

2017 EMEA Financial Institutions Industry Report

Powered by the Aon Global Risk Management survey and Aon GRIP



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Unless otherwise specified, all data has been sourced from the Aon Global Risk Management Surveys.

Introduction

We live in an era of unprecedented volatility. The risk environment for financial institutions continues to evolve rapidly as the magnitude, scope and complexity of risk increase globally.

The disruption to financial markets in the last decade confirmed that managing risk is key to achieving growth and profitability in an environment with more regulation, protracted low interest rates and tight capital requirements.

The stakes for the financial institutions sector are high and market consensus points to increased competition, disintermediation and disruptive innovation likely to impact future performance.

With sustained focus on operational efficiencies, financial returns, and innovation, it is critical to access accurate and timely information and proactively address risk at every level of the organisation.

As a leading provider of risk, retirement and health solutions, Aon has an appreciation for the challenges these issues create and the unforeseen opportunities that can be unlocked. We believe in the power of data and analytics, combined with expert insight, to equip clients with innovative solutions that help them manage volatility, reduce risk and compete in an increasingly complex environment.

Aon's 2017 EMEA Financial Institutions Industry Report provides comprehensive research and industry specific data on key topics. The findings allow organisations to benchmark their risk management and financing against their peers and help to identify practices or solutions to improve the effectiveness of their own risk management strategies.

If you have any comments or questions about this report, or wish to discuss the findings further, please contact your Aon Account Executive.

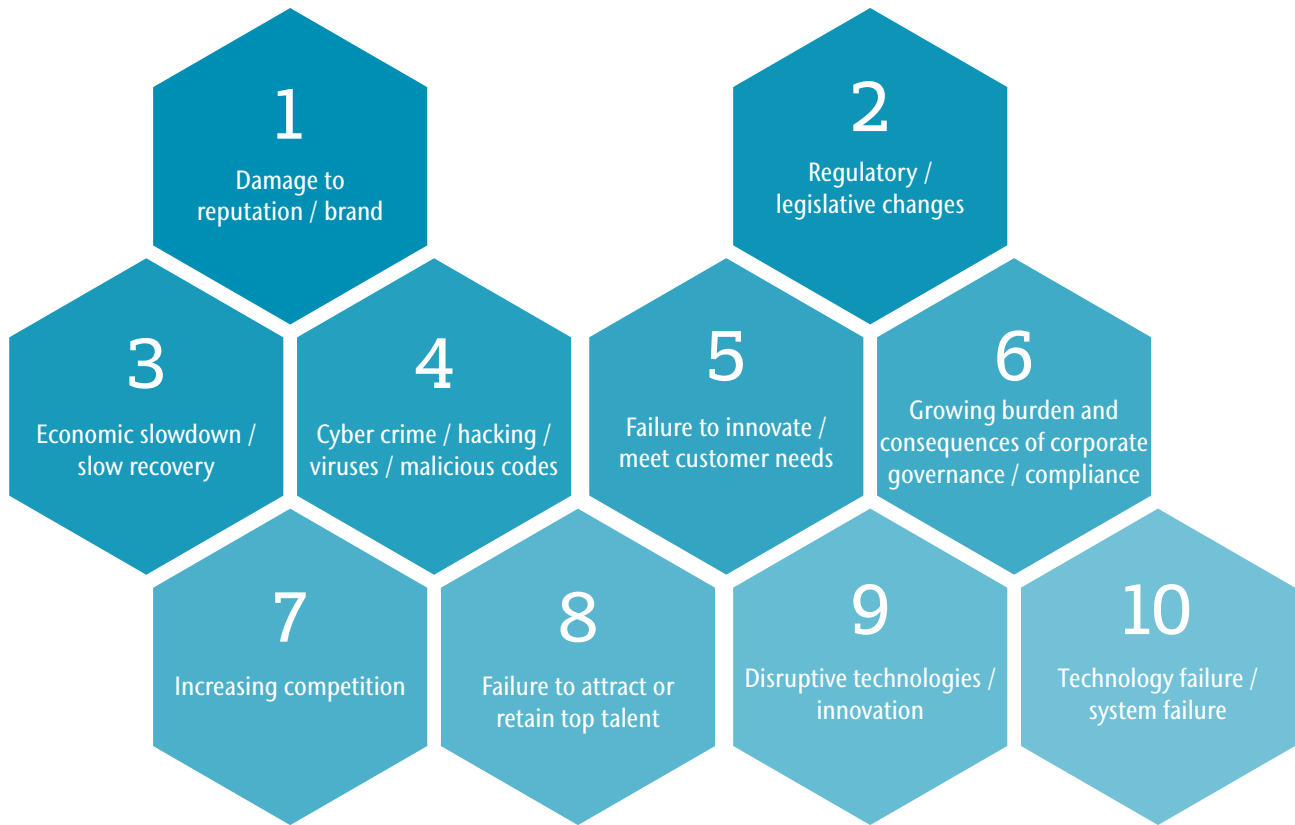


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Executive summary



Data is a powerful tool to complement the knowledge base of our clients, enabling them to understand risk and succeed.

This report provides access to peer group insights as part of Aon's continuing effort to help financial institutions focus on emerging issues, better manage risk and capture opportunities.


The majority of data comes from Aon's 2017 Global Risk Management Survey (GRMS) with detailed analysis of the responses provided by financial institutions in the EMEA region against their global counterparts (see chapter 1).

For a broader picture still, we have also reviewed numbers from the GRMS and Aon Global Risk Insight Platform (GRIP), a leading repository of insurance placement activity, in relation to insurance programme purchasing habits (see chapters 1 & 2).

In combination these data can provide a unique overview of existing and future risk management trends within the financial services community.

Key findings

The biggest stories tend to emerge when a risk category moves up or down the GRMS register. While the top two risks in the survey ('**Damage to reputation / brand**' & '**Economic slowdown / slow recovery**') have remained firmly in place since the previous EMEA edition in 2015, there has been significant change in the risk factors immediately below. Both the perceived and actual threat faced by financial institutions from disintermediation, disruption and fintech have increased. '**Failure to innovate / meet customer needs**' is now a top five risk and it is hitting companies' bottom lines.



Failure to innovate / meet customer needs is now a top five risk and it is hitting companies' bottom lines

Both in EMEA and globally, 24% of financial institutions say they have suffered financial loss during the last 12 months because of this risk factor, while 39% of EMEA financial institutions feel they are unprepared to adapt to it.

More specific is the '**Threat of disruptive technologies / innovation**', which entered the top 10 for both EMEA and global financial institutions in 2017. Risk readiness for this factor stands at just 46% for EMEA financial institutions and 9% confirm they have already suffered a financial loss because of it. Global financial institutions have fared slightly worse with 12% losing money from disruptive technologies in the last 12 months.

The other major move in the top 10 is unsurprisingly from '**Cyber crime / hacking / viruses / malicious codes**' whose rise up the corporate agenda needs little introduction. Our analysis suggests that financial institutions continue to underinsure this risk for myriad reasons, outlined in chapter 3.

Claims the number one factor

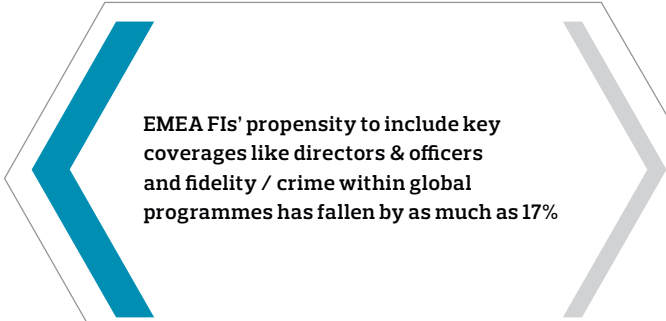
While there is ample evidence that the market is satisfied with the price and availability of cover, both global and EMEA financial institutions have shifted their attention to '**Claims service / settlement**', as they seek maximum value from their risk transfer.

Rising from fifth to first in 2017 as a priority for choosing an insurer, our analysis suggests the demand for better claims service may be longer lasting than before, as financial institutions wield new tools such as UK legislation enabling damages for late payment of claims.

Popularity of global programmes falling

The GRMS also surveyed purchasing habits, revealing many fascinating trends.

Although within financial institutions there is a tightening of central control of the purchase of insurance (decision-making then being the responsibility of the global headquarters), the popularity of global insurance programmes themselves - as a 'catch all' solution for financial institutions - has waned.



EMEA FIs' propensity to include key coverages like directors & officers and fidelity / crime within global programmes has fallen by as much as 17%

Between 2013 and 2017, EMEA financial institutions' propensity to include key coverages like directors & officers and fidelity / crime within global programmes has fallen by as much as 17%, while property and general liability as a component of global programmes has also reduced. There could be a range of drivers behind this trend, including the general downward movement of rates, or challenges in getting claims paid quickly enough from global liability programmes.

Insurance pricing under pressure

With the rating environment continuing to trend downwards, Chapter 2's pricing review indicates that financial institutions are taking advantage of more competitive coverage. Financial and professional risks rates have fallen quickest of all, prompting departures of some insurers from the market and consolidation amongst others as underwriting portfolios face increasing margin pressure.

Top 10 industry risks among financial institutions

	2017	2017	2015	2015
EMEA FI industry top 10 Risks	EMEA FI rank	Global FI rank	EMEA FI rank	Global FI rank
Damage to reputation / brand	1	1	1	1
Regulatory / legislative changes	2	2	2	2
Economic slowdown / slow recovery	3	4	4	3
Cyber crime / hacking / viruses / malicious codes	4	3	7	5
Failure to innovate / meet customer needs	5	5	Not in top 10	Not in top 10
Growing burden and consequences of corporate governance / compliance	6	9	10	8
Increasing competition	7	7	5	6
Failure to attract or retain top talent	7	5	6	4
Disruptive technologies / innovation	9	8	Not in top 10	Not in top 10
Technology failure / system failure	10	10	3	7

In both the 2015 and 2017 surveys 'Damage to brand and reputation' and 'Regulatory or legislative changes' were perceived as the top risk for EMEA and global financial institutions. 'Economic slowdown / slow recovery' continues to be an important concern, coming third and fourth respectively for EMEA and global financial institutions.

'Cyber crime / hacking / viruses / malicious codes' continues to move up the list since first entering the top 10 risks in 2015, climbing from seventh to fourth place in EMEA and from fifth to third place globally.



Key regulatory trends for EMEA Asset Management

- Despite challenging conditions, regulators are pushing ahead with stricter rules in sales, capital and operations. With the implementation of MIFID II in January 2018, the perceived threat of a liquidity crisis in bond markets, and the new developments in collateral management in derivatives trading, the asset management industry is facing new and highly complex compliance challenges
- The Financial Conduct Authority's Asset Management Market Study was published in June 2017, calling for investors to be provided with clearer information on costs. The regulator's reforms, if implemented include the creation of a simplified fee structure and mandatory seats for independent board directors

'Failure to innovate and meet customer needs' (fifth in both the EMEA and global ranking of top risks) and 'Disruptive technologies and innovation' (respectively eighth and ninth) make the top 10 risk ranking for the first time.

We note a direct correlation between the result and the changes experienced in the financial services sector, which is under pressure from disintermediation and the fast development and adoption of new technologies.

'Failure to attract or retain talent' remains stable in seventh place having significantly moved up the list since 2013; this is unsurprising given the scarcity of top talent and the difficulty in retaining key individuals due to increased workforce mobility and pressure on compensation.

Interestingly, 'Crime, theft and fraud' failed to make it into the top 10 risks for the first time ever; indicating that current insurance products covering traditional financial institutions risks may be short lived. For example, the propensity for financial institutions to purchase coverage on a global basis for risks like this has diminished over recent years, in favour of operational risk modelling and an increased focus on internal controls.

'Capital availability, credit risk' and 'Interest rate fluctuation' remain outside the top 10 having dropped out in 2015. This indicates recovery and stabilisation following the financial crisis and a more positive outlook on the development of the global economy.

However, 'Regulatory / legislative changes' remains very high on the sector's risk register and our special feature on the use of credit insurance later in this report as a means to meet the minimum capital requirements pillar of Basel III shows how financial institutions are looking at new ways to mitigate credit risk with innovative solutions.

Key regulatory trends for EMEA Banking

- **From Basel III to Basel IV** Recently published consultative documents on operational risk and Standardised Measurement Approach (SMA) on credit and market risk reveal a new focus on regulatory simplicity and comparability of banks across jurisdictions. The real objective however is to reduce capital arbitrage introduced by internal models and potentially increase the level of regulatory capital
- **MIFID II** A renewed focus on investor protection, putting pressure on distribution processes, sales operations and IT
- **Bank Recovery Resolution Directive (BRRD)** Came into force in January 2016, banks must have contingency and recovery plans, cooperating with resolution authorities and making necessary changes to capital holdings, business activities, legal and operating structures
- **The UK's Open Banking Standard** goes live in January 2018, with the opportunity for third party application providers and fintech companies to 'plug in' their solutions at the behest of consumers. This will create new risks for institutions and consumers

Risk readiness - EMEA financial institutions and the top 10

Risk readiness refers to the level of preparedness a company has to specific factors. A high level typically signifies that the organisation has undertaken a formal review before putting in place a comprehensive risk management plan.

EMEA financial institutions risk readiness



It is unsurprising that ‘Technology failure / system failure’ and ‘Cyber crime / hacking / viruses / malicious codes’, are the risks for which GRMS respondents claim to be best prepared.

This is in part due to a major investment programme in technology, training, business process and data security, which the industry has engaged in over recent years. In addition, financial institutions face a considerable tightening of data protection rules next year in the form of the General Data Protection Regulations (GDPR).

On the other hand, ‘Economic slowdown / slow recovery’ and ‘Increased competition’ are amongst the risks where fewer institutions feel properly prepared.

It cannot be denied that while strategies created to mitigate intangible factors have become more sophisticated over recent years, the constantly changing economic environment and dynamics of competition continue to outrun even the very best risk managers.

This trend is also reflected in the fact that the number 1 survey risk overall ‘Damage to reputation / brand’ finds only 58% of EMEA financial institutions prepared for this threat. Fake news and social media campaigns attacking brands are a growing concern. However, a crisis event if well managed can become an opportunity for an organisation to strengthen their reputation and brand sentiment. Financial institutions will be asking themselves:

- How do we monitor our reputation on social media and across other channels?
- How would we mitigate the potential damage to our brand and reputation if we started attracting negative publicity online and / or in the media?
- How is our media team trained and prepared to respond to a crisis?

As a new topic in this year’s report, the possibility for comparison on risk readiness for damage to reputation / brand will make interesting reading in our next edition.

Losses associated with the top 10 risks

In line with the 2015 results, ‘**Damage to reputation and brand**’ still features as number one of the top 10 risks. However, few financial institutions have suffered a loss of income in the past 12 months from this risk.

The more significant losses continue to stem from ‘**Increasing competition**’ (53% EMEA FI / 47% global FI) and ‘**Economic slowdown / slow recovery**’ (47% EMEA FI / 44% global FI).

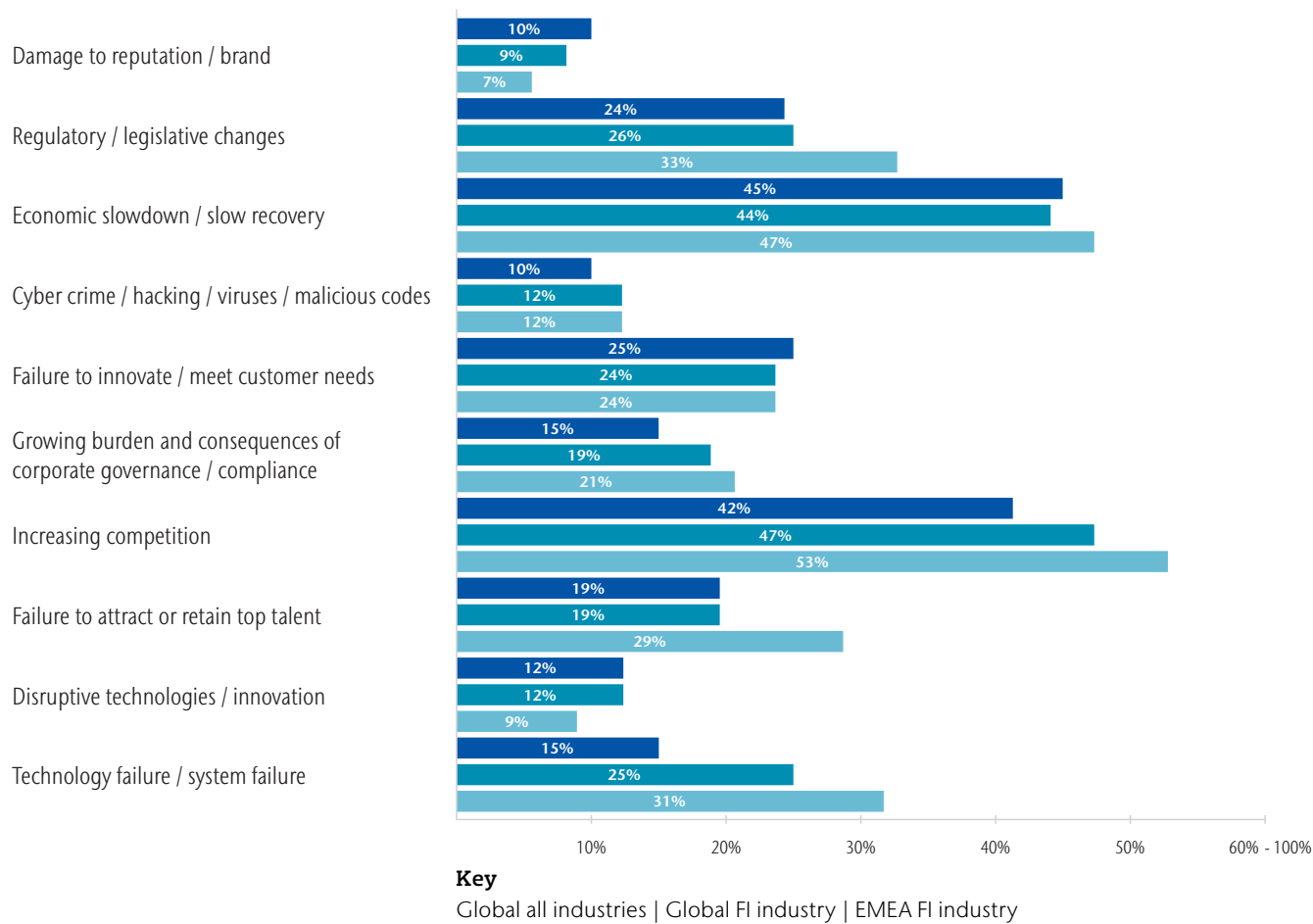
‘**Increasing competition**’ also shows the largest increase of any category in EMEA since 2015, rising considerably from 36% to 53%. Likewise failure to retain top talent, which moved from 13% to 29%.

Battle for talent more competitive than ever

Failure to attract and retain top talent ranked eighth in the top 10 risks for financial institutions across EMEA. Furthermore, an increasing number of financial institutions in the region recognise that such risk is directly linked to a loss in income: rising from 16% in 2015 to 29% today. As a point of comparison, this is the case for only 19% of financial institutions globally. The failure to attract and retain top talent as well as the loss of income directly correlated to it suggests that financial institutions should consider adopting new employee engagement strategies to mitigate these risks, especially in the competitive markets of EMEA.

‘**Regulatory / legislative changes**’ remains a thorn in the side of one third in the EMEA FI sector, however 2017 saw a marked fall from 2013 when 67% confirmed regulation had caused them financial loss, compared to 33% this year.

Frequency of top 10 risks resulting in loss of income in the past 12 months



Projected top 10 in 2020

One of the most telling aspects of the survey is its inclusion of a projected top 10 risk list. This section juxtaposes perception and reality and reflects how quickly priorities can change.

Both EMEA and global respondents this year feel that **'Regulatory / legislative changes'** will be at the top of the risk table by 2020. While it has yet to take top spot officially, most observers would be unsurprised given the range of influences affecting EMEA and global financial institutions.

From Brexit to Basel IV, GDPR and the Open Banking Standard, the sector faces a glut of regulatory obligations which simultaneously restrict activities and add weight to existing compliance burdens while opening up new competitive markets in which fintech players and consumers will increasingly call the shots.

Of course, regulatory risk could only really be eclipsed by one other factor. **'Economic slowdown / slow recovery'** is forecast to be the second highest projected risk in 2020 perhaps reflecting an overall concern that the EMEA region is never far away from a potential downturn.

In our last GRMS, **'Cyber crime / hacking / viruses / malicious codes'** had crept into the top five. This year, respondents predict it will move to number three by 2020, clearly indicating it is a growing problem.

Projected 2020 top five risks

Current EMEA FI ranking 2017



EMEA FI projected ranking 2020

Insurance purchasing habits

The Global Risk Management Survey includes a number of question sets designed to ascertain buyers' attitudes to the insurance and risk transfer industry.

Priorities in choice of insurer

In both 2013 and 2015, buyers ranked **'Value for money and price'** as one of the deciding factors in their choice of insurer. Perhaps the most startling fact from this year's survey is how far this parameter has fallen in the list of priorities. This reflects a continuous softening of the market cycle. Banks have achieved the savings they wanted and as Aon GRIP data in chapter 2 reveals, there have been double digit falls in financial lines (D&O, PI, fidelity & crime), and mid-single digit reductions in property and casualty.

Will damages for late payment have an impact?

'Claims service and settlement' jumped from fifth to first and this reflects the financial services sector's concern with getting claims paid, a recurring trend of the insurance market cycle. A key influencer on whether this risk factor remains in the number one spot could be the success of recent legislation introduced in the UK, enabling damages for late payment of claims under the Enterprise Act 2016. The rules officially came into force in 2017 and there has been speculation that insurers may seek to limit their exposure to this or even 'contract out' of the legislation.

'Financial stability / rating' jumped from sixth to third and **'Capacity'** from ninth to fifth. The presence of these two categories indicate that financial institutions are concerned about the long term sustainability of the insurance sector in its current shape. Once price, terms and conditions targets are achieved, clients can shift their focus to the financial strength of counterparties. It is worth noting an increasing trend of consolidation within the markets serving financial institutions. Profitability in a declining rate environment has proven too difficult to sustain for some underwriters, a number of which have withdrawn capacity or even pulled out completely of the financial institutions space. Mirroring the overall belief that financial institutions must develop more innovative solutions, **'Flexibility / Innovation / Creativity'** rose from tenth to fourth place, showing a high demand for new and more comprehensive risk transfer solutions. This is a clear indication that our clients are demanding new products and solutions that address their emerging risks and changing business operating model needs. As previously mentioned, the challenge of disruptive technology, the rise of fintech and the need to innovate to meet the demands and expectations of their clients presents new risks for traditional financial institution firms as they look to adapt.

Priorities in choice of insurer

	2017	2015	2013
Factor	Rank	Rank	Rank
Claims service & settlement	1	5	2
Coverage terms & conditions	2	2	Not in top 10
Financial stability / rating	3	6	1
Flexibility / innovation / creativity	4	10	8
Capacity	5	9	4
Speed and quality of documentation	6	3	7
Industry experience	7	7	5
Long-term relationship	8	4	6
Value for money / price	9	1	3
Ability to execute and deliver risk finance support proximate to global locations	10	8	9

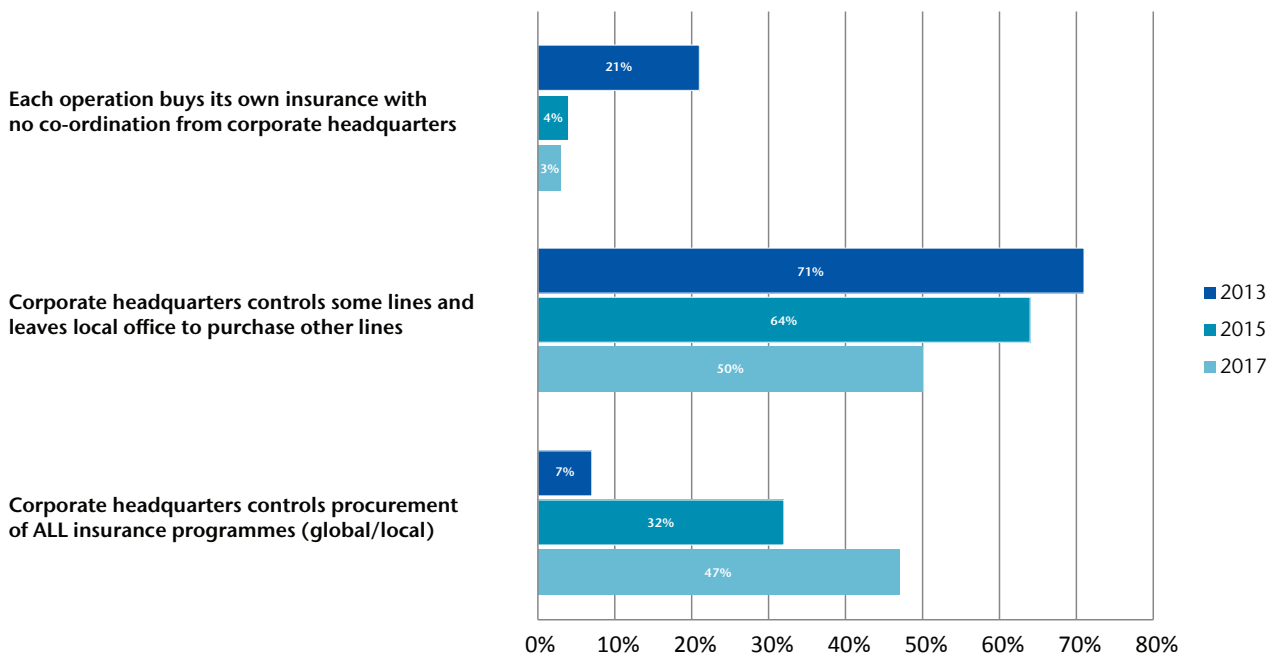
Global insurance purchasing habits

Corporate headquarters have ring-fenced their stronghold on procurement and insurance purchasing; 47% of EMEA and 52% of global financial institutions have their global and local insurance programs controlled from the centre.

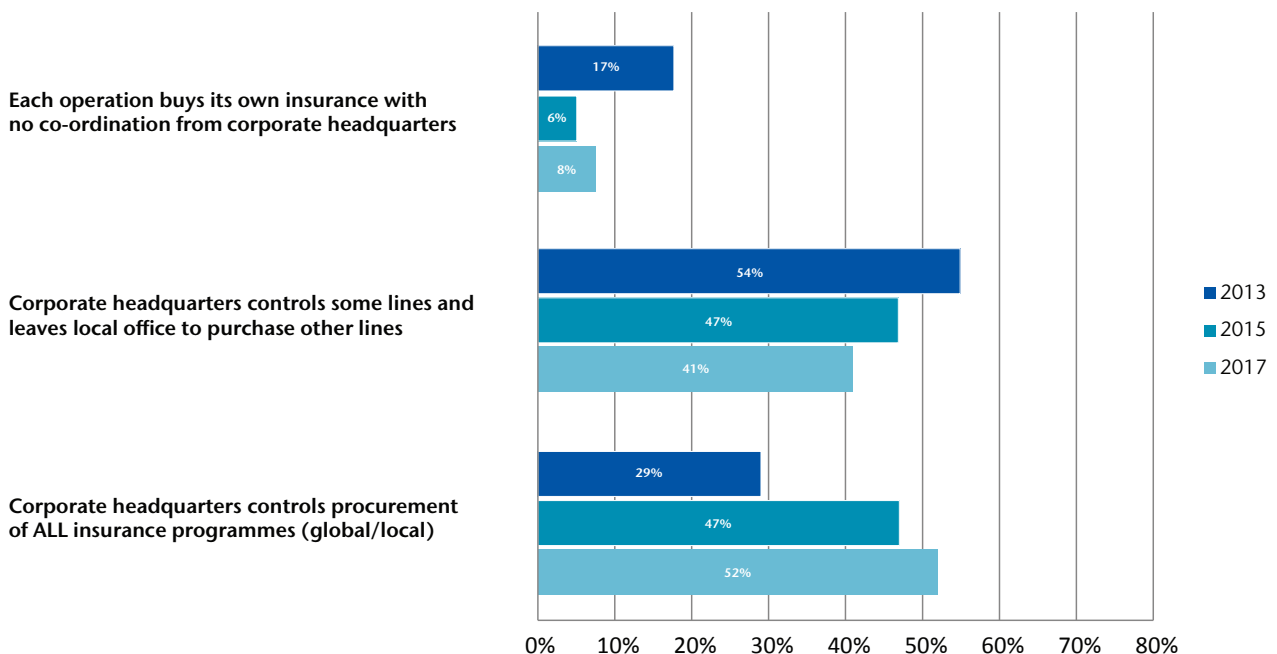
Purchasing habits have shown a significant shift, particularly in EMEA where 21% of operations were able to buy their own insurance with no co-ordination from corporate headquarters as recently as 2013.

This practice has been largely eradicated with just 3% able to take the initiative in 2017.

EMEA financial institutions industry 2013 - 2017



Global financial institutions industry 2013 - 2017



Important factors in global programme purchase decision

‘**Certainty of Coverage**’ is the most important factor influencing the use of global programmes in 2017, with cost moving down to second. Statutory compliance is only third, implying that financial institutions do not put in place international programmes just to follow procedures; they want to ensure coverage for their risk is taken up in the right place.

Importance to global programme purchase decision (1 = high | 6 = low)

	2017	2015	2013
Category	EMEA FI industry	EMEA FI industry	EMEA FI industry
Certainty of coverage Knowledge of what coverage is included in the programme	1	3	1
Cost This approach is more economical	2	1	3
Statutory compliance Access to local admitted coverage where non-admitted is prohibited	3	2	2
Programme performance Access to local claims and / or other services from local insurer / policy provider	4	5	4
Accounting Ability to allocate risk transfer costs to local operations versus pay from corporate	5	6	6
Fiscal compliance Ability to pay insurance premium and related taxes	6	4	5

Types of global insurance purchased

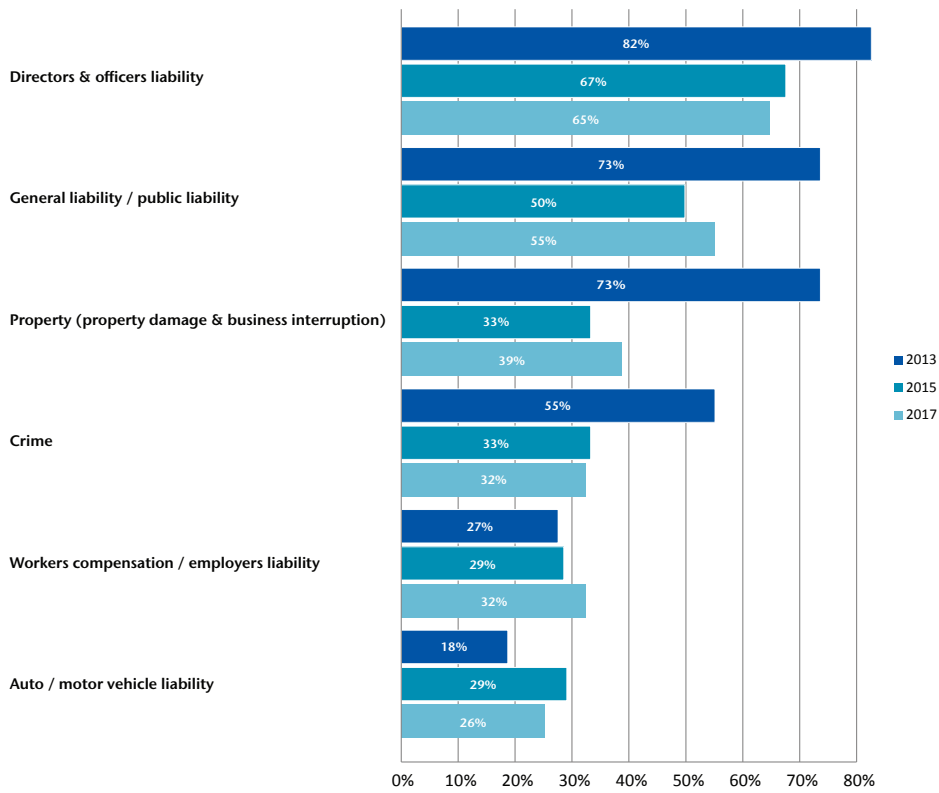
Directors & officers and general liability continue to be the two policies most frequently purchased through global programmes both for EMEA and global financial institutions. This demonstrates a particular concern over risks faced by boards and senior management as well as third party risks.

However, falls across the first four types of insurance cover purchased as part of a global programme between 2013 and 2017 indicate an interesting trend.

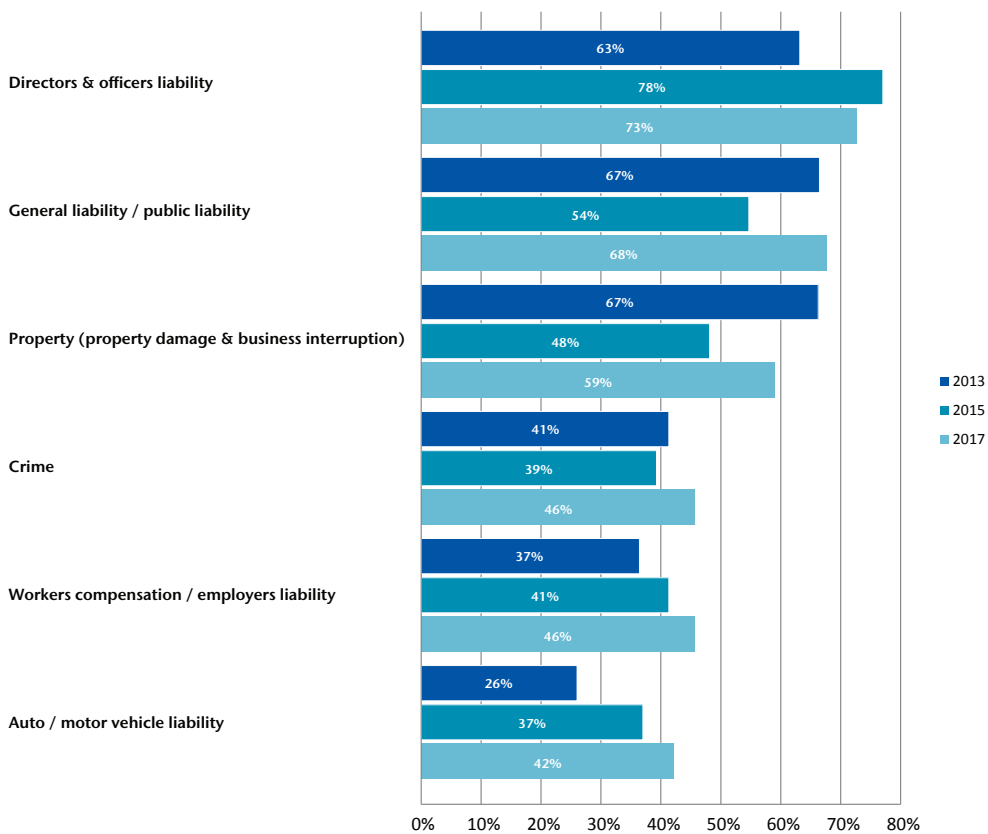
It is possible that following a period of consolidation after the financial crisis, financial institutions with subsidiaries all over the world have moved beyond the integration and centralisation phase of insurance management and purchasing. In combination with a recognition that rates have hit historic lows, both EMEA and global financial institutions may be returning decision making on risk transfer that impacts local P&L to subsidiaries.

When looking at the type of global insurance coverages, we note that workers compensation and employers liability remain key for one third of EMEA participants, rising slightly on the figure from 2015. In fact, by leveraging their global presence, financial institutions appear to be optimising their approach to workers compensation and employer risks. See chapter 3 for more details.

Types of insurance coverages purchased | EMEA financial institutions



Types of insurance coverages purchased | Global financial institutions



Use of captives

Use of a captive continues to decrease substantially. In EMEA, captive usage has fallen from 21% in 2013 to 13% in 2015 and 8% in 2017. For their global counterparts this figure has reduced from 17% in 2013 to 13% in 2017.

The same reduction is evident in the last two years for companies planning to create a new captive (from 7% to 3% in EMEA and from 7% to 6% globally).

Further explanation can be found in the form of a current ‘crackdown’ by the Organisation for Economic Co-operation and Development (OECD) on Base Erosion and Profit Shifting (BEPS), which is causing a number of issues for captive insurance companies.

In addition to an increase in capital requirements as a result of Solvency II and Basel 2.5, consolidation in the banking industry means that there are fewer parents available and captive usage is under historic pressure in the financial institutions sector.

Level of use of captive

Category	2017	2017	2015	2015	2013	2013
	EMEA FI industry	Global FI industry	EMEA FI industry	Global FI industry	EMEA FI industry	Global FI industry
Currently have an active captive or PCC	8%	13%	13%	16%	21%	17%
Plan to create a new or additional captive or PCC in the next three years	3%	6%	7%	7%	4%	12%
Have a captive that is dormant / run-off	1%	4%	4%	2%	0%	2%
Plan to close a captive in the next three years	3%	3%	0%	1%	0%	2%

Primary reason for captive

Strategic risk management and control of insurance programmes have increasingly become the primary driver of captive usage in both EMEA and global financial institution sectors. In line with market dynamics in other industries, financial institutions are moving away from captive usage as purely a cost efficient and control tool.

	2017	2017	2017	2015	2015	2015
What is the primary reason for the captive? (Select one)	Global All industries	Global FI industry	EMEA FI industry	Global All Industries	Global FI industry	EMEA FI industry
Strategic risk management tool	37%	35%	33%	33%	22%	18%
Control on insurance programmes	15%	29%	22%	10%	11%	9%
Ability to establish reserves	3%	3%	11%	4%	4%	0%
Cost efficiencies	13%	13%	11%	16%	30%	27%
Reduction of insurance premiums	10%	3%	11%	11%	4%	0%
Tax optimisation	6%	3%	11%	4%	4%	0%
Access to reinsurance market	5%	0%	0%	9%	4%	9%
Cash flow optimisation	3%	0%	0%	4%	4%	9%
Other	4%	3%	0%	4%	7%	0%
Risk finance expense optimisation	5%	10%	0%	8%	11%	27%

The Global Risk Insight Platform (GRIP) is a leading repository of insurance placement activity. By capturing information about key broking activities, GRIP provides timely insight into market trends and client buying behaviours.

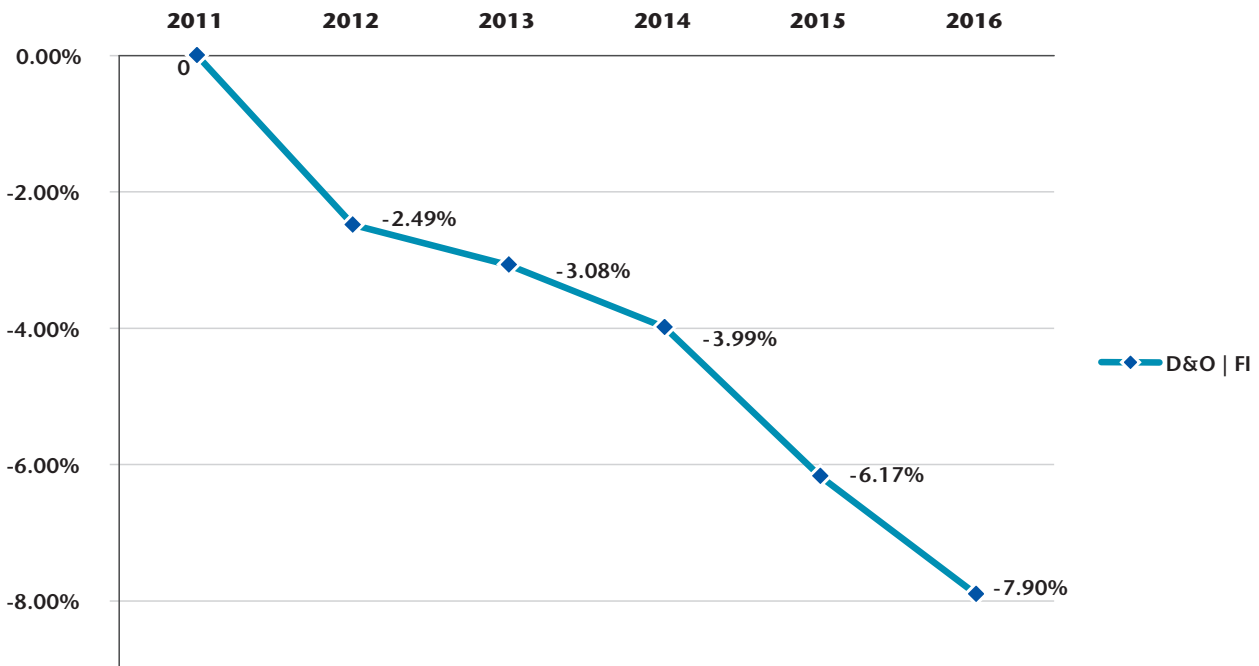
The data demonstrates how rate reductions have been in evidence across the board on the insurance lines purchased by financial institutions. Furthermore, there have been some recent withdrawals from some of these lines by insurers of financial institutions, reflecting a broad malaise in the underwriting community where rates have reduced steadily since 2012. More insurance companies will be reconsidering their position in light of rating pressure and their financial performance will be watched carefully by analysts anxious for price stabilisation, if not a rate turnaround.

Aggregate year on year fluctuation

Financial lines

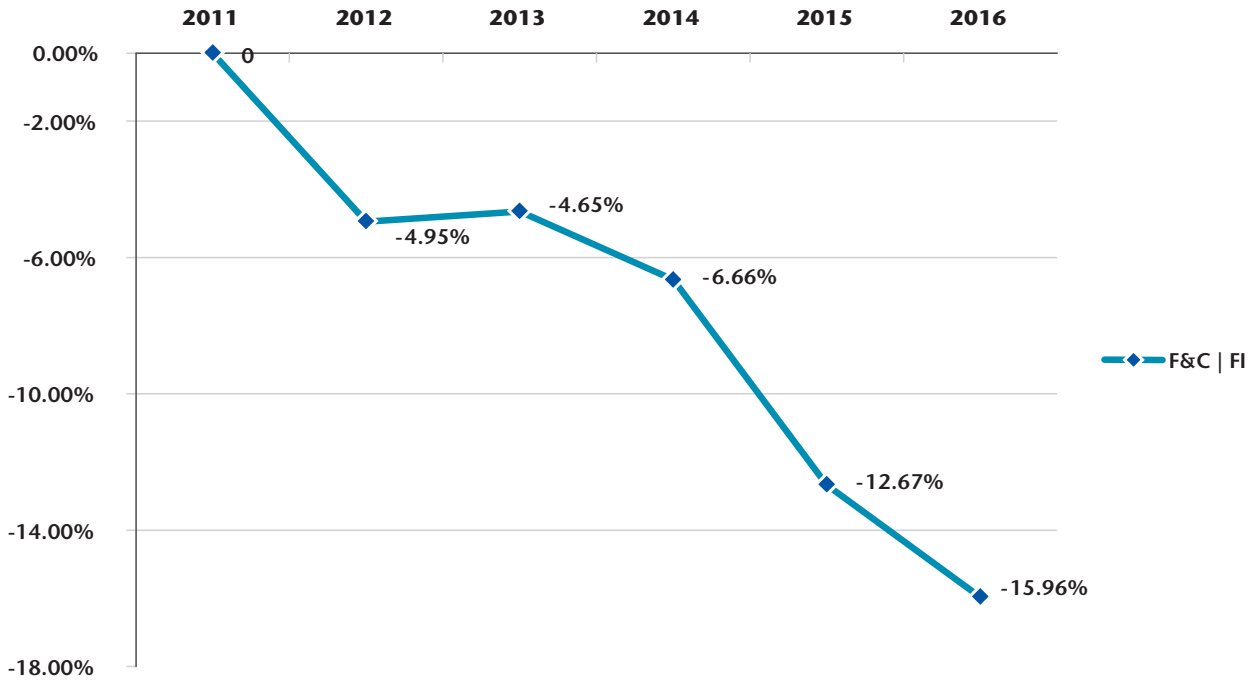
Directors & officers liability

An aggregate fall of nearly 8% since 2012 puts D&O amongst the furthest fallers. The climate for risk transfer pricing remains downward, with capacity still relatively high despite the withdrawal of some underwriting at the beginning of 2017.



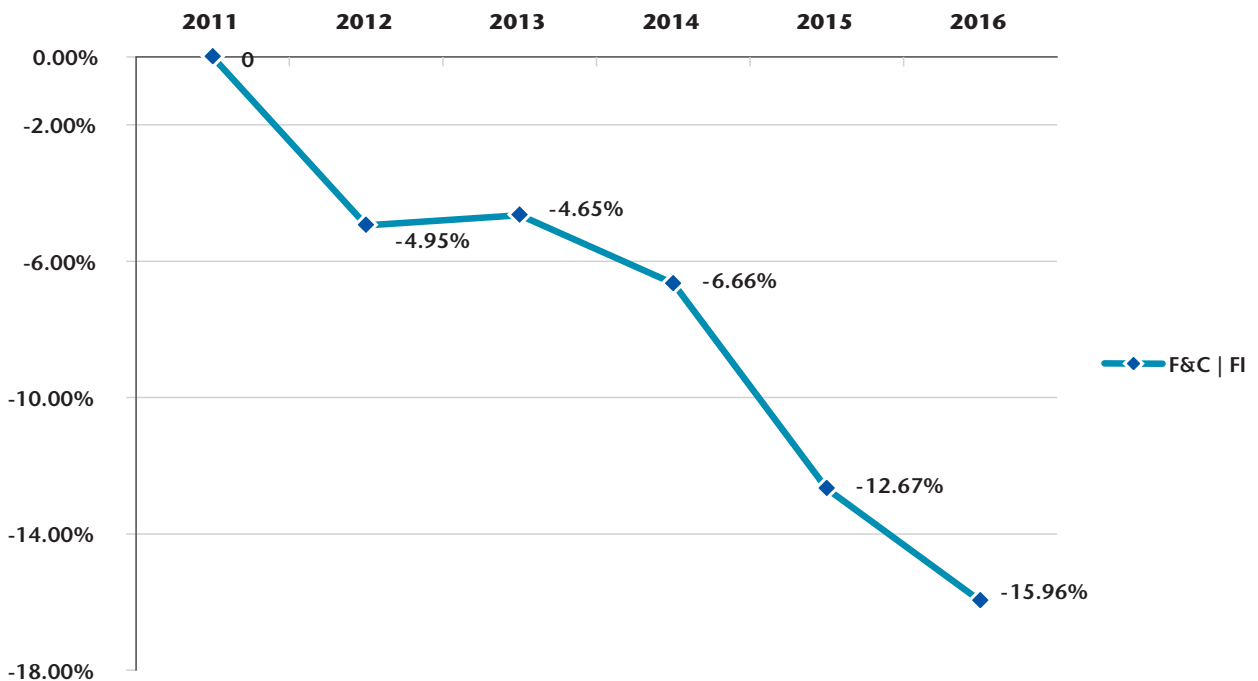
Fidelity & crime

This area has fared worse still, suffering almost a 16% drop since 2012. Aside from competition among insurers and availability of capacity driving down prices, financial institutions' sophistication in developing internal models around operational risk is allowing for increased appetite through higher self-insured retentions.



Credit solutions

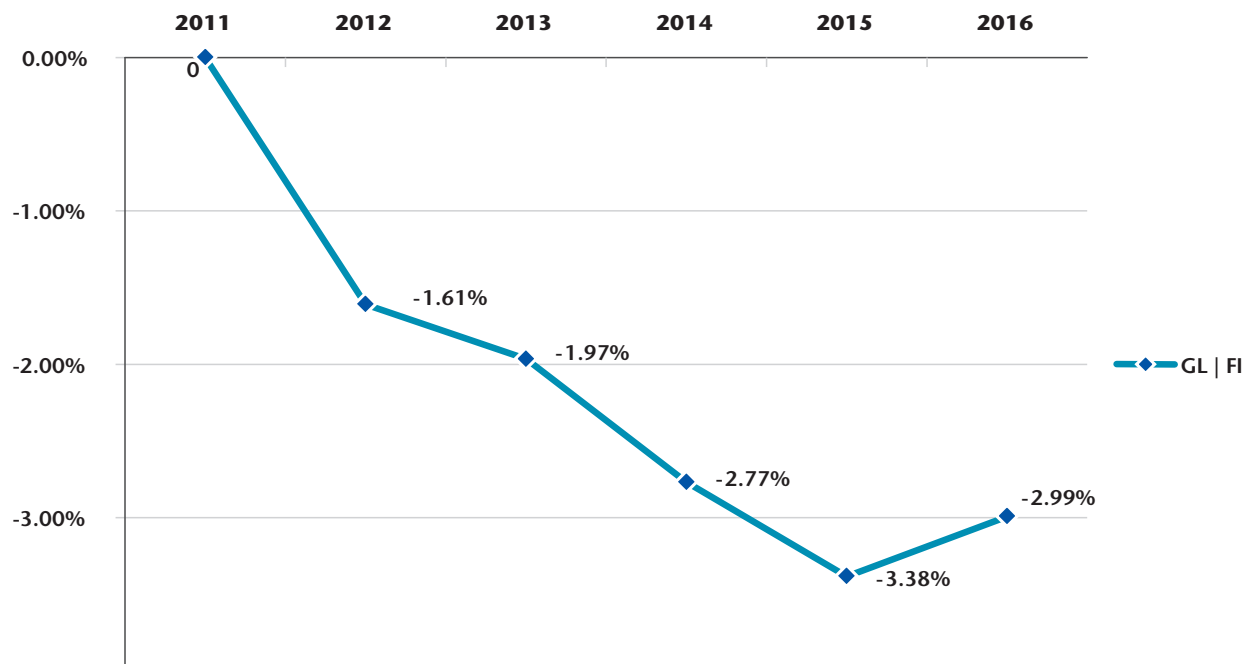
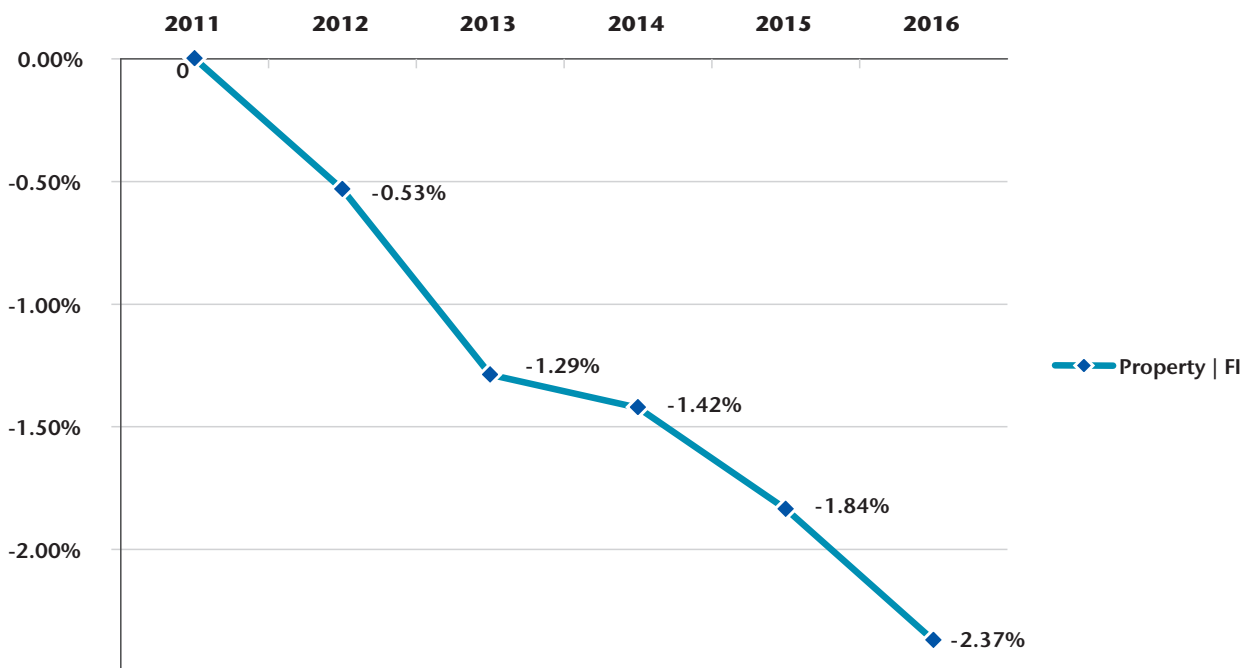
Global demand for credit risk insurance across all industries has pushed rates down by an aggregate of more than 14% since 2012. Financial institutions will typically encounter a less welcoming rating environment than industrial and commercial entities, nevertheless prices were lower in 2016, down just over 3% on 2012's low.



Property & general liability

Financial institutions are typically receiving smaller discounts than the all industries' average, with property falling more than 5% for the latter against 2.3% for financial institutions at renewal. General liability programmes for all industries have also dropped more than for financial institutions (6.5% versus 2.9%). This is not surprising at this point of the underwriting cycle, given the higher premium volumes usually associated with industrial risk's property & liability when compared to financial institutions.

As we observed with the GRMS data on choosing insurers, financial institutions are including general liability and property on a decreasing basis within their global programmes. Meanwhile, claims service has become a deciding factor in insurer choice so it will be imperative for carriers to maintain an efficient claims process if they are not to continue losing this income stream. While improved efficiency is derived from technology implementation, organisations are exposed to additional cyber risk inherent in technology systems.





Financial institutions remain a principal target for cyber criminals with motives of financial gain via theft of confidential information or money. Cyber is a broad risk that organisations face by virtue of their reliance on information, technology, connectivity and automated processes.

According to the GRMS, there has been a significant increase in the number of financial institutions that decided to hedge against this risk by purchasing cyber coverage, with the figure rising from 23% to 37% in EMEA and 40% to 54% globally. Equally, the number of institutions planning to purchase cyber is up from 20% to 28% in EMEA and from 15% to 18% globally.

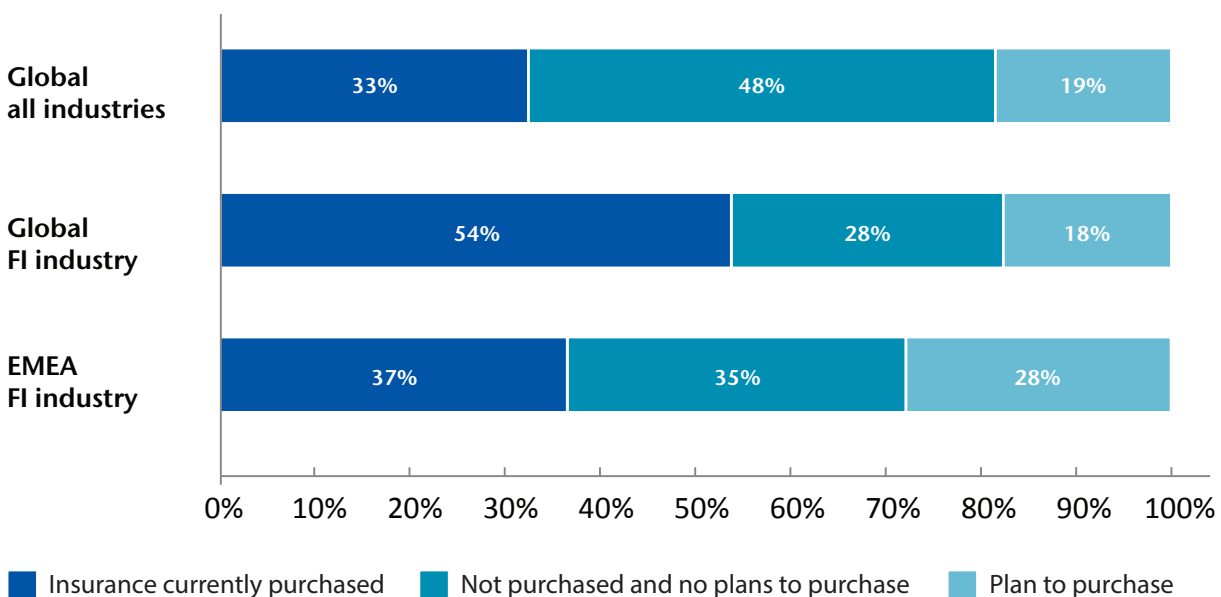
In summary, for 65% of the EMEA FI respondents and 72% of the Global FI respondents, cyber coverage is now an important pillar of their risk transfer strategy. This is not the case yet for Global All Industries respondents where there is a lower penetration of the product (33%, up from 21% in 2015) alongside a higher number of companies that are not purchasing nor planning to purchase the coverage (48% in 2017 albeit down from 61% in 2015).

Though this risk continues to increase in importance, many financial institutions are still not purchasing the full breadth of cyber coverage that is available in the market as the underlying reasons for transferring the risk are different in US and EMEA. In the US, the main reason for coverage is mitigation of the potential liability emanating from loss of personally identifiable information and the cost associated with the breach response.

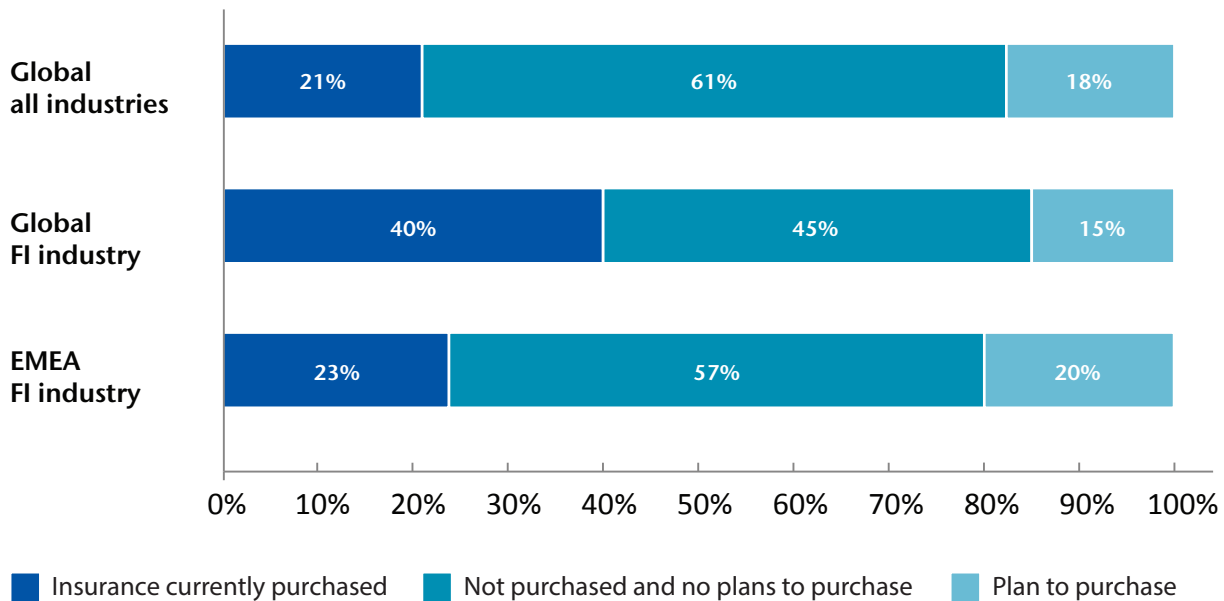
This liability is not a significant concern for financial institutions in EMEA; they do not have the same urgency to purchase coverage to protect against this risk but their choice is guided by the willingness to mitigate first party losses from business interruption. This is likely to change with the new General Data Protection Regulation (GDPR, EU 2016 / 679) as mandatory notification of breaches, higher fines and, potentially, a new landscape for liability will emerge. The new regulation could push more financial institutions with operations in the European Union to buy significant limits for cyber coverage.

Cyber coverage purchased or planned to purchase in the next 12 months

Financial institutions 2017 versus all industries



Financial institutions 2015 versus all industries



Increase in stand-alone capacity

In the last few years many financial institutions have been seeking limits in excess of what the market was able to offer; capacity constraints led to the development of innovative solutions to reach desired level of cyber coverage.

Global insurers stepped up to provide increased capital to make limits compelling enough to warrant risk transfer and the cyber market continues to grow and expand. The focus is now switching from availability of insurance capacity to breadth, quality and clarity of coverage.

Full coverage understanding and existing coverage in other policies

There is often a perceived and ambiguous overlap between a cyber policy and other coverages that a financial institution would purchase (ie fidelity & crime, professional indemnity, K&R, property, liability). Understanding where cyber can fill in the existing gaps is important to determine exactly which cyber components should be purchased on a stand-alone basis. It has been evident that cyber-attacks to financial institutions, particularly commercial banks, often lead to the theft of funds.

Traditionally, this has not been covered under a cyber policy, which could make it appear less applicable. Additionally, the perceived value of having coverage for business interruption may diminish if the waiting periods to trigger indemnity were long (eg 24 hours or more).

The market continues to evolve on many of these issues with broader business interruption coverage available and some insurers providing elements of what would traditionally be crime or social engineering protection under a cyber policy.

Financial institutions demand a fully *blended* coverage solution comprising crime and cyber and we expect the insurance market offer to rapidly move in this direction.

Fintech - the reality of disruption?

As the numbers from this year's GRMS show, financial institutions face considerable perceived and actual risk from the disruptive influence of fintech.

According to Innovate Finance global investment into fintech companies totalled USD 17.4bn, in 2016, up 10.9% from 2015. The first half of 2017 saw USD 6.5bn of investment¹.

While our data indicates up to 12% of financial institutions have already experienced financial loss from '**Disruptive technologies / innovation**', other reports - most notably from PwC² - have claimed the vast majority (83%) of companies fear their business is at risk of being lost to standalone fintech companies. Traditional financial institutions can be hampered by their culture, organisational silos and their legacy systems making it hard for them to compete with digitally advanced and cost-efficient fintech firms, who utilise technology to improve the efficacy of existing processes, while also reducing costs.

However, traditional financial institutions are attempting to adapt. Speaking at the World Economic Forum in Davos in January 2017, Deutsche Bank CEO John Cryan said the company's approach is now to work with fintech firms and entrepreneurs, 'but at a slight distance'³.

Major banks are investing in the fintech sector through their own VC funds whilst other financial institutions have invested in 'Innovation Centres' to support their digital transformation programmes.

This trend is likely to continue as over 50% of the workforce in five years will be between the ages of 18 and 30, and their digital sophistication will continue to reshape how banks deliver products and services⁴.



Building a fintech risk profile

Aon has analysed the major trends experienced by fintech companies, both standalone and those associated with larger financial institutions. Although many ventures remain at an embryonic stage, it has been possible to begin developing a working risk profile for the sector as it moves towards the mainstream. We have already started placing innovative insurance policies for fintech firms based on this analysis on behalf of our clients.

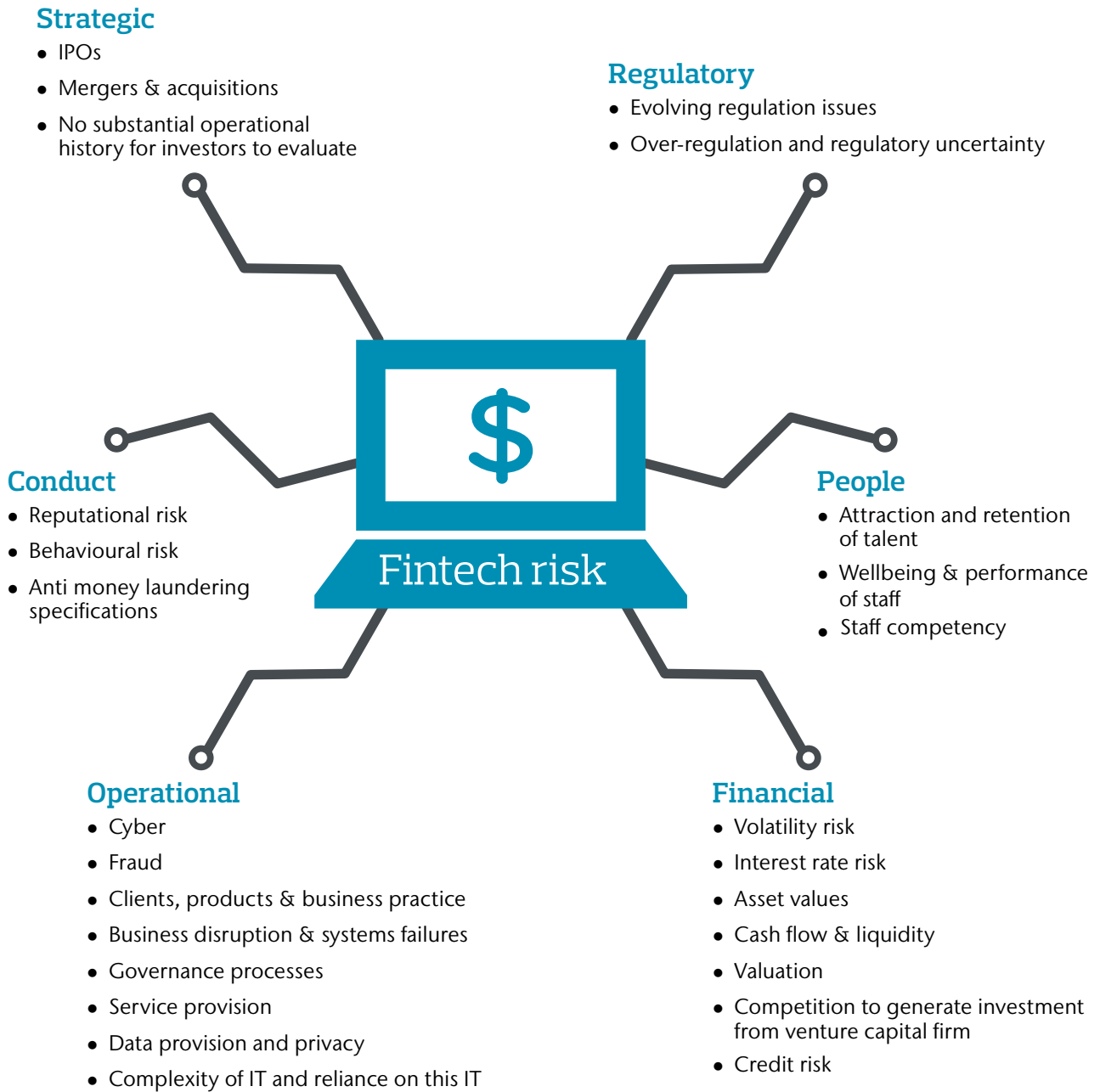
Fintech is growing at an exciting rate but in order for businesses to secure profit, growth and continuity, it is important to take stock of that development in the context of key risk factors illustrated overleaf.

1. Source | Innovate Finance: <http://new.innovatefinance.com/reports/h1-2017-vc-fintech-investment-landscape/>

2. Source | PwC: https://www.pwc.com/il/en/home/assets/pwc_fintech_global_report.pdf (p.19)

3. Source | <http://www.cityam.com/257226/deutsche-bank-chief-blames-regulation-lack-banking>

4. Source | KPMG: <https://home.kpmg.com/au/en/home/media/press-releases/2017/03/gen-y-banking-demands-15-mar-2017.html>





Global insurance coverage for liability, health and benefits - dealing with talent engagement and people risk globally

Global insurance coverage has proven an efficient way to better manage employee benefits policies but also to rationalise the overall cost while making the benefit package competitive and engaging for employees.

Within the financial institutions sector, global participants have acknowledged that four main reasons motivate the decision to increasingly purchase (from 37% in 2013 to 46% in 2017) a global insurance coverage. In order of importance, they are:

1. A good knowledge of the coverage included in the programme
2. The cost
3. The statutory compliance
4. The programme performance

From an employee insurance and benefits perspective, this means:

- A central access to local employee plans for each country
- Enhanced and more cost-effective terms and conditions
- Ongoing information on local laws and regulations
- An efficient delivery of employee insurance and benefits programmes
- Reporting on progress and analytics to help inform decision and further drive the strategy

Overall, this confirms the trend amongst financial institutions to further integrate their data in order to better understand, manage and mitigate people risks.

Engaging talent through healthcare

Medical insurance is a benefit that illustrates the possibility for an employer to deal effectively with talent engagement, cost management and people risk. In 2017, the annual medical trend rate¹ reached 4.1% in Europe and 7.6% in Middle-East and Africa². The main risk factors that both threaten employees' health and drive supplemental medical plan cost in EMEA are the following:

- High blood pressure
- High cholesterol
- Physical inactivity
- Obesity
- Poor stress management

As a consequence, employees tend to suffer a variety of medical conditions from cardiovascular to musculoskeletal issues, diabetes and cancers.

Because employees from the financial sector may suffer specific conditions linked to physical and mental health, there needs to be a thorough analysis of their risk profile. Specific preventive actions as well as adapted medical insurance can help mitigate these risks and manage their increasing costs.

In global employee insurance programmes, particularly in EMEA, cost mitigation methods include innovative benefit designs, employee / employer cost sharing but also provider networks. A proactive employee insurance approach allows employers not only to manage risks and costs effectively but also to benefit from a healthy workforce. Helping employees to take care of their health results in lower absenteeism, a higher productivity and ultimately is the first step towards engaging and retaining talented employees.

- **Annual medical trend rates in 2017 reached 4.1% in Europe and 7.6% in the Middle East and Africa regions**
- **Top risk factors were high blood pressure, high cholesterol, physical inactivity, obesity and poor stress management**

¹. percentage increases in medical plan (insured and self-insured) unit costs that are anticipated to be technically required in order to address projected price inflation, technology advances in the medical field, plan utilisation patterns, and cost shifting from social programmes

². 2017 Aon Global Medical Trend Report



Credit solutions - deploying insurance effectively

The first pillar of the new Basel III regulations, Minimum Capital Requirements has increased the amount of capital that financial institutions need to hold on to for doing business. For banks specifically, this includes minimum leverage capital requirements and risk-based capital thresholds.

The Minimum Capital Requirements pillar of Basel III is articulated around three critical components:

1. Credit risk
2. Operational risk
3. Market risk

Credit risks for banks essentially relate to the potential that counterparties might fail to meet their repayment obligations in accordance with agreed terms (eg non-payment, delays in payment). These credits risks typically have a low probability but significant financial impact.

The 2008 financial crisis has increased the industry's particular focus on credit risks, and banks have been looking for new ways to mitigate these with innovative solutions.

Banks and lending institutions are increasingly using credit insurance to mitigate credit risk on loans, improve capital relief and meet tightening capital regulatory standards. Most importantly, the insurance contract must be an eligible credit risk mitigant under Basel and Regulatory Authority requirements. Although generally based on non-payment insurance policy templates, the contract wordings need to be tightly reviewed in the context of each bank's governance requirements and suitability to meet the needs of the bank's risk and legal teams.

In Europe particularly, banks have historically been subject to strong regulatory supervision. As a result the institutions have longer experience in using credit insurance for improving the return on risk-weighted-assets, and therefore reducing their levels of regulatory capital, compared to their peers in other parts of the world. Aon's specialist teams have facilitated transactions resulting in up to 80% improvement in risk-weighted assets.

Banks also admittedly appreciate the fact that the insurance companies they are partnering up with are not involved in the origination of trade loans and therefore are not direct competitors.

Financial strength and counterparty risk ratings are key considerations for financial institutions using insurance as unfunded credit protection. Though capital optimisation solutions can be achieved with a large number of insurers (the whole market includes around 60 carriers), it is broadly recognised that S&P / Fitch AA and A.M. Best A+ (or above) credit ratings are more attractive to banks who are leveraging insurance to improve return on risk-weighted assets.

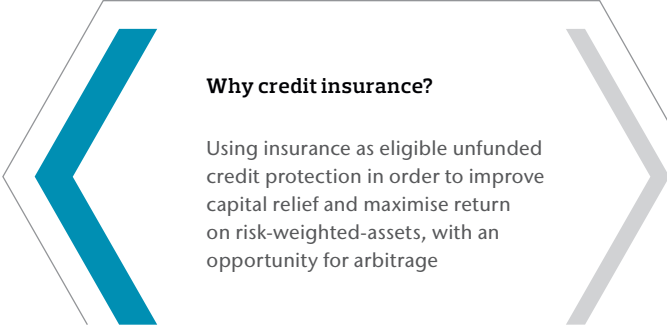
Banks are more successful in securing the best insurance capacity if they have the critical size to insure large exposures. Insurance coverage for certain large transactions can reach the USD 1bn threshold.

The insurance market is perceived to have growing risk appetite for bank-related transactions and, while financial institutions entering this market should take the time to consider and identify the appropriate insurance solution, carefully built credit insurance partnerships have a long-term life span.

What are the rules?

In order to be an eligible credit risk mitigant and qualify for capital relief, insurance contracts typically need to have the following features:

- Explicit, clearly defined and legally enforceable
- Issued by an eligible guarantor
- Irrevocable and non-cancellable
- Cover for all or pro rata exposures
- Credit quality deterioration cannot affect the premium cost
- Shorter claim payment waiting periods



Why credit insurance?

Using insurance as eligible unfunded credit protection in order to improve capital relief and maximise return on risk-weighted-assets, with an opportunity for arbitrage

This report has unearthed a number of important trends for financial institutions to consider, namely:

- **Disruption and the demand for innovation is occupying minds and causing financial loss according to the GRMS Survey data**
- **Buyers want broader coverage from the cyber market as well as fully *blended* solutions comprising at least crime and cyber**
- **Technology investment is paying off; financial institutions feel simultaneously well prepared for computer / system failures and cyber-attack**
- **Financial institutions feel poorly prepared for reputational threats and increasing competition**
- **Fear of reputational damage may not reflect its true financial loss potential**

When an established order faces disruption to the status quo, there is inevitably a collective sideways glance to see which member of the pack will blink first.

In the context of Aon's Global Risk Management Survey, our findings demonstrate there may be something of this nature currently in play, contributing to a rising anxiety and a growing sense of urgency within the industry.

There are genuine concerns amongst EMEA and global financial institutions that their position is under threat should they fail to innovate and develop new ways of supporting customers.

However, the industry's acceptance of this as a top five risk probably counts in its favour, particularly given the rapid and unpredictable advance of risk factors like '**Disruptive technologies / innovation**'.

There is already evidence that this risk is a serious threat. Up to 12% of the market says it has already experienced financial loss from '**Disruptive technologies / innovation**' so wariness is understandable if you consider that it took a longer time for '**Cyber crime / hacking / viruses / malicious codes**' to generate a similar loss frequency.

Keep up the pressure

As the financial industry sector responds to disruption, insurance and risk management advisors need to have innovative solutions to meet those needs. Aon is working towards a framework that supports financial institutions and considers the dynamic risk profile of companies ranging from independent start-ups (or financial institution-owned incubators) that nurture new applications, to organisations with an acquisition strategy designed to keep them ahead of the curve.

Equally, the insurance market's offering for credit solutions as an alternative to loan syndication provides a new tool to dilute exposures and meet regulatory capital requirements, thus favouring lenders that make full use of the opportunity.

Further strengthening of a competitive position comes from strategic planning and implementation of employee benefits, particularly healthcare, that prove to be an effective way to mitigate people risk and boost talent engagement.

Meanwhile, our previous report encouraged financial institutions to maintain pressure on the insurance market and develop cyber coverage so that it can respond to dynamic threats. Aon's GRMS numbers indicate the financial institutions sector is purchasing cyber coverage on an increasing basis, but there remains some frustration amongst buyers around gaps in coverage and *blended* programmes. We know the insurance market is committed to delivering responsive cyber insurance solutions, however it remains our challenge to convince financial institutions of the genuine determination carriers have to support them.

Finally this report underlines the enduring value financial institutions attach to their brands and reputation. There have been notable scandals in recent months where failures have resulted in a measurable hit to brand equity and it quite rightly takes its place at the top of the GRMS table. Nevertheless, its contribution to actual losses remains negligible. In truth, failure to mitigate any one of the remaining top 10 risks could result in damage to brand or reputation as a consequence and all risk management roads lead in that direction.

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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