

Understanding the modern risk environment

What are the emerging risks of today? The COVID-19 pandemic has all but overshadowed the classic topics that industry engages in, such as NatCAT and supply chain and cyber, but as that shadow begins to recede, are newer risks being brought to light? Willis Towers Watson, in conjunction with Asia Insurance Review, brought together a panel of risk specialists to discuss the emerging risks that the industry should take note of.

By Ahmad Zaki

It is easy to just focus on the pandemic and all the new problems and disruptions it has brought about to the world at large, but the risks that existed before 2020 are still in play today – risks such as NatCAT and cyber.

“A major factor in current emerging risks is the asymmetry. Power that was once only wielded at the state level is now in the hands of small groups and individuals to cause massive harm. We see their attack capabilities strengthening and our defensive capabilities struggling to keep up. This is an era of distributed empowerment that we’re in whereby anyone with a laptop could attack even without being a super hacker,” said Willis Towers Watson (WTW) regional director of risk and analytics and head of Southeast Asia David Hill.

Apart from a few distressed sectors, many large corporations ended 2020 reasonably well financially, having adapted to the disruptions caused by COVID-19. Whilst having strong capital bases and government support certainly helped, being agile and decisive are key success factors”, said WTW director of strategic risk consulting partner of Asia James Wong. “We’ve learned the importance of understanding the risk and opportunities presented to adapt to the changing environment and, most importantly, a well-looked after workforce to ride through all the challenges,” he said.

There has been an increased emphasis on cyber and supply chain risk, he said. While these risks are not necessarily new or regarded as an emerging risk, it is when the world starts seeing a systemic risk like a pandemic that these risks have downstream effects.

“A couple of things we learned, after more than a year or so, is that these existing risks can manifest themselves in much more profound ways under drastic circumstances. Many risks are interconnected, and organizations with a developed risk culture where risk ownership and awareness are spread across the business can respond to these changes quickly and more appropriately,” he said.

Ships being made obsolete

Despite the turmoil of 2020, many organizations still classified climate change to be the number one risk facing their industry, given the long-term nature of the risk and the wide-ranging impacts it can have.

Specifically for the shipping industry, climate change is an existential risk, with the pressure to decarbonise and reach a net-zero status within a few short years. This makes obsolescence risk one of the most important risks that the industry faces.

“As an example, a new LNG carrier costs about \$180m and are built to last 40 years,” said BW Group executive vice president of corporate services and general counsel Nicholas Fell.

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“How can we invest that kind of money if we don’t know whether these ships have a commercial lifetime of more than 10 years?”

There is an added pressure from regulators. The shipping industry is also expected to find and deploy new fuels, which have yet to be discovered or adequately developed. The current ‘new’ fuel the industry is expected to utilize – LNG – is still considered a ‘bridge’ fuel, meant to be a stopgap measure.

“But what do the regulators expect that bridge time to be? Is it five, 10, 20 or 30 years? We are expected to find and deploy new fuels like ammonia methanol, or hydrogen, traditional wind and biodiesel and so on, but the technology is not there yet,” he said.

Increasing demands on efficiencies on the industry by regulatory bodies means that current fleets could face obsolescence within a few short years, discouraging shipowners from purchasing newly constructed vessels.

Innovating to face systemic risk

An observation that has been proven true is how systemic risk is not a natural fit for insurance, as there is no insurer with a big enough balance sheet or capital to absorb the potential losses associated with many insureds having large losses at the same time.

“However, there is still room for innovative new solutions and continuous enhancement of existing products. Insurance will continue to work best for well-defined low frequency, high impact events where it is efficient for insureds to transfer the risk and for the insurers to underwrite on a portfolio basis,” said Mr Wong.

With the constant shift towards intangible assets over the past 20 to 30 years, there will be a greater appetite and demand from the market for new and more sophisticated solutions. It is expected for insurers to commit greater rigour and resources in formulating these products and solutions.

“I would say in many insurance and risk management departments, there's still an awful lot of manual work that's done. I know there is the ability to automate a lot of those tasks,” said Mr Fell. “I feel that the insurance industry can really work well in partnership with companies like ours to reduce that manual work, to make things work in a much more automated, efficient fashion.”

He also noted that there is a lot of innovation coming from the P&C sectors as well as from the renewable energy sector and there is a possibility for transplanting those innovations into more traditional sectors.

Evolution of the corporate risk role

Within an organization, the corporate risk function typically focuses on credit and operational risks, but the richer risk environment has forced a broadening to the role. A trap that some might fall into is expecting emerging risks to be completely new and unique. However, Mr Hill noted that emerging risks can still be expected to fall into the same categories that the industry has been using for decades.

“What is really necessary is not only to recognize new risks in those categories, but also expect the consequences of new risks to change considerably,” he said. A familiar example is catastrophe events that had global impacts, such as the 2011 Thailand floods. This was, according to Mr Hill, due to the extended enterprise business models, the complexity of supply chains and concentration of technologies.

“Impact is exacerbated by inherent vulnerabilities, complex interactions, and the increasing application of technology. In terms of response, what is absolutely essential is for companies to have a strong understanding of where their exposures are and what the impacts can be,” he said. Traditional credit market and operational risks are still very relevant today, but most risk managers are no longer looking at them in isolation. It is vital to consider the

interconnectivity, but at the same time, it is also difficult to look at how a single event or overarching type of risk can have effects across the entire organization.

“Interconnectivity greatly complicates risk evaluation and consequently the need for succinct data, and use of modelling and scenario analysis is increasingly common. It is nonetheless relevant to emphasise that aside from catastrophe scenarios, the biggest risk to an organization can be the failure to respond or adapt to entrenched technologies as they tend to obsolescence. And obsolescence is accelerating,” he said.

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