenges, labour shortages and rising costs present real potential to drive claims activity as well as resulting losses. A major concern is reliance on specialised staff, who may be over-stretched or burnt out, or who may be covered for by under-trained substitutes, feeding into a worsening claims picture.

Beth Diamond
Group Head of Claims

Perception of supply chain risk



Percentage of sector business leaders predicting supply chain would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

How challenging is business continuity?

As the flow of goods slowed and the backlog at ports grew last year, storage capacity begun to be maxed out. This in turn created logjams that made a mockery of the lean, just-in-time manufacturing models on which many businesses depend and creating knock-ons for business continuity.

Overall, more Tech, Media and Telecoms businesses predicted that business interruption would be their top risk in this category this year than any other sector.

Perception of business risk

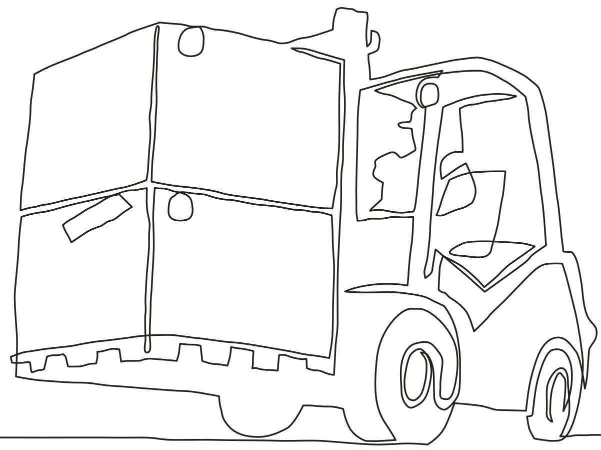
Percentage of sector leaders predicting business interruption would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

What's the solution?

Supply chains are adapting and rebounding[2].

While there is no universal answer to the current supply chain issues, many companies are combining multiple strategies to build supply chain and business interruption resilience: increasing the inventory of critical products and components while simultaneously diversifying the supplier base and bringing some elements on-shore.

While approaches differ, the goals are common: to shorten and simplify supply chains and to reduce the dependencies within them[3].

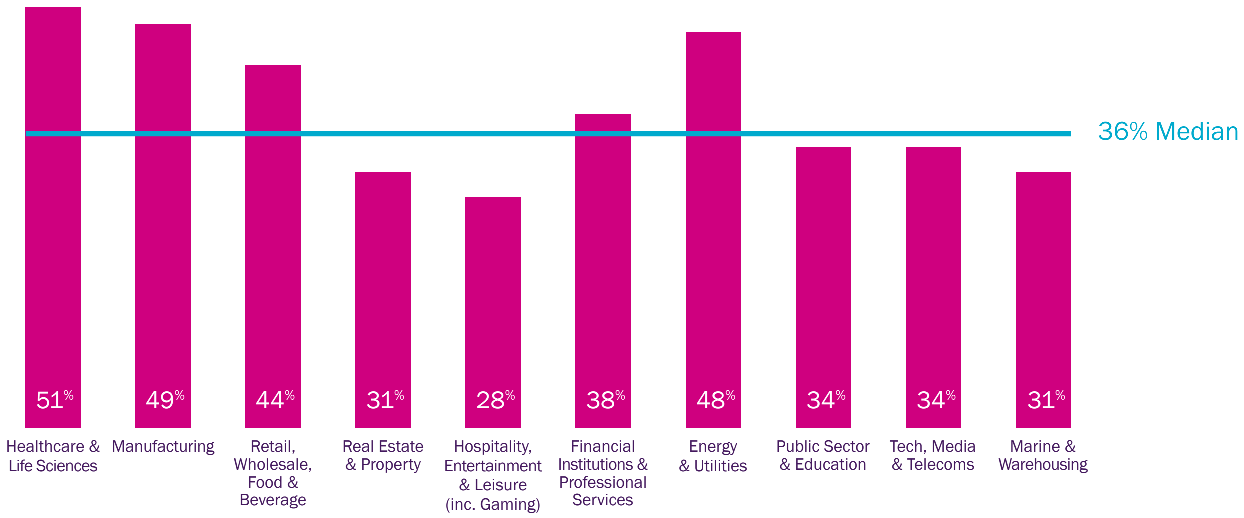


[2] Global supply chains are still a source of strength, not weakness | The Economist
[3] Here's how global supply chains will change after COVID-19 | World Economic Forum (weforum.org)

Although this process is ongoing, business leaders are not confident that this year will see a significant rise in resilience to supply chain risk.

Hospitality, Entertainment and Leisure businesses are particularly pessimistic on supply chain risk, as are Marine and Warehousing. For Business Interruption, sectors expecting to be least resilient in 2022 include the Public Sector, Education and Healthcare and Life Sciences.

Perception of supply chain resilience



Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to supply chain risk in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

Perception of business interruption resilience

Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to business interruption risk in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

Is supply chain re-set an opportunity to add value?

Already business leaders are monitoring tier one suppliers for key personnel changes, quality issues or commodity crunches that may signal disruption is likely. They are also focused on understanding the supply web better. Currently, only 2% have visibility of tier three suppliers and beyond, even though key component shortages, such as semiconductors, often happen here.[4]

While traditional supply chain insurances might include contingent business interruption covers - such as lost income (the money the company would have earned if the triggering event hadn't occurred), extra expenses (such as replacement costs for obtaining the necessary goods from other suppliers, or expenses incurred to mitigate/prevent additional losses) - the real value of insurance is likely to come from more than traditional risk transfer policies.

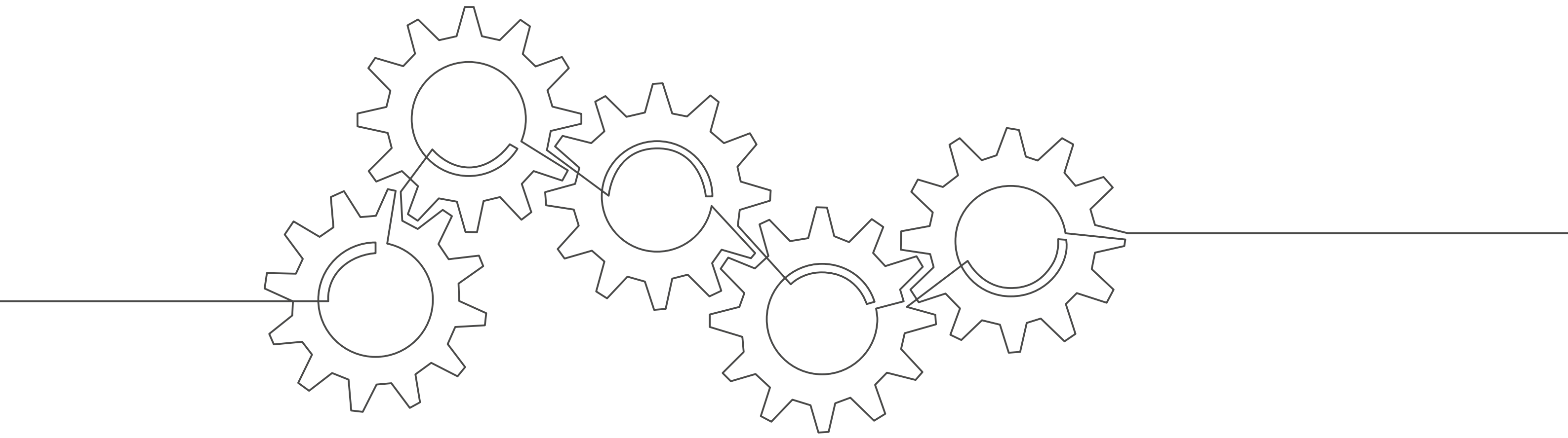
How can the industry innovate and tailor cover to add value?

As a specialist insurer, we can work with insureds across industries to pool and interrogate the data from automated supply chains. Over time, we will be able to develop a hub of centralised services adding risk management value, surrounded by straight-forward risk transfer mechanisms for transferable risks.

Central services could include risk analysis, benchmarking and mitigation advice that can help analyse supply chain quality and business interruption resilience. They will almost certainly be contingent on improved use of 'big data' technologies that are becoming better understood by insurance businesses. Over time, such developments should help insurers offer greater limits.

> The onus is on us to think through how we can help and how we can put together a product for supply chain risk because it is very material.

Adrian Cox
CEO



[4] How COVID-19 is reshaping supply chains | McKinsey

When will boardroom and reputation risk move centre stage

When business leaders are forced to prioritise, it is inevitable that a risk pecking order will emerge. But are boardroom and reputation risk being given the attention they deserve?

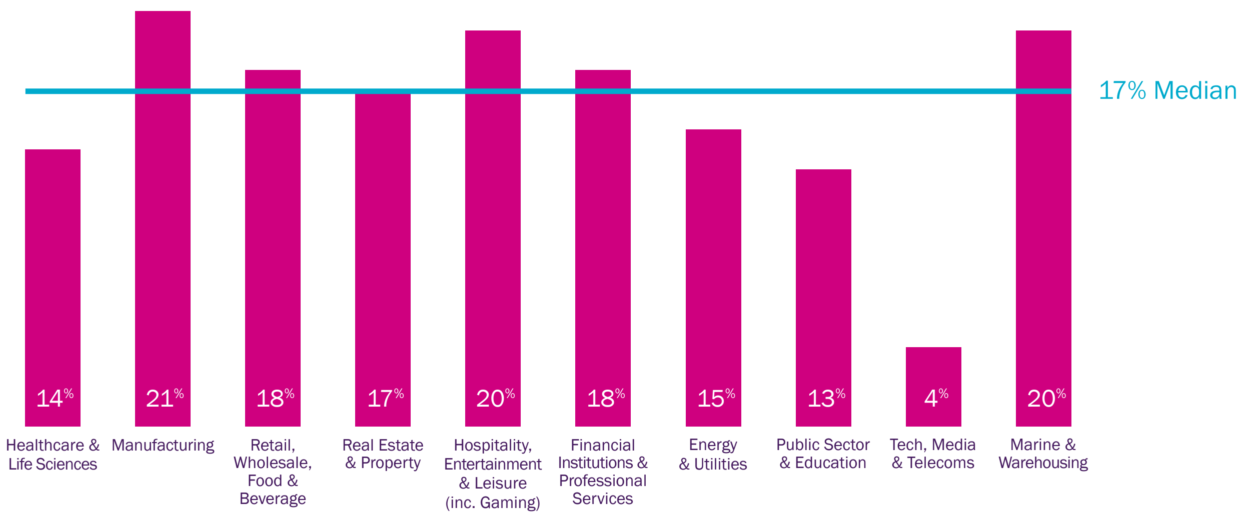
All the time that supply chain weaknesses persist, the potential grows for long term reputational harm to stock valuations and to corporate reputations.

Boardroom threats are driven by supply chain problems

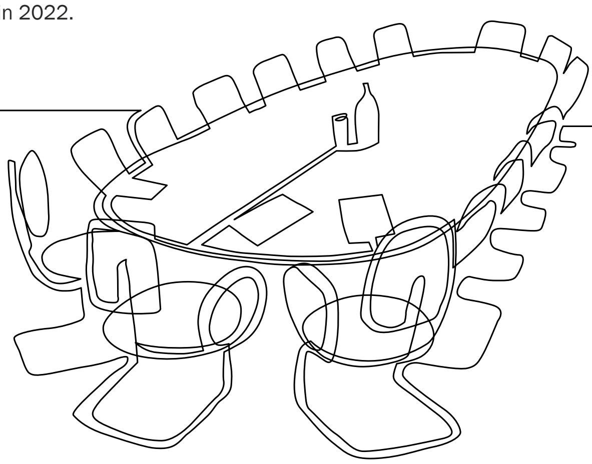
Forty percent of businesses say their brand image has been markedly tarnished due to disrupted supply chains,[5] but businesses leaders appear not yet to be fully focused on this risk either as an emerging D&O liability, or a broader reputational risk. Fewer than a fifth - a median of just 17% - predicted that boardroom risk would become their top concern in 2022.

With many companies already reporting a rise in customer complaints, delays to product launches and the consequent loss of regular customers in 2021. It seems inevitable that valuations will suffer during 2022 if supply chain issues continue, and that shareholder actions against directors are likely to follow[6]. This could also possibly push the issue up the boardroom agenda as we look further ahead.

Perception of boardroom risk



Percentage of sector leaders predicting boardroom risk would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.



[5] PGEP: Brand reputations damaged over supply chain disruption (supplychaindigital.com)
[6] Recent Shareholder Activism Trends (harvard.edu)

Why is reputation risk so multi-faceted?

Of course, supply chain is not the only driver of boardroom and reputation risk. Many other factors are at play, not least the threat that COVID-19 and its many variants pose from a broader liability perspective. As businesses face challenges from customers, suppliers and employees in terms of duty of care, so company leaders are coming to grips with the challenges of operating in a much less predictable social and economic environment.

Undoubtedly, there is a risk that COVID-19 issues will drive D&O claims as COVID-19 positive employees or their families bring injury and manslaughter claims or raise issues around vaccine mandates – with potential for actions from those required to vaccinate as well as from those who caught COVID-19 from unvaccinated employees. More employer liability issues may also arise in terms of companies' ability to maintain appropriate support for staff isolated during lockdowns, or alleging discrimination in terms of promotions, pay and conditions as employees make different decisions about how and when to return to the office.

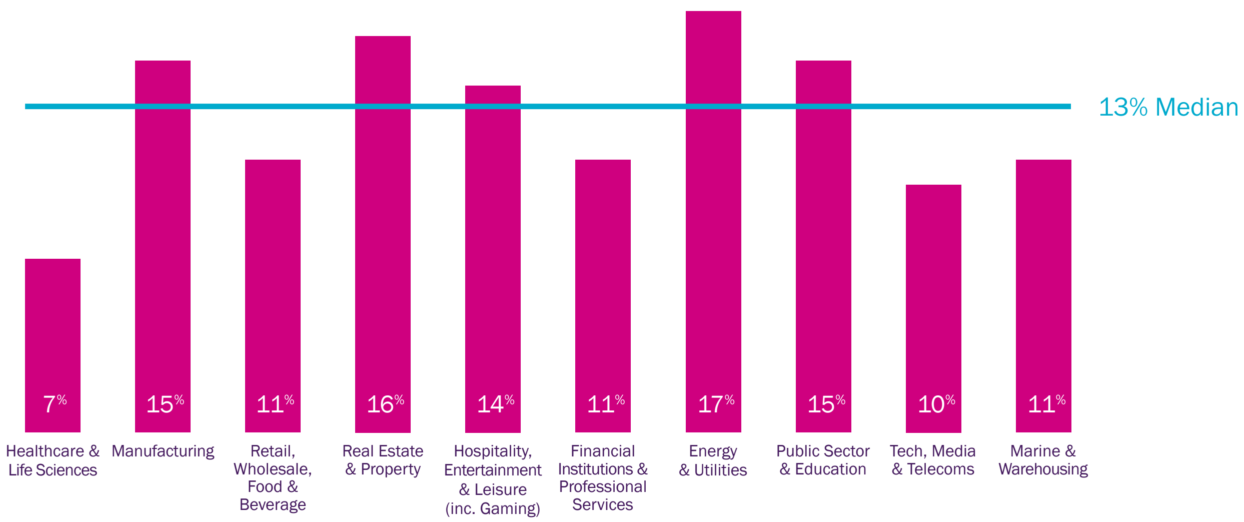
Against this backdrop, it is inevitable that the risk of perceived corporate mismanagement will remain elevated,[7] putting corporate reputations very firmly under the spotlight and raising expectations of insurers to step in and help mitigate reputational risk. Rising expectations in terms of ESG reporting only serve to up the ante.

> All companies are being asked to raise their game in terms of ESG reporting. Issues are likely to arise around how companies manage their compliance obligations and how they communicate with stakeholders. Any companies that miss regulatory or self-imposed targets could potentially face litigation; even those companies that succeed in achieving their ESG goals will face the risk of being accused of greenwashing. This is an area we are very conscious of in our underwriting and it is the subject of extensive discussion with clients and brokers.

Wayne Imrie
Focus Group Leader - London Market D&O

Energy and utility companies rate reputation risk top in our research, with 17% of business leaders in the US and UK ranking this their top risk in this category overall, a figure that falls to as low as 7% for the healthcare and life sciences sector, where leaders may believe that reputations have been bolstered by their undoubted contribution to managing the pandemic.

Perception of reputational risk



Percentage of sector leaders predicting reputation risk would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

[7] D&O pricing increases range from 30%-100% globally, GILC research finds - Commercial Risk (commercialriskonline.com)

What do businesses' resilience scores tell us?

As we move towards a post COVID-19 world, with every aspect of how, when and where to do business remaining under scrutiny, including how to manage the customer interface; to enforce or adapt employment contracts and report accurately, businesses across the board score their resilience to boardroom and reputation risks at the lower end of our spectrum, with a median of just 37% of US and UK boardrooms expecting to feel 'very prepared' to anticipate and respond to reputation risks in 2022, falling to 36% for boardroom risks.

The industry feeling particularly exposed to boardroom risk in the US is hospitality, with just 33% feeling very prepared to manage these risks. Whereas in the UK, it is manufacturing, retail, wholesale and food and beverage businesses that score the business risk category the lowest at 28%.

Perception of boardroom Resilience

Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to boardroom risk in 2022. Median line indicates the mid-point of the data set across all industries surveyed.

Perception of reputational Resilience

Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to reputational risk in 2022. Median line indicates the mid-point of the data set across all industries surveyed.

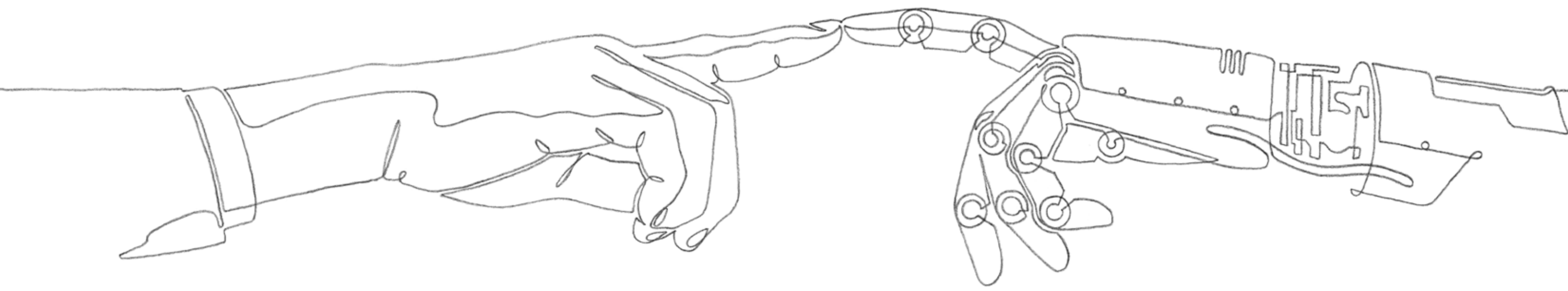
How can insurance support reputation risk transfer?

Insurance is a need, not a want. If the frequency and severity context is not real, companies will seek to retain the risk themselves. The question for this year therefore is when will boardroom and reputation risks achieve critical mass?

Only when boardroom and reputation threats fall into the high risk/low resilience quadrant of the risk resilience matrix will novel approaches to D&O and reputation risk find their place in the market.

> We must make best use of artificial intelligence (AI) and industry intelligence to support our customers to manage their reputation by benchmarking objectively against their peers to understand the material implications of what their stakeholders are saying in real time.

George Beattie
Head of Incubation Underwriting



Will employer and crime risks catch companies out?

As we look ahead, how prepared are companies for the complex and shifting liability landscape they now face?

Are business leaders under-playing employer risk?

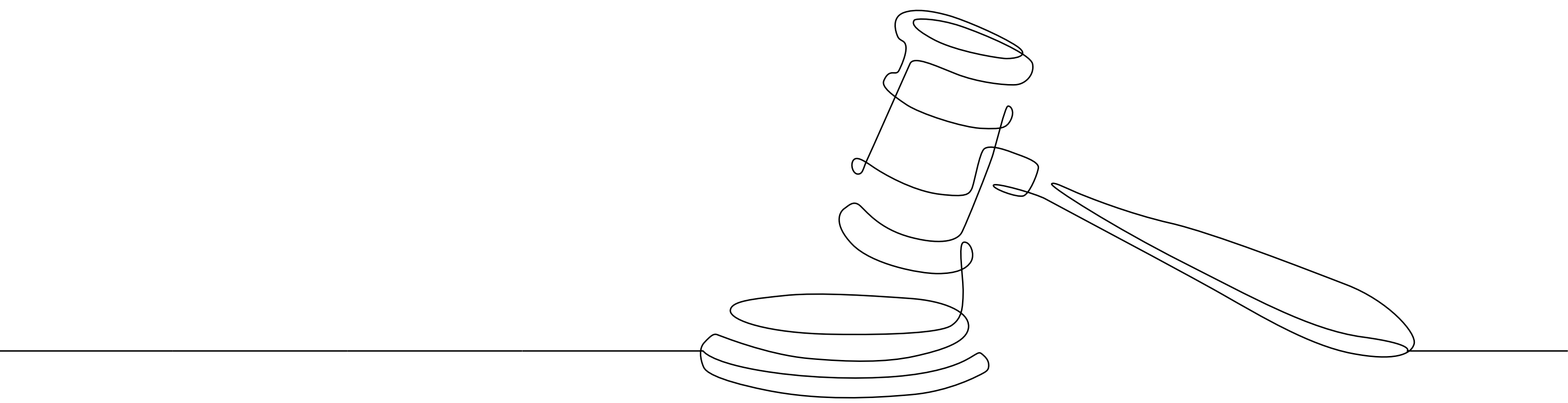
Employer risk is ranked moderately low by business leaders on both sides of the Atlantic and companies feel broadly resilient to it.

But in many ways the challenges could be just beginning. In a world where there are no longer any reliable 'right' answers, we may expect to see an increase in COVID-19 claims, including challenges over vaccine mandates in the workplace, wrongful termination, discrimination claims and even harassment.

Business leaders in the financial institutions and professional services sector expected to feel most exposed to employer risk overall in 2022, with 16% ranking it top. By contrast, real estate and construction business leaders were least concerned, with only 7% expecting to rank employer risk their top concern in this category in 2022.

Perception of employer risk

Percentage of sector leaders predicting employer risk would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.



Is resilience mis-placed?

COVID-19 has shone a spotlight on many of the long-term struggles faced by gig workers. While gig employment models offer flexibility, workers have limited access to unemployment benefits, health insurance or sick leave. Many workers have said they are not satisfied with the support they received from their companies during the pandemic, according to the World Economic Forum.[8]

Established businesses are also struggling to work out the best way forward particularly on working from home or hybrid working. In the banking sector different approaches are being adopted which typify a dilemma that faces every business[9], with some high-profile investment banks advocating or insisting on a full return to the office and others opting for a more flexible approach.

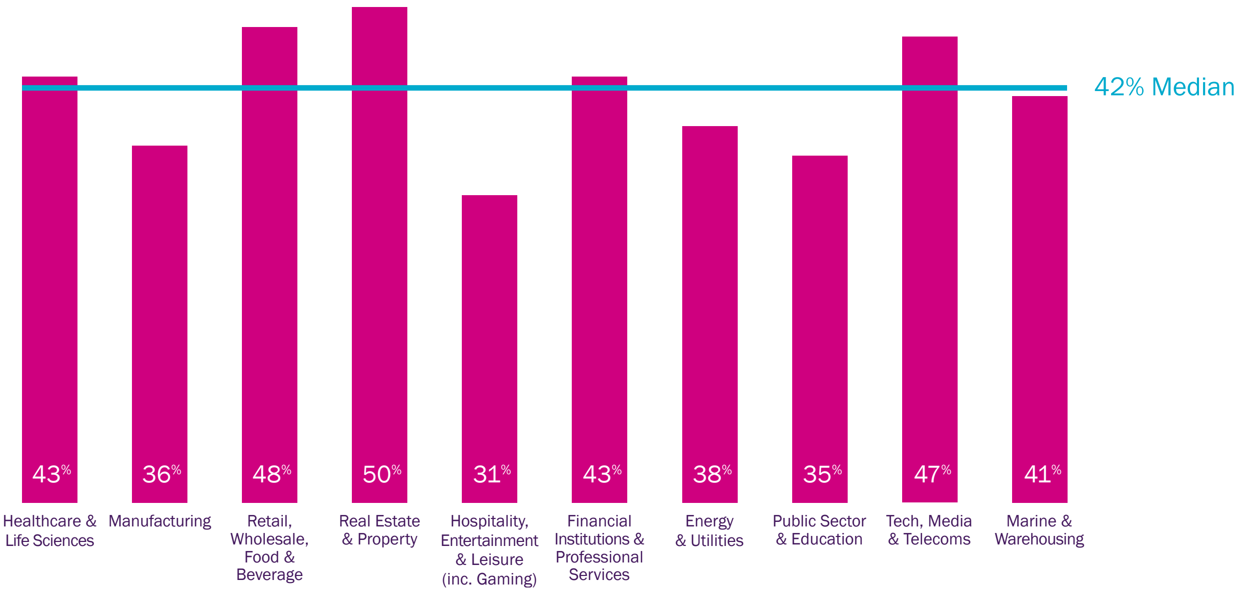
Some companies in more modern tech-led industry sectors are at the other end of the extreme stating that employees can continue to work from home "indefinitely".[10]

Challenges such as these, compounded by the impact of movements including #metoo and #socialjustice are set to impact employer liability claims and lead us to question whether business leaders' strong sense of resilience to employer risk is well placed.

Claims rose in frequency and severity through 2014-2018, with a consequent market hardening in 2019. Court closures due to COVID-19 slowed claims development and has had a direct impact on claims frequency, but as they begin to reopen, we are starting to see an increase in severity with recent settlement amounts far exceeding historic levels. As we enter a new claims cycle facing a fragmented US plaintiff bar and rising defence attorney costs, we hope claims frequency will remain stable, but the ongoing COVID-19 situation will make both frequency and severity harder to predict. We believe COVID-19 could create a myriad of issues around employment, plus third party exposures in relation to clients and business partners. Cases will start with employment practices liability and discrimination issues. But if the trend becomes wider spread, this could easily morph into management liability or boardroom issues if we see COVID-19-related class actions.

Wayne Imrie
Focus Group Leader - London Market D&O

Perception of employer risk resilience



Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to employer risk in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

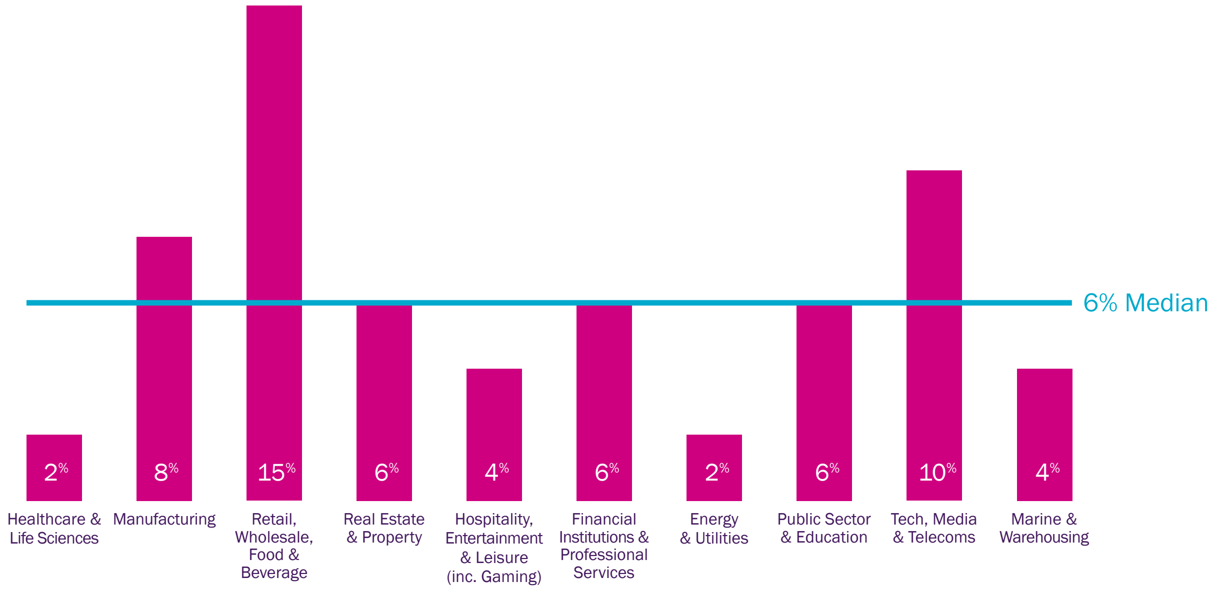
[8] Gig workers among the hardest hit by coronavirus pandemic | World Economic Forum (weforum.org)
[9] HSBC and Goldman Sachs take different approach to hybrid working model (humanresourcesonline.net)
[10] Twitter announces employees will be allowed to work from home 'forever' | Twitter | The Guardian

Are criminal risks yet to surface?

Only 6% of business leaders in the US and UK expected to rank crime as their top concern for 2022, though retailers, wholesalers and food and beverage businesses are a notable exception, with 15% overall rating this their likely top risk for 2022. At 41%, however, the proportion of businesses expecting to feel 'very prepared' to anticipate and respond to the risk is at the top of our range, with notably higher levels of confidence reported by US business leaders.

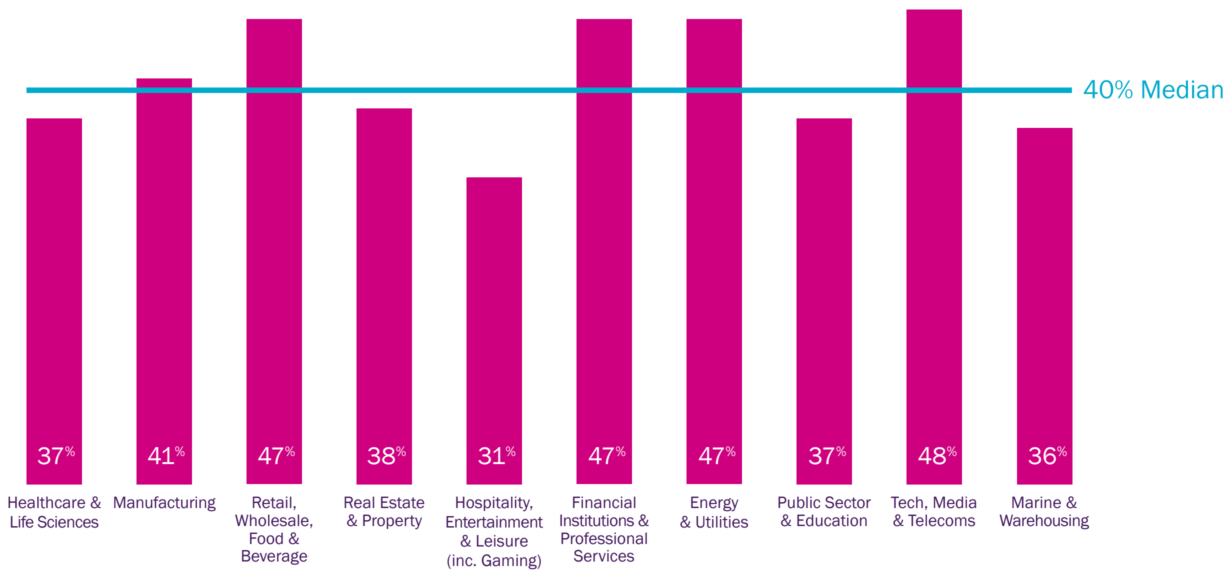
Only time will tell whether the recession returns and its historic association with crime is renewed.[11]

Perception of crime risk



Percentage of sector leaders predicting crime risk would be their top concern in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

Perception of crime risk resilience



Percentage of sector business leaders expecting to feel 'very prepared' to anticipate and respond to crime risk in 2022.
Median line indicates the mid-point of the data set across all industries surveyed.

[11] The Reasons Fraud Spikes in a Recession - TIME

About our Risk & Resilience research

During January and February 2021 we commissioned research company Opinion Matters to survey the opinions of over 1,000 business leaders and insurance buyers of businesses based in the UK and US with international operations. With a minimum of 40 respondents per country per industry sector, respondents represented businesses operating in:

- Healthcare & life sciences
- Manufacturing
- Retail, wholesale, food & beverage
- Real estate and construction
- Hospitality, entertainment & leisure (including gaming)
- Financial institutions & professional services
- Energy and utilities (including mining)
- Public sector & education
- Tech, media & telecoms
- Marine & warehousing.

Survey participants were asked about their views on four key categories of risk:

- **Technology** – including the threat of disruption, failure to keep pace with changing technology, cyber risk and intellectual property risk.
- **Business** – including supply chain instability, business interruption, boardroom risk, crime, reputational and employer risk.
- **Political & economic** – including strikes and civil disruption, changes in legislation and regulation (including ESG), economic uncertainty and war & terror.
- **Environmental** – including climate change and associated catastrophic risks, environmental damage, pandemic risk, food insecurity and energy transition risk.

Of the firms surveyed in both the US and the UK there was an equal split of respondents across company sizes of: $250,000 - $1 million, $1,000,001 - $10 million, $10,000,001 - $100million, $100,000,001 - $1 billion, more than $1 billion.

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This is the fifth in our series of Risk & Resilience reports, which explore business leaders attitudes to risk and their perceived resilience to these risks both in Q1 2021 and in 12 months' time. To view our other Risk & Resilience reports please visit: www.beazley.com/risk-resilience