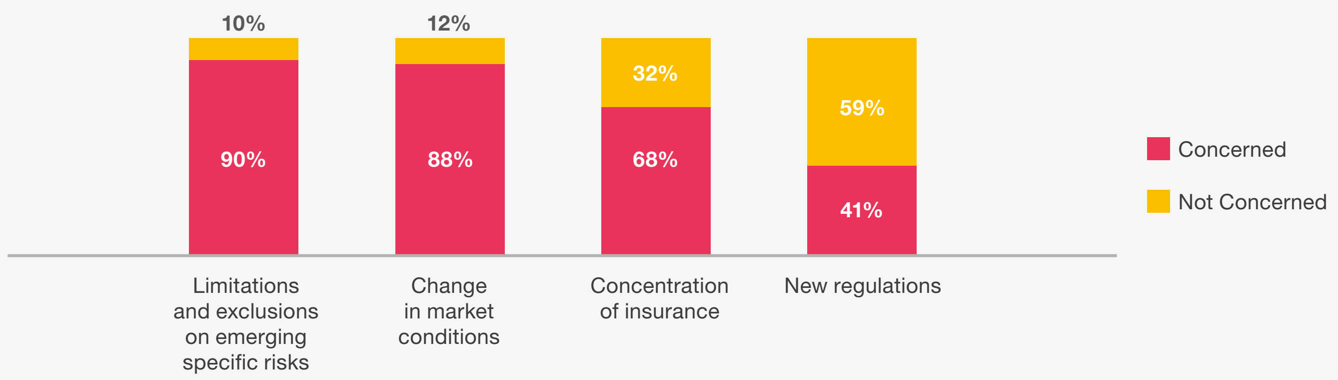
Part III: The risk manager facing hardening insurance market conditions

Tougher insurance market conditions are risk managers' top concern

Risk managers' concerns regarding the four following insurance market topics



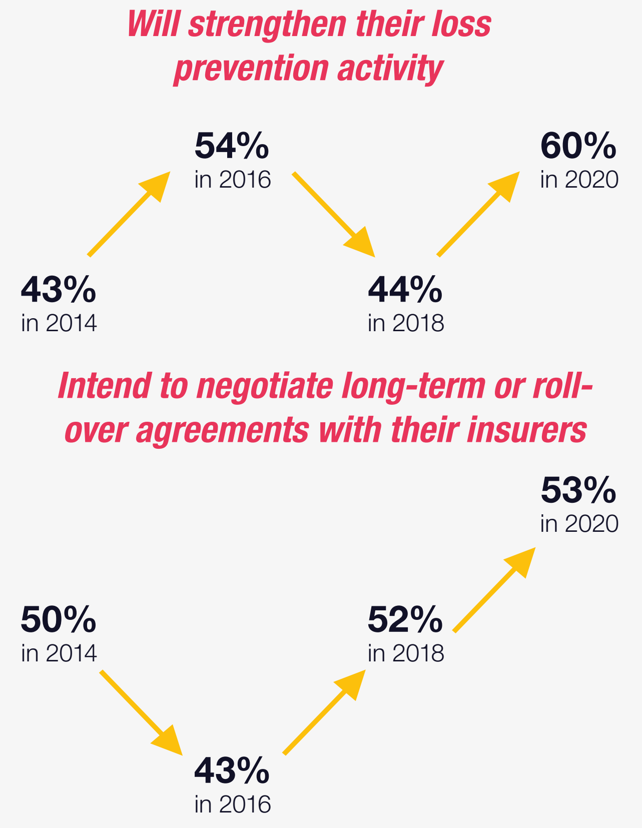
Risk managers with an IM profile regard limits and exclusions of emerging / specific risks in insurance contracts (90%) and change in market conditions (88%) as their main concerns about the insurance market.

The market was already hardening before the pandemic. Premiums had increased while coverages were contracting, with the Covid-19 outbreak adding even more pressure. Insurers are expected to add more restrictions and exclusions in property and casualty insurance policies. Some of major risks discussed in this report are likely to be affected by these tougher conditions.

Additionally, recent mergers and acquisitions among insurers and brokers are concerning IM profile risk managers about the concentration of the market and potentially reduced choice.

In this context, risk managers will focus on two main changes in relation to insurance programmes:

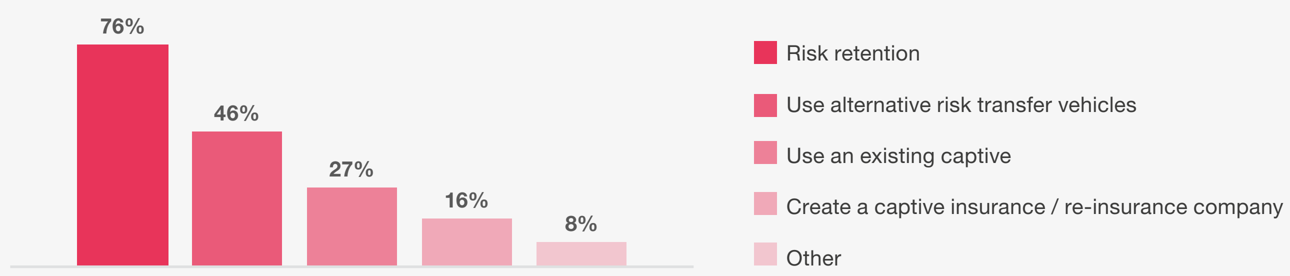
- Strengthen loss prevention activity (60%): highest increase in loss prevention activity since 2014. This demonstrates a desire for reduction of the company's exposure and balance sheet protection;
- Negotiate long-term agreements or roll-overs (53%), which suggests that risk managers expect further changes in pricing levels and wish to invest in a long-term relationship with their insurers.



The rise of captives confirmed

The analysis of the risks confronting European companies and the hardening insurance market highlight the growing concerns of risk managers regarding emerging risks and their need for viable solutions.

Over the next 2 years, what will be your strategy with regard to risks which are difficult to place on the insurance market?

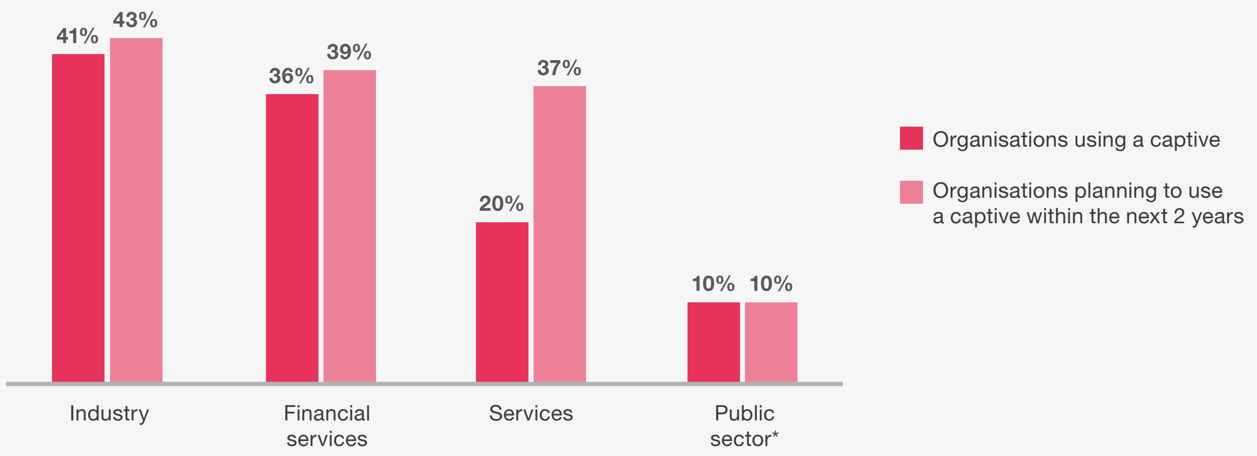


While risk retention and alternative risk transfer vehicles are seen as the main methods for dealing with a shortage of capacity for emerging / specific risks, the use of **captives is the strategy that increased the most in 2 years.** In 2018, 15% of respondents were considering using captives. Now 43% are considering this solution. Indeed, in 2020:

- 27% of risk managers say they will continue to use an existing captive by 2022 for difficult to place risks (1% in 2018)
- 16% plan to create a captive insurance / re-insurance company (14% in 2018)

This finding demonstrates the attractiveness of captives when risks are difficult or very expensive to place on the insurance market. It reinforces FERMA's emphasis on the value of captives as a genuine risk management tool for organisations. 37% of risk managers continue to show confidence in captives (use a captive dedicated to their company or share a captive with other organisations).

Organisations using a captive or planning to use one within the next 2 years by sector of activity

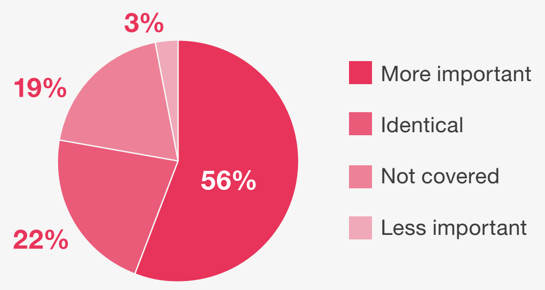


** Public sector is less representative as only 4% of respondents (refer to survey sample).*

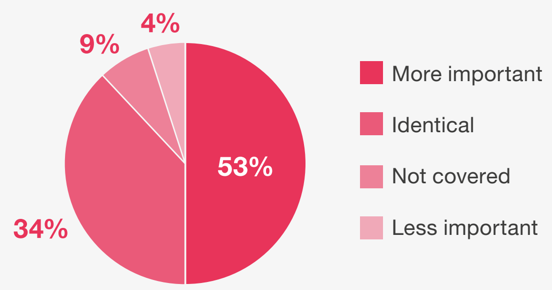
Risk managers' answers to the question about their expectations of their captives' activities over the next 2 years confirm the view of captives as a valuable tool to manage traditional and non-traditional lines that are difficult to cover. The respondents believe that their captives will be more important across all lines of business.

Industry is the main sector of activity that currently uses captives but also the 1st sector that plans to use a captive within the next 2 years. The financial services are closely following, and services sector organisations are moving towards this solution as only 20% are currently using a captive but 37% plan to use one within the next 2 years.

Use of captives for non-traditional lines of cover (e.g. cyber threats, employee benefits, etc.)



Use of captives for traditional lines of cover (e.g. general liability, property damage, etc.)



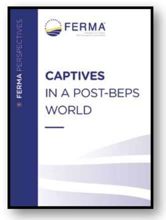
The captive, a collaboration between ERM and insurance management?

A captive is an efficient risk management tool that can bring together ERM and insurance management methodologies, especially in the need for a clear understanding of risk exposure to drive risk and insurance management decision-making. In a hard insurance market, risk managers may have to make sensitive decisions about financing more risk with a captive because of the market's underwriting restrictions or pricing.

Hardening insurance market conditions should put ERM/IM synergies high on any organisation's agenda, especially for all questions around the use of captive companies. How much self-insurance can we take? How do we differentiate a "must-have" from a "nice-to-have" cover? What is the actual exposure and how does it match the insurance market's price for it?

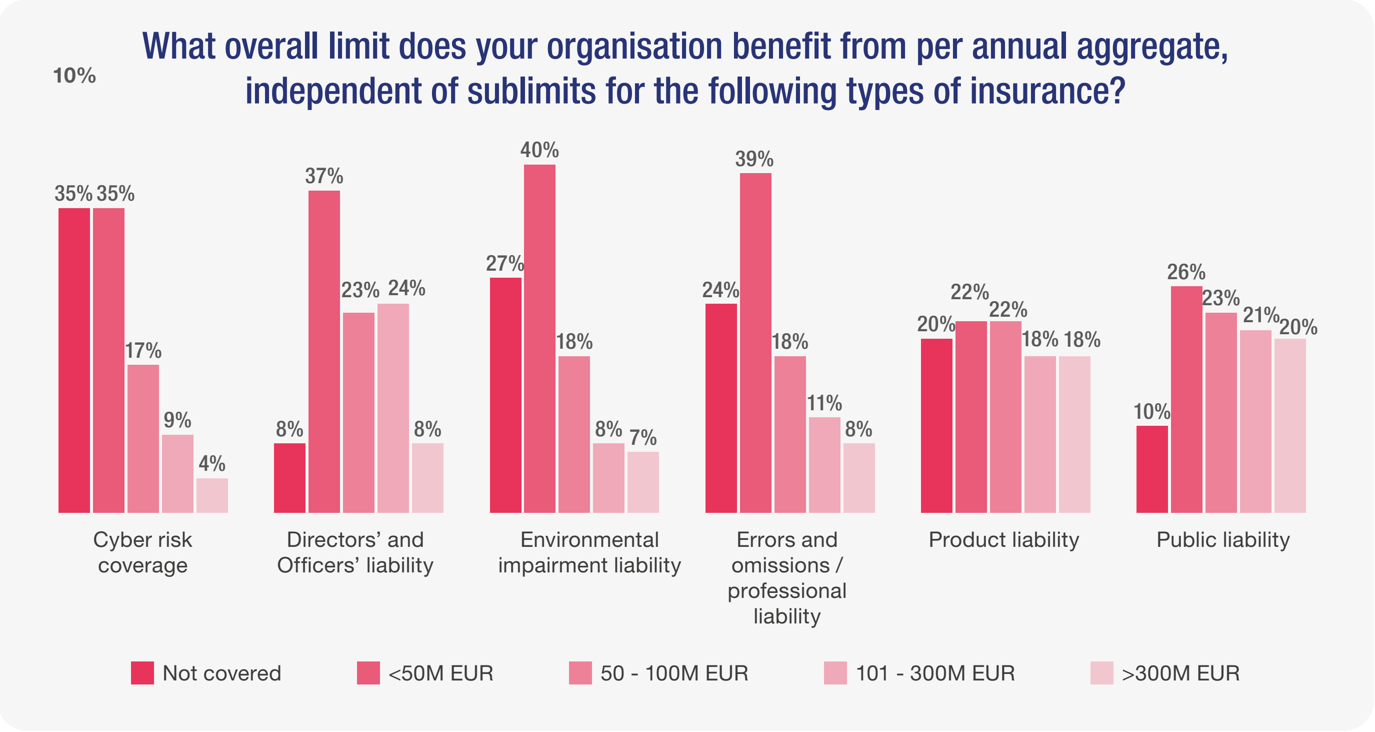
As ERM assesses the exposure and allows the organisation to set its risk appetite, it is crucial for ERM and IM to efficiently liaise and assess these questions holistically. In doing so, they can provide their entire organisation with a way to expand and mutualise group risks, build relevant experience data, leverage discussions with traditional insurance markets and offer added value to customers.

***FERMA Perspectives: Captives in a Post-BEPS World* explains how multi-national organisations can use captives effectively for their risk management programme in a modern regulatory environment.**



Insurance management purchasing contrasted

The limits of insurance cover that organisations buy can be different from the perceived risks.



Despite the high ranking of cyber threats and data fraud and theft in the top 5 risks for the next 12 months, 35% of respondents bought no stand-alone cyber coverage and stand-alone cyber risks policies had the least coverage for limits above €50 million.

For D&O more than half (56%) purchase limits of €50 million or more.

"As a result of the impact of COVID-19, we expect organisations will look for higher limits for their D&O coverage." FERMA

"Insurance has been an efficient tool to finance the consequences of risks over the last 20 years, but the hardening market makes it less cost-effective for organisations. The shortage of insurance capacity for some exposures will also push risk and insurance managers to explore other ways for financing risks.

Within this context, the use of captive (re)insurance companies will undoubtedly rise. Captives allow companies to buffer insurance market conditions thanks to a risk financing based on the technical premium for low- to medium-impact risks. The pricing consequently gives more weight to the unique risk performance of the organisation than the insurance market typically does."

Laurent Nihoul, General Manager – Group Head of Insurance, ArcelorMittal, Group Finance and FERMA Board member