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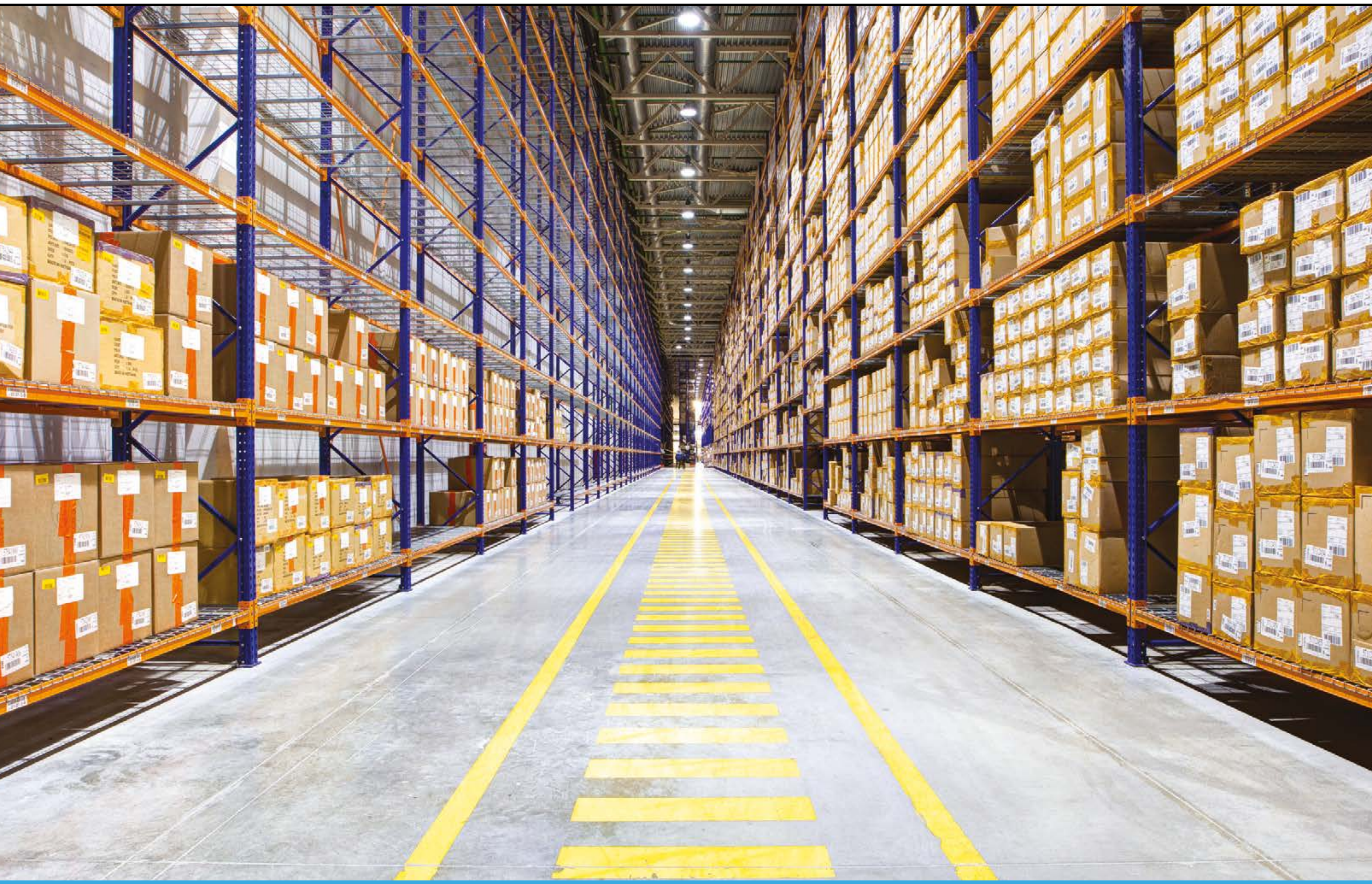

Collaboration and connection *Supply chain risk management has become inherently complex. David Jones explains QBE's approach to understanding and managing supply chain risks using cost-effective and sustainable steps against a backdrop of heightened geopolitical and financial uncertainty*

Controlling insurance costs with risk management *As the impact of inflation continues to bite in the insurance market, Deborah Ritchie speaks to David Jones, director of underwriting, QBE Europe, about risk management and cost control*

Supply chain risk

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As BT's chief risk advisor, Ben Cattaneo, stated so succinctly, "Uncertainty is an enduring characteristic of our current age." And in an age of increasing geopolitical and financial uncertainty, supply chain management has become inherently complex.

While risk managers have been historic champions of supply chain risk management, it is now a growing priority for procurement, operations and distribution teams. Good risk management requires strong leadership to protect your company, customers and future profitability – and as such, the need to actively manage supply chain risks has moved from a prudent step to core focus area.

The modern global supply chain

Driven by several factors, including cost optimisation and specialisation, the global network of supply chains has developed rapidly in recent years, with the advent of concepts such as just-in-time production and multi-tier supplier management.

However, factors including the pandemic, the war in Ukraine and the fuel crisis, have placed this complex web of suppliers under increasing threat. These disruptions have forced businesses to weigh the benefits of a global supply chain against the fundamental need to serve their customers – and increasingly, they are looking for alternative approaches to ensure they can continue to source, produce and deliver to their customers.

In the words of my QBE colleague Adrian Simmonds, senior risk manager, the era of the "ever extending supply chain [is] more fragile than it's ever been".

Permanent Pestel-ing

Supply chain risk is the uncertainty that exists in a company's ability to source materials for production and deliver goods and services to customers. With levels of uncertainty increasing, understanding this risk, its impact on your supply chain (from minor to catastrophic) and how operations could be protected, has become a core competency.

While several frameworks exist to describe a firm's macro landscape, the traditional Pestel (political, economic, social, technological, environmental and legal) framework does a good job to analyse your external environment and possible drivers of risk in a systematic and complete manner.

Julia Graham, CEO of Airmic says that firms need to be "permanently Pestel-ing" for dynamic risk management – and Christopher Hess, partner with consultancy Hesmur, recommends integrating supply chain information into strategic reporting systems for continuous risk monitoring.

Understanding the impact

Proactive management and mitigation across the end-to-end supply chain begins with an understanding of activities by profit and volume, with assessment of how customers would be affected by a disruption to the supply of a particular product or service.

QBE research shows that firms can expect to encounter, on average, a significant supply chain shock once every four years. Varying in both severity and global reach, the impact of supply chain shocks can be dramatic, with an average firm losing over half its annual net profit.

The digital evolution

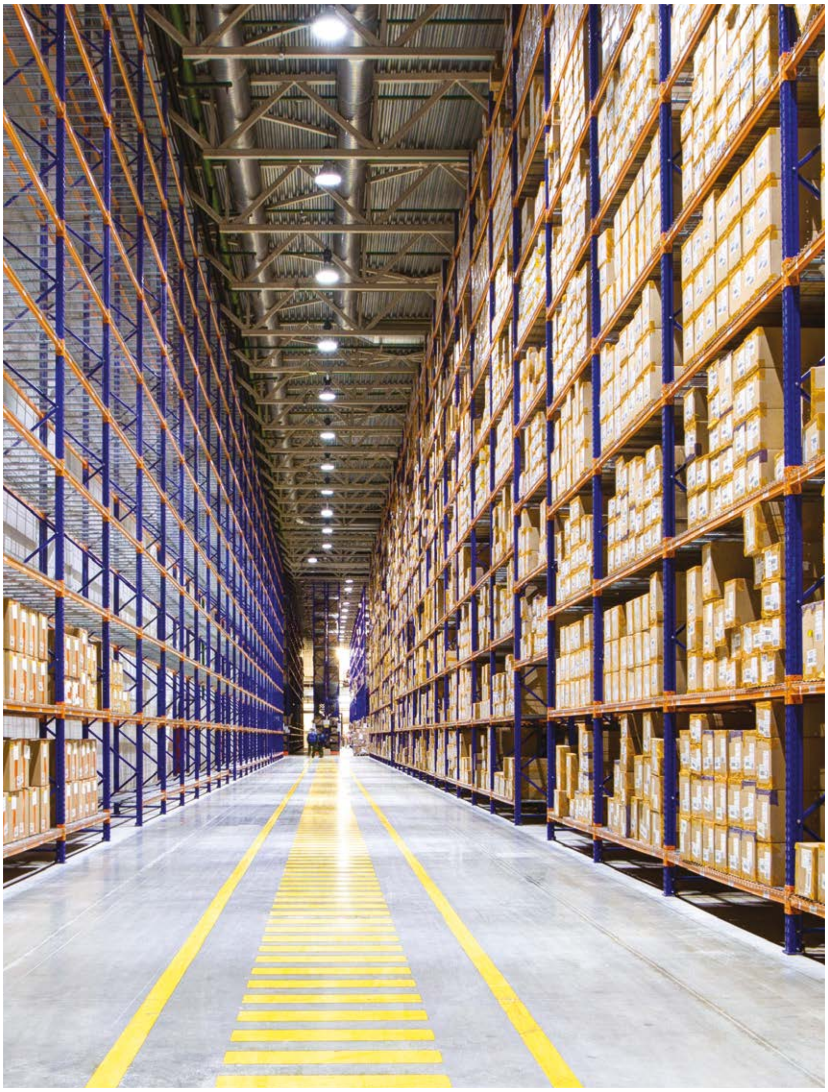
While past supply chain digitalisation has focused on integration across counterparties, cost reduction and efficiency, businesses musts still have full oversight and understanding of the end-to-end network to identify risks.

Digitalisation has also introduced a new set of cyber risks which can impact businesses directly but become amplified the more that your company is integrated with supplier networks. With cyber security, companies are only as strong as the weakest link and must ensure that all parties are adhering to the same set of cyber security protocols.

Working with global networks

Many sector supply chains hold significant geographic concentrations, often without this being immediately visible. While final assembly and distribution may be regional, looking further up the value chain can highlight significant issues.

For example, in the pharmaceuticals industry, while the manufacturing of



end products often occurs regionally, at least 50 per cent of all active pharmaceutical ingredients used in production in Europe are produced in India or China.

Logistics of inventory and transport

Historically JIT inventory concepts have focused on improving the efficiency and cost-effectiveness of the extended supply chain. More recently, firms have realised that this efficiency can come at a cost that far outweighs the benefits when exposed to even minor disruption.

Understanding the likelihood and impact, of disruptions in your supply chain is a key input to determining optimal inventory levels including major components, raw materials and tools.

Firms should understand not only who and where their suppliers are, but also how the supplies are getting to their destination. While materials are often still the responsibility of the supplier until received, this is a poor consolation if these materials are critical to the ultimate delivery to your customers. The six-day blockage of the Suez Canal in March 2021 is a case in point. Staying close to your carriers and those of your suppliers can help identify alternative methods or routes if problems arise.

Risk culture and resilience

The ability to address crisis situations is more than the sum of the information gathered and the plans put in place. It is how your teams view risk and deal with uncertainty. Building a robust risk culture, with high levels of risk intelligence at an individual and enterprise level, helps achieve this.

Most firms are now working to build greater resilience into their overall operations. Whether this is increasing inventory levels to deal with uncertain supplier deliveries or building alternative supplier networks, there has been a clear move from just-in-time to 'just in case'.

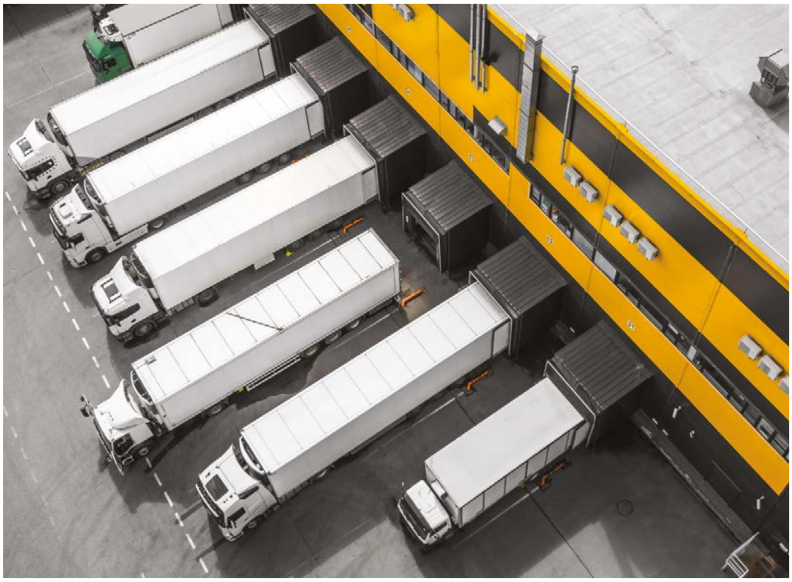
Even after you have understood your supply chain and built approaches for addressing the related risks, there will be some exposures that are too great to address alone. Insurance protection should be viewed and managed as an integrated part of your overall risk management strategy.

Specialist insurance cover

Every business should have a good property insurance policy including business interruption cover. A key consideration is how long you are covered after an interruption, which is reflected in the maximum indemnity period you choose.

Is there enough time – in the worst case – to source critical machinery, to rebuild from scratch on your current site or to relocate and start operations elsewhere? Are you covered for interruptions caused by the failure of your own suppliers?

Cover is generally available for direct supplier risk but for major



exposures it is imperative you seek protection on a named supplier basis where the risk can be underwritten and agreed limits negotiated accordingly. It is possible to secure some cover for unnamed suppliers generally for a modest limit and with cover restricted to Flexa perils (fire, lightning, explosion and aircraft damage) outside the UK.

Ensuring that you get your property insurance right is a collaborative effort. You should seek advice from your broker and discuss cover with your insurer. Loss adjuster consultation is recommended for vulnerable businesses.

Notably, more business interruption claims are made on product liability policies than on property policies. Product liability insurance also provides protection in upstream supply chain failure, covering the producer, wholesaler, or retailer of a faulty product.

Contracts and the transfer of risk

The legal protection offered by contracts passes responsibility for product-related supply chain risks to those who produce the raw materials or parts. This is done through a so-called vendor indemnification clause, under which the supplier agrees to take responsibility for all third-party claims, liabilities, losses, damages, suits, expenses and legal fees arising out of any harm caused by their product.

In a complex supply chain, it's possible to insist that your supplier is responsible for ensuring that labelling, instructions and the product itself comply with regulations in the area where you plan to sell the finished product. It's also advisable to include a best efforts clause that lets you move without penalty to an alternative supplier in certain circumstances – and instead of an indemnity clause, ask your suppliers to purchase insurance that covers the importer.

If the worst happens

Even with the best preparation, unexpected shocks will arise and impact your business. This is where the act of preparing for multiple scenarios rather than 'fighting the last war' will help your teams assess and diagnose risks and develop responses. A close working relationship with your insurer before and during a crisis will help ensure that everyone working together.

- Understand: mapping and monitoring your supply chain can prevent issues before they arise and give a significant head start
- Prepare: scenario planning and preparing playbooks of responses will help prepare for the events you plan for, alongside responses to unexpected ones
- Train: training teams to address crisis situations can prevent issues from impacting the business or lessen the impact if they do
- Involve: involving your network in both planning and responses is critical; your insurer should be part of this discussion.

With the increased uncertainty in global markets, understanding your supply chain and the related risks, scenario planning outcomes and practising crisis management procedures will stand you in good stead.

You can read QBE's Building Supply Chain Resilience report here: www.qbeeurope.com/document-library/news-events/reports/building-supply-chain-resilience

The QBE risk culture profiling tool can help you understand your risk culture and the actions you can take to improve it. For more information visit: www.qbeeurope.com/risk-solutions/risk-culture

David Jones is Director of underwriting at QBE Europe

Controlling insurance costs with risk management

As the impact of inflation continues to bite in the insurance market, Deborah Ritchie speaks to David Jones, director of underwriting, QBE Europe, about risk management and cost control

Can you detail the affects of current global inflationary pressures on the insurance industry?
As you know, the impact of inflation on insurance is complex and multi-layered, affecting both reserves and future claims costs, across almost all lines of business.

Policies underwritten when inflation rates were much lower, result in claims settled at much higher prices today. Inflation can also influence ongoing claims, increasing reserve estimates for long-tail liability lines and complex business interruption, which can take many years to settle.

How does this impact property lines and claims?
For property lines, the increased cost of materials and labour is already impacting claims. The costs of rebuilding and recovery have risen in line with big increases in construction costs, which are in turn driven by a jump in prices for key building materials, fuel and transport, alongside a critical skilled labour shortage.

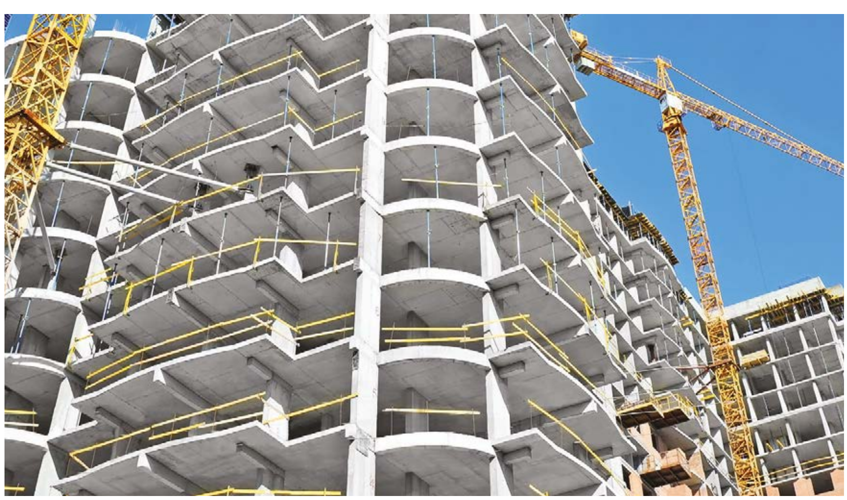
According to the CBRE Construction Cost Index, building costs in the US increased by an estimated 14.5 per cent in 2022 and 11.5 per cent in 2021. In comparison, Europe saw construction costs leap by more than 16.5 per cent between the first quarter of 2021 and the second quarter 2022.

Property damage and business interruption claims can also be magnified by inflation and supply chain disruption. Delays in obtaining spare parts lead to longer periods of downtime, while skilled workforce shortages and higher prices result in increased operation costs. Post-pandemic uplifts in demand and higher commodity prices have also led some businesses to encounter severe volatility in revenue and profit in the last two years.

How is liability insurance affected?
While businesses are generally alive to the impact of inflation and supply chain disruption on property risks, it is important not to overlook the potential implications for liability insurance.

Legal, medical and care costs are also rising, alongside transport, accommodation and therapy expenses, while wage inflation results in sometimes substantial loss of earnings claims. These inflationary pressures are particularly acute for severe and large complex personal injury, where claims can take many months to settle and cover long periods of indemnity.

And what about the human factors of inflation?
Insurers and their customers ought not to forget the wider effects of inflation change. Most businesses are managed and staffed by people who will have been impacted by the pandemic and the current cost-of-living crisis. Policyholders must therefore be aware of the



mental health impact this can have on employees. There is a direct correlation between employee mental health and risk awareness. Although accidents can always happen, they are more likely to occur when the local environment becomes more uncertain.

How are insurers approaching the impact of inflation within property and casualty claims?

Changes in exposures will have implications for the type and scope of cover required, alongside the information required by underwriters, so now is not the time to roll over last year's insurance at renewal time.

QBE, for example, has been collaborating with its customers on more holistic forms of risk financing and alternative structures that help maintain insurance programmes in line with inflation. Deductible levels, aggregate retentions, limits and indemnity periods set just a few years ago may no longer be appropriate, given the compound effect of higher inflation over several years.

What should businesses consider ahead of renewal?

To avoid underinsurance or over insurance amid changing exposures, businesses will need to think carefully about the most appropriate covers and structures going forward. Some insurance products provide direct indemnification based on the sum insured, placing the onus on the insured to value property accurately. Other policies may include provisions for inflation, but even these may need to be reviewed during periods of prolonged inflation.

Businesses should ensure their insurance coverage is fit for future inflation by asking:

- Do deductible levels and attachment points reflect changes in inflation?
- Are property and liability policy limits and sub-limits sufficient?
- Are indemnity periods appropriate and able to cope with supply chain disruption or delays?
- Are current measures of exposure still relevant?
- Are values and exposures accurate and appropriate?

How can risk management control insurance costs?

Investments in loss prevention and risk mitigation will pay even bigger dividends in an environment of rising prices and supply chain disruption. Businesses can help counteract the increased cost of claims by minimising potential property losses, increasing diversification, or looking out for employees.

For example, businesses can assess their mental health and wellbeing strategies using QBE's self-assessment tool. Analysis can help develop an improved, more holistic risk management strategy.

We believe the case for working with your insurer has never been stronger. By making maximum use of risk engineering, risk management services and advice, we can help break the link between inflation and claims.

About QBE

QBE is a global business insurer helping businesses build resilience through risk management and insurance, with operations in all key markets. We have been helping businesses to build resilience for more than 30 years with a dedicated team of experts who understand the key industry issues and can focus on the real challenges faced by our customers.

Our approach is to not just provide an insurance policy and be there when things go wrong, but to add value and engage with our customers to understand their risks and business. We believe our collaborative approach to underwriting, claims and risk management support fits our customers' needs and demonstrates that we really do put the customer at the centre of everything we do.

Ask your insurance broker about QBE Business Insurance or see www.QBEeurope.com