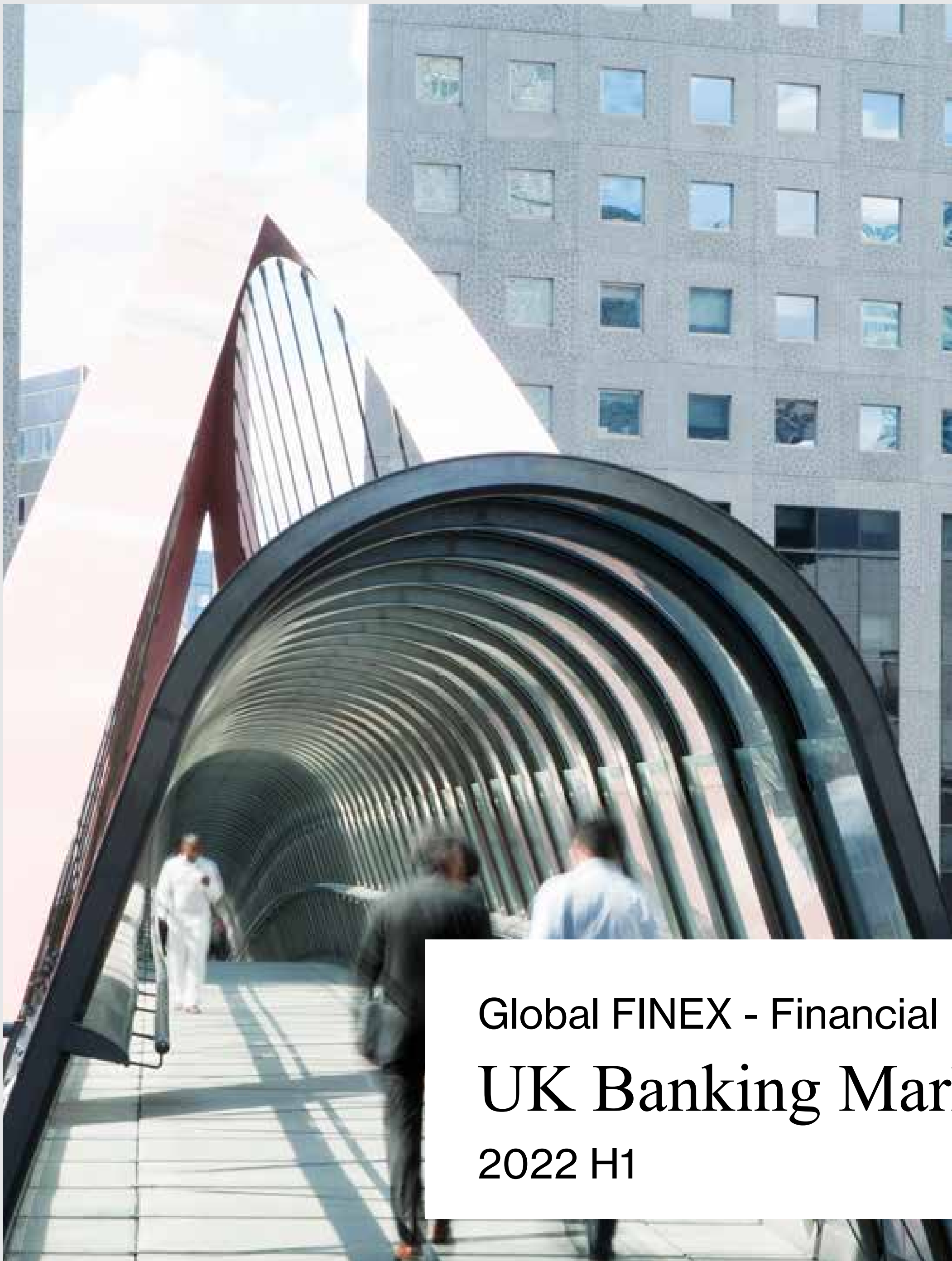

Global FINEX - Financial Institutions

UK Banking Market Update

2022 H1

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Executive summary

Welcome to FINEX UK's Banking market update. In this issue, we share our experiences for the first half of 2022 and our outlook for the second half, whilst also discussing some of the emerging issues that the Banking sector are likely to be navigating.

During this first half of the year, the lingering effects of COVID-19 began to fade with the lifting of government restrictions, many people returning to their offices, at least for part of the week, and life beginning to resemble something close to normal. The difficult market conditions that the banking sector has endured whilst procuring their financial lines insurances over the past two years has much improved. The combination of aggressive insurer growth targets and an injection of new capital has meant that healthy market forces have returned, and there is a general sense from insurers that portfolios are in a more sustainable place. However, Cyber insurance is the notable exception to these positive trends.

There are however some headwinds with which to contend, including the cost of living crisis, the end of government support for businesses, and of course the crisis in Ukraine. Environmental, social and governance (ESG) remains high on the agenda for banks, governments and regulators worldwide, and we expect to see continuing close insurer scrutiny on how banks are managing these issues.

We hope that this update provides meaningful guidance to clients when preparing for upcoming renewals, managing stakeholder expectations, and assessing the impacts that industry events may have on your financial lines programmes. At WTW, we remain focused on working closely with our clients and delivering excellent service, and utilising our market leading data and analytics, risk insights and our experienced team to support clients to achieve the best outcomes. Even with the moderation in the market that we have outlined, we continue to work with our clients to explore the use of captives, alternative programme structures, self-insurance and risk financing portfolio analytics to better manage programme volatility in the future.

Should you have any questions or wish to discuss any of these issues in greater detail, please do contact me or a member of your WTW team.

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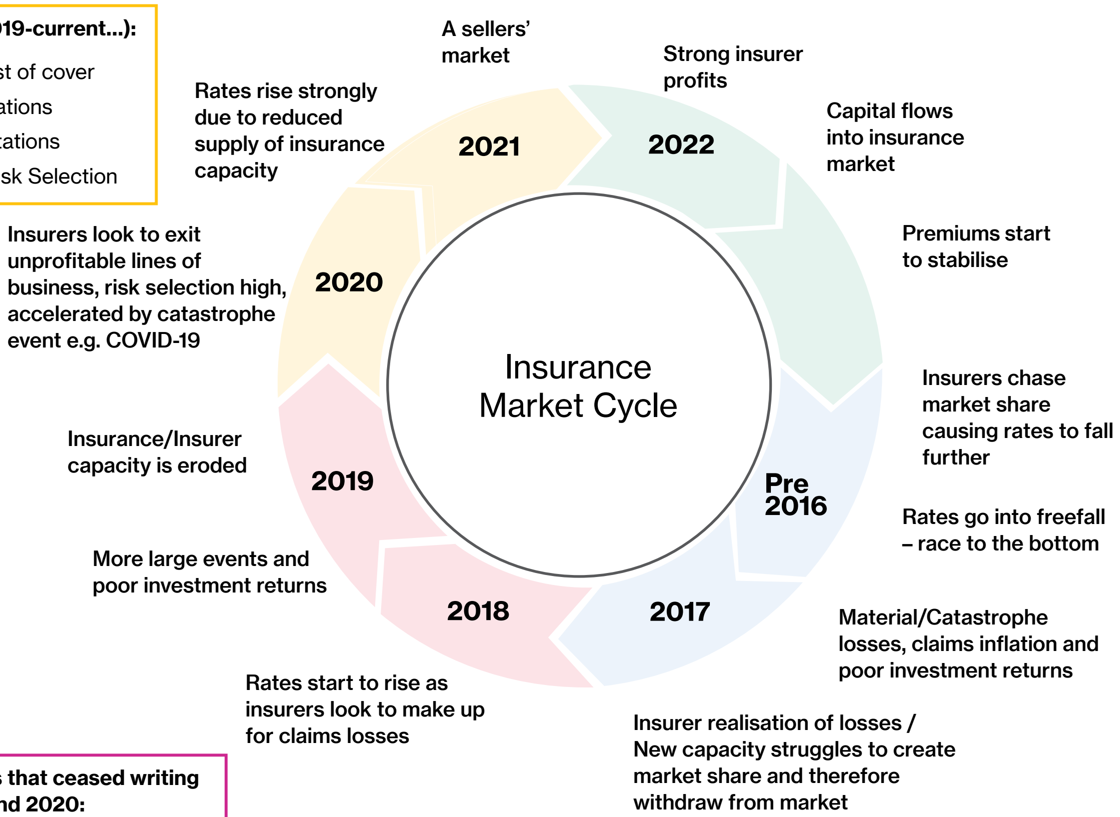
Current insurance market cycle ‘radar’

Putting things into perspective for 2022

- Premium increases are levelling off and if there is market appetite, flat renewals are very achievable.
- Insurers will still look to increase premiums for clients whose risk profile has increased down to factors such as substantial growth, opening offices in North America and the like, or having suffered claims.
- We expect new insurers that have entered the market over the last 12 months or so to start aggressively competing for market share.

Hard market (2019-current...):

- Increasing cost of cover
- Capacity limitations
- Coverage limitations
- Heightened Risk Selection



London markets that ceased writing FI risk in 2019 and 2020:

- AXA XL
- Argo Global
- Channel Syndicate
- Neon Syndicate
- Nexus
- RSA
- Startpont
- Vertex
- Vibe

Soft market (2000 – 2018):

- Decreasing cost of cover
- Choice of capacity
- Broadening coverage

Financial Lines market update:

Costs and retentions

Premium Rates: With the exception of Cyber and Employment Practices Liability, we are seeing favourable results for our clients, with renewals ranging from flat to approximately 10% lower than the previous policy period, for clean and well managed risks. The situation however is fluid, and we expect further improvement as the year progresses. Where a programme includes BiPar pricing (where different insurers charge different pricing on a layer), there is a strong focus on reducing this outlier pricing, which will bring clients a higher overall programme saving. Clients with adverse claims records or distressed portfolios, however, may still see modest increases. Some territories, for example Australia and Israel remain challenging.

Excess Rates: Increased limit factors (ILFs) (the discount applied to excess layers) underwent significant rate rises in 2020 and 2021, as insurers looked to apply corrections for sizeable excess layer discounting during soft market conditions. Insurers are now generally confident that these corrections applied in the previous years adequately reflect the catastrophe exposures, and so again we are seeing a favourable response ranging from flat to approximately 10% lower than the previous policy period.

Retentions: Corrective actions taken in the previous two years have moderated, and on the whole, some insurers are not looking to increase retentions further.

Markets

- Newer capacity which entered the marketplace over the past couple of years continues to build momentum. Whilst these markets entered cautiously at first, perhaps filling in some gaps in Excess Layers, some are now taking primary positions. Insurers are focused on new business and growing their portfolios, some with aggressive new business targets, which is driving competition, putting pressure on pricing and is generally favourable for clients.
- Examples of this newer capacity include the first ever algorithm-based Syndicate that aims to provide clients with security, sustainability and scalability.
- Beazley Group launched the first Lloyd's ESG syndicate 4321[1] at the beginning of this year which is able to provide an additional £2.5m of capacity, on layers where the Beazley main syndicate already participates, for clients who have a strong ESG profile. Eligibility for this is assessed by Beazley's 3 rating partners, and allows clients to embed ESG into their insurance procurement.

We believe that this approach will be a growing trend across the marketplace, as clients' boards and risks managers are increasingly scrutinising their supply chain to ensure it meets their ESG standards, with insurance buying being a key part of this.

Coverage

- **Stable:** Broad coverage is generally still available, and maintaining the breadth of coverage currently enjoyed, without new restrictions being applied, should be considered a good result. However, the following are areas of challenge:
  - **Boundary Cyber Risks:** the application of Silent Cyber exclusions/endorsements to non cyber policies (Crime, Professional Indemnity and D&O policies) in the previous two years has clarified the intersection and overlap of cyber risks across different coverages. In view of the number of ransomware attacks, where cyber related extortion coverage is provided as part of a Crime policy, this continues to be challenged as Insurers look to limit their overall cyber exposure. We recommend that clients review all cyber-related coverage across their portfolios to ensure it is appropriate and to ensure alignment and integration between different policies.
  - **Crypto currency exclusions:** Insurers are focused on understanding crypto/digital asset exposures for all types of financial institutions, and a small number have applied specific exclusions to Crime policies. Whilst many banks have cautiously approached crypto/digital assets due to a lack of regulatory framework, there is a growing demand from clients for solutions in this area. We recommend that companies review their exposure and near and long term strategy for use of crypto/digital assets with their broker in order that solutions can be developed.
  - **Russia/Ukraine:** Insurers are keen to understand how clients are assessing their direct and indirect exposures to Russia and Ukraine, how this is being monitored, and what corrective measures are being taken. Sanctions exclusions are being imposed but some are far more reaching than others. We recommend reviewing these with your broker to ensure that, where applicable, the most appropriate clause is applied.
  - **ESG:** Sustainable lending, greenwashing, evolving global regulatory regimes, natural catastrophe concentration and disclosures are growing areas of underwriting focus. We recommend that companies take the time to articulate their ESG framework, strategy, governance and initiatives to demonstrate their progress in this area.

1. https://www.beazley.com/news/2021/beazley_launches_lloyds_first_esg_syndicate.html

Capacity

- **Stable:** Insurers are generally comfortable with current capacity and attachment points in view of the corrective measures taken in the past two years. Some insurers however are looking to increase capacity, usually on a ventilated basis, and attach on lower layers of a programme tower, particularly as rates compress higher up the programme.
- **BiPar:** Those insurers who applied BiPar pricing in the harder market conditions of the past year are increasingly seeing pressure on their positions, with the increase in competition across the marketplace.
- **New Business:** We see increasing competition for new business as insurers look to grow their portfolios and meet aggressive new business targets.

Renewal Planning

Although renewals are less challenging than previous years, we still recommend allowing plenty of time. Beginning the process early allows for engagement with senior stakeholders, provides more time to gather renewal information and allows space to negotiate with the market effectively. Early planning should not just focus on data gathering and quoting, but also on undertaking a thorough review of coverage, the policy limits required, and ensuring risk optimisation. Insurance purchase should remain aligned to your evolving risk profile.

Banking industry trends:

Key issues to watch

Cost of Living Crisis

Observation:

The financial impact of the pandemic, the crisis in Ukraine, the surging prices of oil and energy, and supply chain issues as a result of China's zero tolerance to Covid-19, are all converging to create a cost of living crisis. Inflation in the UK is at a 30 year high, and we have had four consecutive interest rate rises since December 2021, as the Bank of England attempts to head off a recession. This comes at the same time that government support given during the pandemic is being withdrawn, and National Insurance, fuel and food price hikes. Families and businesses alike will struggle to meet their financial obligations which will likely directly impact the banking sector.

Concern:

Historically, challenging economic conditions and times of high unemployment, correlate with greater claims activity across financial lines.

Suggestion:

Be prepared for additional scrutiny from Insurers around the strength of loan portfolios, Know Your Client (KYC) checks, dual signatories, internal controls and procedures, requirement for employees to take holidays.

Russia and Ukraine

Observation:

In response to the crisis in Ukraine, allies of Ukraine imposed a number of severe sanctions intended to have both immediate and long term effects on the Russian economy and financial system. Additionally, Russian banks have been blocked from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system, the financial-messaging infrastructure linking the world's banks. Such actions against Russia have created significant volatility and uncertainty that is being felt throughout the global financial markets.

It was reported that several Ukrainian government websites were offline on 23 February 2022 as a result of a mass distributed denial of service attack, and that a number of banks were also impacted. Russia is of course suspected to be involved in this attack; however, this has not been confirmed. The outcome of a cyberattack can cause significant financial, operational and reputational impacts to financial institutions.

Concerns:

1. **Errors:** The actions taken against Russia have created compliance, divestment and settlement challenges for institutions with exposure to Russia, which may lead to increased claims activity under Directors & Officers (D&O) and Professional Indemnity policies.

2. **Extortion:** Extortion coverage has been widely available under crime policies for many years. Over the last decade however, the coverage has expanded to include more cyber-related perils due to the rise in ransomware attacks. As these attacks evolved and became more sophisticated, this led to organisations considering stand-alone cyber insurance policies as a solution to protect their business and their customers' data. It was apparent that there was an overlap between crime and cyber policies, which would need to be addressed. Due to the rise in cyberattacks – and more specifically ransomware attacks – some insurers are looking to exclude cyber extortion cover from crime policies and to signpost coverage, as well as any potential recovery of loss to a cyber policy.

3. **War and Terrorism Exclusion:** Where coverage remains within a crime policy, given the current Russia-Ukraine crisis, some consideration should be given to the war and terrorism exclusion. Some of the ransomware attacks that took place prior to this most recent crisis were being conducted by state-backed entities, including some cases perpetrated by Russian state-backed entities. This has brought the war and terrorism exclusion into the limelight. Most, if not all, crime policies and cyber policies have a war and/or terrorism exclusion. The language can vary from policy to policy and jurisdiction to jurisdiction and, as such, so can its interpretation.

4. **Sanctions Clauses/Territory Exclusions:** Sanctions Clauses/Territory exclusions being imposed vary from insurer to insurer, with some being far more reaching than others, going well beyond sanctioned matters. Furthermore, it should be noted that the first securities class action lawsuit concerning the enforcement of economic sanctions imposed on Russian oligarchs in the wake of the Russian invasion has been filed, and similar actions may follow.

Suggestion:

Clients should anticipate probing questions around exposure to Russia and other sanctioned territories and for a sanctions clause to be imposed if not already in place. This should be reviewed carefully with your broker. Clients should also conduct due diligence on any extortion coverage, and review their current war and terrorism exclusion under their crime and/or cyber policies.

Banking industry trends:

Key issues to watch continued

Digital Transformation and Cyber Security

Observation:

Digital transformation within the banking industry has really taken off during the past decade with the advent of online banking, mobile applications, and the creation of challenger banks and disruptors from outside of the traditional banking sector. Further, digitalisation is focused on enhancing the customer experience and ensuring that the banks can develop and maintain a connection to the customer in the absence of in-branch personnel.

Open Banking, Payment Services Directive II (PSD2) and the increasing use of Application Programming Interfaces (API's) and, the array of potential losses and liabilities that could arise from API abuses, means heightened exposure for the banking sector.

On the horizon is the potential for national digital currencies, fuelled by the rise in new technology and accelerated by the COVID-19 pandemic, as we move away from the use of cash. Currently, more than 90 countries are actively researching, piloting and in some cases implementing, a new form of government money known as CBDC (Central Bank Digital Currency). We discuss this topic further in our article Making change: Advancements in national digital currency and implications for financial institutions.

On April 4, 2022, the UK government announced plans to become a "global hub" for the cryptoasset industry[2] with proposals for the regulation of stablecoins, development of an NFT (non-fungible token) issued by the Royal Mint, together with other measures, including the introduction of a "financial market infrastructure sandbox", to help firms experiment and innovate.

Concern:

Cybersecurity and resiliency in the banking sector remains a key focus in all jurisdictions, with scrutiny coming from regulators, business counterparties and investors in their search for evidence that cybersecurity risk management policies and procedures are robust.

There is an ever growing patchwork of cybersecurity regulatory requirements around the world that must be carefully navigated.

The potential to run foul of these regulations, combined with the increasing cyber risks associated with the Russia/Ukraine crisis, has raised concerns in both the Cyber and the Crime, Professional Indemnity and D&O markets. The penalty for running foul of the regulations is high, both financially and reputationally.

All of this is happening at a time when the Cyber insurance market remains challenging due to the ransomware pandemic, and many insurers are imposing minimum standards of cyber hygiene before even considering offering terms. Certain sectors considered at increased risk from the Russia/Ukraine crisis, including financial institutions, may also not be offered terms.

Suggestion:

- Review each of your financial lines policies in line with your digital risk profile to ensure that activities and exposures are covered as broadly as possible and are in line with your risk appetite.
- Consider the purchase of a Cyber insurance policy if Cyber insurance is not already part of your risk transfer strategy.
- Understand the limitations/boundaries of each policy and ensure that coverages dovetail as far as possible.

2. https://www.gov.uk/government/news/government-sets-out-plan-to-make-uk-a-global-cryptoasset-technology-hub

Banking industry trends:

Key issues to watch continued

Financial Crime

Observation:

Financial Crime continues to be a prominent risk for banks and other financial institutions who hold significant financial deposits. Some of the biggest threats remain sophisticated social engineering schemes including phishing, vishing, and malware, that dupe victims into providing confidential information and access to bank accounts. Technology, and a difficult-to-police dark web, allow fraudsters to evolve schemes as banking controls improve in reaction to losses. Tackling financial crime requires vast resources and evolution of methods to control losses; with such significant profits to be made globally, financial crime is expected to be an ever present item on board agendas.

Concern:

Banks owe a general duty to their customers to take steps to prevent fraud when executing payment instructions, and this was recently confirmed in the Court of Appeal (Sir Julian Flaux C, Coulson and Birss LJJ). The appellant had, as part of an "authorised push payment" scam, been persuaded by a fraudster to instruct their bank to make a transfer of funds to accounts under the fraudster's control.

The bank had sought to argue that the so called "Quincecare Duty" was confined to protecting against the risk to a corporate customer of a fraud by its own directors. The Court of Appeal however held that the duty was not so narrow. Given the prevalence of authorised push payment scams, the Court of Appeal's judgment is important and will be welcomed by victims of financial fraud, and potentially opens the floodgates to similar claims against banks[3].

Suggestion:

Review the terms and conditions of your Crime and Professional Indemnity policies, to ensure that coverage is as broad as it can be, any conditions are complied with, and the boundaries are fully understood.

3. Birss LJ, Philipp v Barclays Bank UK Plc [2022] EWCA Civ 318, [30] www.casemine.com/judgement/uk/62322e00b50db9fc0c92605b

Banking industry trends:

Key issues to watch continued

Environmental, Social and Governance (ESG)

Observation:

Climate

ESG remains, and will continue to be, an area of regulatory focus for 2022. From 1 January 2021, the Financial Conduct Authority (FCA) set out a requirement for all premium listed UK companies to comply with Task Force on Climate-Related Financial Disclosures (TCFD) and disclose how they are considering the impacts of climate change, and on a comply or explain basis report against the TCFD framework[4]. The framework aims to drive real and significant change in how companies think about, and prepare for, climate impacts on their business. Rather than a simple reporting exercise, complying means having and presenting a clear understanding of the climate change risks and opportunities and, critically, showing how these might impact the financial statements of the organisation. Similar requirements have been rolled out around the world.

In the US, the Securities Exchange Commission (SEC) has recently proposed a sweeping new rule[5] which would potentially drastically increase the climate-related disclosures which the SEC requires, including Scope 3 disclosures relating to the greenhouse gas emissions of companies throughout an entity's supply chain.

Diversity and Inclusion

The FCA has published a policy statement (PS22/3)[6] setting out rule changes that will require premium and standard listed companies to make disclosures in relation to gender and ethnic diversity at board and executive management level for financial years starting on or after 1 April 2022. Under the new Listing Rule requirements, premium and standard listed companies will have to include in their annual report a statement confirming whether they have met specified board diversity targets as at a reference date, chosen by the company, in the financial year. The targets are that:

- the board comprises at least 40% women;
- at least one of the Chair, CEO, CFO or Senior Independent Director is a woman; and
- at least one member of the board is from a minority ethnic background (that is one of the ethnic background categories recommended by the UK Office for National Statistics, other than a white ethnic group).

Concern:

Increasing regulatory oversight in the sector, and the complexity of due diligence for ESG-related activities and reporting, could result in increased regulatory investigations. Climate protestors and activist shareholders are applying pressure for lending to be sustainable and responsible. Litigation and public appetite to hold banks to account for so called "dirty lending" may result in increased defence costs, if not indemnity costs.

Suggestion:

Insurers will expect banks to be focused on ESG and clients should be prepared to articulate their ESG strategy and risk assessments. As ESG activities and reporting gain momentum it is important to monitor any corresponding impact on Financial Lines insurances to ensure that coverage remains as robust as possible, particularly your D&O policy and the breadth of coverage provided for Regulatory Investigations.

4. https://www.fca.org.uk/news/news-stories/new-rules-climate-related-disclosures-help-investors-clients-consumers

5. https://www.sec.gov/news/press-release/2022-46

6. https://www.fca.org.uk/publication/policy/ps22-3.pdf

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Disclaimer

Each applicable policy of insurance must be reviewed to determine the extent, if any, of coverage for losses relating to the Ukraine crisis. Coverage may vary depending on the jurisdiction and circumstances. For global client programs it is critical to consider all local operations and how policies may or may not include coverage relating to the Ukraine crisis.

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