Honan.
Insurance. Advice. Support.

RISK SOLUTIONS FOR FINANCIAL INSTITUTIONS

Insurance. Advice. Support

Financial Services accounted for **13% of Australia's** class action filings in 2022.

Meanwhile, the **spotlight on data security and privacy has intensified,** following multiple high-profile breaches since 2022.

It's essential to be aware of the types of conduct that may give rise to class actions and to ensure appropriate risk management systems are in place.

Investment Management insurance is a portfolio of insurance covers designed to cover three main exposures for financial institutions. These include:

Professional Indemnity (PI)

To protect directors, employees and the business through cover for damages arising out of the provision of your financial services

Directors and Officers Liability (D&O)

To protect directors and managers for liabilities arising from alleged mismanagement

Crime

To cover the business for direct financial loss against the policyholder either internally through employee fraud or dishonesty, or by an external party fraud in some scenarios, including funds transfer fraud or computer fraud

What broader **trends** are impacting the sector?

> The present economic outlook, characterised by low growth rates, climbing inflation, the energy crisis, stock market volatility, high interest rates, and ongoing supply chain issues continue to impact broader market liquidity and profitability. **With these factors at play, the last few years have made it difficult for fund allocators and financial services firms to generate consistent returns.**

Fundamentals have been resilient through these shocks, but further deterioration is expected. Consumers' cushion of savings from the lockdowns has been eroded with the broadening negative wealth effect sustained across housing, bonds, equities, alternative/private investments, and cryptocurrency (JP Morgan, 2023).

The Ai Group Australian Industry Index has remained in the contraction zone since the Reserve Bank's monetary policy tightening cycle began.

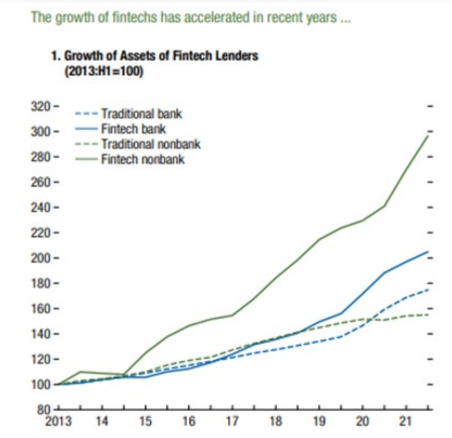
Business conditions indicators

Source: Haver, KPMG

Fund manager investment committees and company directors are facing greater scrutiny amid declining assets quality, reduced profitability and share price, along with pressure on funding and liquidity.

Key developments in the financial services market

RISE AND RISE OF FINTECH



Technological innovation in financial activities or 'fintech', is disrupting traditional banking services. The rapid growth of fintech firms, coupled with their expansion into high-risk business segments, sometimes inadequate regulation and supervision, in certain instances have created systemic risks.

(International Monetary Fund, 2022)

This sample is based on 13 advanced economies and 7 emerging market economies

REGULATORY CONTROLS

Financial services firms are subject to strict regulations and reforms designed to impose strong controls, transparency and disclosures, risk measurement, corporate governance, and compliance standards.

Australians lost more than $242 million to investment scams in the first half of 2022*

Heightened scrutiny around business practices has informed ASIC's core strategic priorities which are designed to enhance supervision and control frameworks. One area of focus is stricter compliance/oversight/data collection mechanisms by AFSL holders as investors continue to remain vulnerable to investment scams.

*(ASIC Corporate Plan 2022 – 26).

CYBER RISKS AND INCIDENT RESPONSE

$1.01million Is the average cyber ransom**

Cyber concerns including data security and information protection and incident response are top priorities for directors and regulators. As more financial institutions collaborate with third-party providers to explore cloud services and app development, the operational risks and exposures will continue to rise.

**(McGrathNicol 2023).

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) ISSUES

1,200+ climate change-related litigation cases have been filed since 2015

(AGCS 2023).

Misrepresentations of ESG credentials and inadequate action on climate change or diversity and inclusion issues have become major risk exposures in the financial services sector. Highlighting this is the recent action by **ASIC against Mercer Superannuation for alleged greenwashing, accusing the firm of misleading statements about the sustainable nature of some of its superannuation investment options.**

Market developments

Contending with a combination of geopolitical and economic challenges – the war in Ukraine, inflation, high interest rates, supply chain disruptions and economic slowdown, the insurance market has remained relatively stable for financial institutions - mainly buoyed by a strong capacity supply and the absence of severe claims. We do stress that there are individual factors that may impact the terms and conditions. These are outlined below:

Retail vs Wholesale Client Base

Generally, financial institutions with a retail sector skewed base are more heavily scrutinised by bodies such as ASIC and the Australian Prudential Regulation Authority (APRA) (and consequently underwriters). Those with institutional or high net worth clients are scrutinised to a lesser extent, given their sophisticated profile and expected due diligence.

Funds/Assets Under Management (FUM/AUM)

The quantum or rate of change in FUM/AUM from the prior year can be a major factor in premium adjustment. A large increase in FUM can indicate the potential quantum of loss and a higher perception of risk associated with that fund. Conversely, large redemption runs and decreases can result in higher premiums as this can be a precursor for claims.

Hedge Funds

Hedge Funds with high gearing ratios promoting an aggressive alpha focus, compared to more benign strategies, are considered higher risk. Underlying alternative asset classes are also a key driver, with funds exposed to private credit, quant strategies and commodities most impacted. Hedge funds with a history of shareholder activism can concern underwriters as this can be a breeding ground for claims, especially in the wake of retail social media activism.

Venture Capital/Private Equity Funds

The performance of the underlying investee company portfolio can determine whether there are implications for venture capital/private equity funds. Companies with enduring profitability models, recurring and stable revenue streams and strong Series Round interest are looked upon favourably by underwriters. Funds heavily weighted towards growth stocks/ technology are scrutinised more closely by underwriters given the high impairment risk.

Passive Index Funds vs Actively Managed

Passive index funds that deliver solid returns and low Management Expense Ratios (MERs) are least affected, as well as mutual funds with low risk long only strategies. Those with large retail investor bases are affected given the more litigious nature of this class, versus the sophisticated wholesale/institutional sector.

Listed Investment Companies (LICs)

LICS with high discounts to Net Tangible Assets (NTAs) often make underwriters wary, especially if there is a risk of further drops. Valuation risk and ASX continuous disclosure exposures have been key concerns for underwriters.

Aggressive Return Forecasts or Assurances of Minimal Risk

Insureds making aggressive return forecasts or assurances to minimal investment risk in Product Disclosure Statement (PDS) documents have been highly scrutinised. This was fuelled by the Federal Court finding that promoter Mayfair 101 engaged in false advertising by targeting investors who used Google search engine terms such as "best term deposit". **It should be stressed that misrepresentations in PDS documents are a key source of claims.**

Lending and Property

As lending criteria for banks have been subject to tighter controls, we have seen an influx of alternative capital into the private debt and distressed asset space. Underwriters are highly cautious to offer cover to those exposed to a undiversified single underlying asset, especially property development given the potential for variation mid-term.

IPO and Tech Exposure

There was a flurry of initial public offerings (IPOs) in 2021 and 2022. In response, we have seen an influx of IT based Cloud focused companies listing as a by-product of their ability to quickly scale and attract higher valuation multiples. With higher multiples we have seen more incidents of sudden devaluations which has been concerning for insurers due to impairment risk.

Fintech

The market has been awash with new asset management-focused fintechs; many of which are modelling entirely new ways of investing, trading, clearing, settlement and custody, funds management/administration as a service. Given these are relatively new, insurers have been cautious to begin accommodating these risks until recently.

Insureds with Corporate Authorised Representatives (CARS) under their AFSL have been underwritten with greater caution. This is due to claims arising from instances of lax risk management in overseeing CAR compliance.

Cryptocurrency

We are beginning to see institutions acknowledge decentralised finance (DEFI) and cryptocurrency as a legitimate asset class. Many allocators are now accepting bitcoin as a solid store of value, a "digital gold" given its stock to flow ratio. Alternative currencies such as Ethereum are attracting attention given their potential for smart contracts in the DEFI infrastructure area. Ark Invest and Van Eyck have been pioneers in this space with more managers following suit and allocating capital. As a discrete asset class, cryptocurrency is not regulated. However, on the basis cryptocurrency is classified as a "financial product" and is subject to ASIC's regulation, we are starting to see more insurers enter this space.

Fixed Interest Anomaly/ Loss of Parity to Stocks

Insurers have been more cautious than usual about the bond market, given the effects of global expansive monetary policy dampening the fixed incomes defensive position, especially due to the decline in returns when adjusted for inflation. The negative returns to most bond portfolios have put underwriters on high alert, especially considering the uncertainty regarding fundamental macro policy.

Digital Banks

We are starting to see more insurer scrutiny following the recent collapse of some of the larger first-mover digital banks. This has raised questions about the viability of the disruptor model, with many insurers taking a "wait and see" approach before offering cover. There are positive signs however, with APRA now insisting neo banks have an income-generating product e.g., lending product before taking on deposits.

ESG

More funds are embracing the ESG theme (Environmental, Sustainability, Governance) such as promoting investments in the electric and renewables space as opposed to fossil fuels etc. Alongside this, insurers have been more sensitive to "green washing" concerns and will look upon risks with such a track record unfavourably.

What does the future hold for **AFSL holders in Australia?**

EVOLVING REGULATORY ENVIRONMENT

The regulatory environment is changing, with climate risk, emerging data and digital technologies, and volatility in the crypto-assets market all having an impact. In its Corporate Plan (2022-26), ASIC has identified four major regulatory initiatives:

PRODUCT DESIGN AND DISTRIBUTION

Reducing the risk of harm to consumers of financial and credit products caused by poor product design, distribution and marketing

SUSTAINABLE FINANCE

Actively monitoring and enforcing governance, transparency, and disclosure standards related to sustainable finance

TECHNOLOGY RISKS

Promoting sound cyber-risk and operational resilience measures, and tackling digital misconduct, such as fraudulent activities and scams

RETIREMENT DECISION MAKING

Protecting consumers particularly during their retirement planning and decision-making process, with an emphasis on financial advice, managed investments, and superannuation products

CYBER AND OPERATIONAL RESILIENCE

Cyber and operational resilience among financial markets and service providers minimises the risk of disruption from cyber-attacks and promotes confidence in markets. ASIC will raise awareness, encourage active management of operational risks, and take enforcement action against egregious conduct.

Financial Accountability Regime (FAR)

The FAR is intended to improve the risk and governance cultures of entities in the banking, superannuation, and insurance sectors. ASIC will work closely with APRA to implement the regime through guidance, industry engagement, and effective registration processes.

OPEN BANKING

Open Banking initiatives will gain momentum, giving customers greater control over their financial data and fuelling increased competition and innovation as financial institutions share customer data securely with authorised third-party providers. This will lead to the development of new services and personalised financial solutions for customers.

DIGITAL TRANSFORMATION

We will continue to witness the adoption of technologies such as artificial intelligence, automation, and blockchain. This will enhance efficiency, improve customer experience, and drive innovation.

FINTECHS BECOME MAINSTREAM

Fintechs will continue to disrupt traditional financial institutions in Australia, particularly in areas such as payments, lending, and personal finance management.

SUSTAINABLE FINANCE

Sustainable finance will remain in the spotlight. Financial institutions will continue to adopt ESG criteria in their investment strategies and financial products to meet the evolving demands of customers.

How can **Honan help?**

Our business is different in all the right ways.
We go beyond just insurance, advising leaders on strategies to mitigate current and evolving risks, limit exposures, and enhance employee safety and retention.

The team at Honan is younger and more diverse than the industry standard. Our advisors bring **expertise and fresh thinking** to deliver a high-quality, customer-led service that's more akin to leading consultancies than the traditional world of corporate insurance.

> Our financial services capabilities support all facets of the financial services sector from large complex alternative asset managers to conservative boutique fund managers.

OUR FINANCIAL SERVICES BROKING OFFERING INCLUDES

- Reviewing insurance liabilities
- Analysing the effectiveness of existing insurance solutions
- Assessing self-retention risk programs
- Identifying any uninsured risks that need to be insured
- Contractual indemnity reviews and advice
- Benchmarking existing insurance programs against best practice
- Providing recommendations for optimum risk transfer solutions, including estimated costs
- Structuring bespoke insurance solutions

OVERSIGHT AND COORDINATION

- With a dedicated client manager as your point of contact, we will advocate for your business at every step
- We'll manage key negotiations and marketing of your program to insurers prior to implementation, and at renewal time

EDUCATION AND INSIGHTS

- Provision of market-leading, relevant, and timely content about industry news, legal, compliance, and regulatory changes

OUR CLAIMS SERVICE

- Legally qualified, highly experienced claims team with specialised cyber claims capabilities
- Dedicated claims manager for the lifecycle of a claim
- Analysis and policy response to provide a smooth claims experience

What **sets us apart?**

We are passionate about being a true partner, taking the lead as advisor and educator, and thinking creatively about solutions to optimise your business outcomes.

HONAN: AN AUSTRALIAN-FOUNDED INDUSTRY LEADER

Established in 1964, and with over 450 staff, we're the largest independent broker in Australia.

CARRIER MARKET LEVERAGE

We place over $500 million in insurance premium annually, and partner with over 103 insurance companies globally. With our global reach and insights, we help clients navigate the challenges and opportunities of a global market, while providing market-leading local expertise.

CLAIMS SOLUTIONS

In-house claims specialists, led by industry and legal experts who know how policies and coverages will respond.

INNOVATION

Winner 5-Star Insurance Innovator Award, Insurance Business Magazine (2021, 2022 & 2023).

SPECIALIST KNOWLEDGE

We have a proven ability to manage and place unique and complex risk profiles. We stay across the key emerging trends, proactively adjusting our insurance product offerings to align with these trends and the risks they pose.

IPO NETWORK

As the IPO Network's Insurance Placement and Risk Advisor, we are experienced in structuring the risk solutions and negotiating insurance coverage on your behalf for pre-IPO, to listing date and beyond.

DIVERSITY & INCLUSION

A key focus for Honan, both within our organisation and through supporting community organisations as captured in our Inclusion Charter.

REGINAL SOLUTIONS

With offices in Australia, New Zealand, Singapore and Malaysia, we're deeply rooted across Asia-Pacific.

Industry experience and expertise.

To find out how we can support your growth, please get in touch.

info@honan.com.au
+61 3 9947 4777
honan.com.au
Honan Insurance Group