The YearAhead 2024

Gallagher

Insurance | Risk Management | Consulting

Contents

Foreword

As 2024 gets underway, it's natural to reflect on what we've learned in the past 12 months and how we can apply it to the future. Gallagher's inaugural The Year Ahead report aims to support you in this process. By collaborating with our own specialists and our partner companies, the report offers valuable insights into the current economic challenges and emerging risks for 2024. Our goal is to empower you with the knowledge necessary to face your future with confidence.

Key points:

- The global economy and politics continue to affect UK businesses. While inflation rose slightly in December, the trend remains downward; however, with roughly two million households due to re-mortgage this year, the drag on the UK economy is likely to remain.
- Insolvencies increased last year, and this trajectory is likely to continue in 2024 as companies that have been clinging on succumb to the persistently high interest rates, which are not expected to drop until we are well into the second half of the year.
- While M&A activity was quiet last year, an uptick in activity is expected in 2024. Challenging economic conditions may persist, but there is only so long that businesses can delay these transactions.
- The UK general election and nearly 80 other elections scheduled worldwide this year will increase uncertainty and volatility, which could impact security and civil unrest.
- AI and ESG were the buzzwords of 2023 and are no longer considered to be emerging trends. Businesses are adopting measures relating to both, and they are influencing the claims landscape. Consequently, while cyber and D&O premiums remain flat at the beginning of 2024, it's important to ensure that insurance programmes accurately reflect the risks businesses are likely to be exposed to.
- Businesses can't escape the increased threat posed by extreme weather, but they can mitigate against it. Likewise, underinsurance continues to be an enduring issue, but one that can be managed by understanding your business's true value.

"In this constantly changing and challenging environment, it's crucial for Gallagher to collaborate closely with our clients to gain a better understanding of their business and help them mitigate their risks. I hope you find this report informative, and we are looking forward to supporting your business in 2024."

Simon Collings
Managing Director
National Broking and Placement, Gallagher

Section 02

Reinsurance

1/1 Reinsurance Renewal: Setting the Tone for 2024?

1/1 is a key date for renewing and adjusting prices for 12-month reinsurance policies, and the outcome reverberates across the insurance industry.

Reinsurers insure insurance companies and help them manage risks by absorbing some of their losses. They are effectively the wholesalers of the insurance industry, and if wholesale prices go up, then retail prices tend to follow suit.

However, the renewal itself extends beyond individual transactions as it dictates the global risk culture for the coming year. Last year's renewal was challenging: reinsurers reduced capacity and changed coverage, attachment, and pricing for catastrophe reinsurance.

Property rates for a loss-free programme increased by 20%–25% plus exposure, while motor and casualty rates jumped by approximately 10%. Unsurprisingly, insurers were keen to pass rate increases onto clients as they looked to recover margins.

While a quiet US wind season was good news for reinsurer and insurer results alike, there were more than USD100 billion of insured property catastrophe losses in 2023, with significant events in France, Italy, and Turkey.[1]

Simon Collings
Managing Director
National Broking and Placement, Gallagher

[1] "1st View: What a Difference a Year Makes", Gallagher Re, 2 January 2024.

Future forecast

The 1/1/2024 renewal saw a return to more stability and predictability. Yet, Japan's New Year's Day earthquake is a testament to how quickly the balance can change and the event could impact 1/4 renewals.

Closer to home, the UK has endured heavy flooding and storm damage this winter, the extent of which is yet to be fully understood from a claims perspective.

Nevertheless, the UK had a catastrophe-free 2023, but certain insurers faced losses related to the December 2022 freeze, which impacted their reinsurance programme. The considerable catastrophe increases insurers paid last year have been labelled by Gallagher Re as a market correction rather than a long-term upward trend.[1] Solid returns for catastrophe reinsurers mean a return of capacity with flat to moderate rate increases for loss-free insurer accounts.

Loss activity heavily influenced property pricing; loss-free programmes experienced a 5% to 10% increase, while loss-hit insurers faced anything up to 20%.

This approach will likely be mirrored by direct insurers in the coming year, and rates will likely start flattening off for low-risk clients.

While property reinsurance is enjoying a moment of calm after significant correction, casualty reinsurance rates have started to increase, and these will be passed onto the primary buyer in the fullness of time.

Overall in this area, reinsurers adopted a more cautious approach. In third-party liability, reinsurers were most concerned about London market insurers' exposure to US business, Per- and Polyfluorinated Substances (PFAS), and inflation and recessionary impacts. While in professional liability and financial lines, they focused their attention on bankruptcy risk, D&O rates and limit expansion. These concerns will influence insurer appetite in the casualty arena, and rates may increase by 5% to 10%.

It may come as little surprise that primary motor rate increases were so significant last year that excess of loss (where the reinsurer provides protection to the insurer by paying claims in excess of a predetermined amount) income rates were reduced while reinsurers achieved the necessary premium on a per vehicle basis. However, with claims inflation and labour shortages still acute concerns, motor rates may increase by as much as 10%. We discuss the motor claims environment in more detail on page 35.

[1] "1st View: What a Difference a Year Makes", Gallagher Re, 2 January 2024.

In cyber, the supply and demand balance shifted in insurers' favour. As the market becomes more mature, insurers' buying habits are evolving as they grow in confidence. Nevertheless, the risks in cyber loom large, and one interesting development has been the completion of multiple underwritten catastrophe bonds for the first time in Q4 2023.

Insurers have typically used catastrophe bonds for protection against extreme weather; they offer investors above-average returns in exchange for them taking on significant risk, including the fact that they could lose all the money they placed in the bond. Due to the challenging nature of cyber risk, these bonds had been restricted to private markets where investors have more control over terms. However, Beazley announced it closed its first public 144A cyber catastrophe bond in early January. Structured and placed by Gallagher Securities; the bond provides coverage of USD140 million.[2] We go into more detail on the future forecast for cyber risk on page 18.

In trade credit, inflation drove demand for cover and increasing limits for peak risks continued. Reinsurer appetite increased compared to last year, and historical performance, results, and demand dominated negotiations. We discuss the impact of insolvency and trade credit further on page 27.

"It's remarkable how different the picture looks with this renewal. The return to stability is positive news for clients, but it should be viewed against a backdrop of other factors that influence how insurers price risk, such as claims history, location, risk management, regulatory changes, and economic trends."

Simon Collings
Managing Director
National Broking and Placement, Gallagher

While inflation has been on a downward trajectory for over a year, claims inflation is likely to persist this year. However, most insurers are now in a profitable position and, therefore, are looking to grow in 2024 — this will mean there is increased competition in certain sectors, which in turn increases choice for clients. Gallagher is on hand to support businesses as they navigate the nuances of their renewal; we are positioned to leverage the best optimal for our clients.

[2] "Beazley closes $140m cyber catastrophe bond", Beazley, 2 January 2024.

Section 03

UK Security Threat Update

From

This year witnesses an election bonanza, with the UK expected to hold its general election in the autumn.

Nearly 80 elections are scheduled across the globe, some of which are democratic, while others are less so. The outcome of these elections is uncertain, which makes it difficult to predict the future direction of many countries and the businesses that operate within them.

This increased volatility has a direct impact on security, with the threat of terrorism on the rise after a period of relative calm. State actors, conflict, and fraud heighten security risks for businesses, against a backdrop where emerging technology is becoming an increasing cause for concern.

Laura Hawkes
Head of Intelligence, AnotherDay

Marlon Pinto
Director of Investigations, AnotherDay

Terrorism: Political extremism

Religious beliefs used to be the primary driver of terrorism in the West, but this has now been overtaken by political extremism. The UK is no stranger to the threat of the far right. For the second consecutive year, the government's Prevent strategy has reported more referrals for far-right ideology than extremist Islamic beliefs, and there was a 30% increase in individuals being referred to the strategy.[1] These findings illustrate that terrorism is still a significant threat to UK security but is also experiencing a shift in focus.

Emerging tech

The use of emerging technologies in terrorist attacks is becoming a serious concern. With the increasing usage of 3D printers, drones, virtual currencies, and end-to-end encryption, it has become easier for attackers to create sophisticated capabilities that are harder for security services to track down.

For instance, anyone can potentially print a gun at home and use it in an attack. A wealth of information available online, including manuals, blueprints, and forums, makes it easier for untrained individuals to plan and carry out attacks.

The impact of conflict

The Israel-Palestine conflict has ignited strong emotions across the world. The counter-terrorism police have warned there could be an increase in attacks in the UK in response to the situation in Gaza.

Between the 7 and 25 of October last year, the anti-terrorism hotline reported double the number of calls compared to the same period in 2022.[2] There are concerns that frustrations relating to the conflict could manifest into extremist terrorism.

State actors

The threat from state actors has increased to a level not experienced since the Cold War period. Mostly stemming from China, Russia, and Iran, the threat focuses on espionage and the facilitation of kidnaps, forced repatriation, and assassination. MI5 has stated that Iran poses a direct threat to the UK through its aggressive intelligence services.[3]

> "The use of emerging technologies in terrorist attacks is becoming a serious concern."
>
> **Laura Hawkes**
> Head of Intelligence, AnotherDay

[1]"Individuals referred to and supported through the Prevent Programme", April 2021 to March 2022, Gov.UK, 26 January 2023.

[2]"Counter Terrorism Policing launches Winter Vigilance Campaign 2023/24", Protect UK, 10 November 2023.

[3]"Director General Ken McCallum Gives Annual Threat Update", Security Service MI5, 16 November 2022.

Civil unrest and political activism

Strikes, riots and civil commotion (SRCC) directly impact businesses operating in the UK, and businesses are becoming increasingly concerned about their exposure. The fashion industry, for example, has been the target of activism campaigns due to their real or perceived links with global issues.

If we look back two to three years ago, however, brands in this sector were largely concerned about supply chain exposure and being linked to certain parts of China that had human rights issues. Just recently, at the end of 2023, the UK has seen large-scale, mostly peaceful, pro-Palestinian protests, with London at the epicentre. Clients that have significant business interests in Israel or Palestinian-occupied territories have been the target of protests and calls for boycotts, which can have substantial repercussions for their reputation and finances.

Cyberthreats

The predominant cyberthreats are ransomware and phishing, targeted at an organisational level. However, geopolitical events and global conflict are also impacting UK companies. For example, the war in Ukraine led to an uptick in attacks from Russian-based assailants. While Ukrainian companies were the primary target, a recent report from the National Cyber Security Centre states that the UK's critical sectors are facing an enduring and significant threat from Russian-based actors as well.[4]

We have also, more recently, seen an increased cyberthreat relating to the Israel and Palestine conflict. Unlike Russia's strategic targeting of internet communications, electricity, water and transport, the exposure largely relates to companies that are openly voicing partisan opinions.

Fraud

Fraud is the most common crime type in the UK, and the sums involved are vast. It is estimated that fraud costs the UK economy £137 billion each year.[5]

However, the total loss is likely to be higher, since many victims do not report offences for a variety of reasons, such as concern around negative publicity.

The COVID-19 pandemic led to a spike in organised criminality, but also gave opportunity for staff members to expose vulnerabilities in their organisations. The pandemic led to more staff working from home and an increased reliance on digital technology. This presented opportunities for cybercriminals to target vulnerabilities, and offered corrupt or disgruntled staff the chance to exploit their companies when working remotely.

In the current economic and political climate, the likelihood of fraud being committed has increased — the motive for staff to steal from an employer is potentially exacerbated by the rise in costs, mortgage rates, debt, or to pay off other monies owed, such as gambling debts.

Furthermore, fraud is seldom a local issue — cybercriminals and fraudsters are most often based overseas, and often in jurisdictions where local enforcement is difficult, if not impossible. With international supply chains and logistics, criminals regularly target overseas companies and those involved in cross-border transactions, exploiting supply chain vulnerabilities.

It is estimated that fraud costs the UK economy

£137Bn

each year.[5]

[4]"NCSC warns of enduring and significant threat to UK's critical infrastructure", National Cyber Security Centre, 14 November 2023.

[5]"Chris Hine, The Financial Cost of Fraud 2021", Crowe LLP, 23 June 2021.

Section 04

Economic Forecast

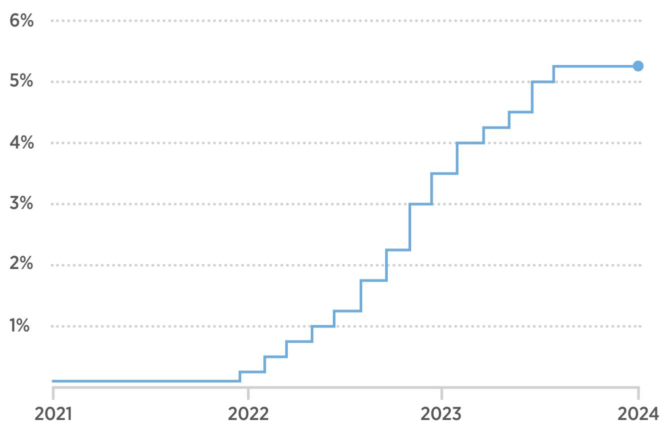
From

Last year, the two defining themes for the UK were the cost of living and the cost of borrowing.

While it would be remiss to claim the cost of living crisis is over when so many households are still struggling, the situation evolved in the last quarter of 2023. Inflation fell sharply despite the 0.1% surprise rise in December, and real wages in aggregate started to rise, spelling an end to the tight squeeze on actual earnings.

Tom Pugh
UK Economist, RSM

While the cost of living crisis is unlikely to shape this year in the same fashion, the cost of borrowing could still provide economic challenges. In Q4 last year, interest rates rose to 5.25%, and it is unlikely they will start to drop until we are well into the second half of this year. Even when they do turn, the drop will be gradual and is predicted to reach levels of approximately 4% at the end of the year.



Bank of England Base Rate Increases

Sector-wise, hospitality spending has been resilient throughout the cost of living crisis. This could be due to pent-up demand post-pandemic, and it will be interesting to see if this growth is sustained in 2024. Retailers have had a tough time — again, this could be due to temporary spending habits induced by the pandemic. If trends revert to normal levels, there could be a recovery in retail spending next year.

The manufacturing sector has been extremely weak for the last couple of years, and construction has been hit very hard by falling house prices and house building. Now that interest rates have peaked, mortgage rates should start to drop, and if they haven't bottomed out, house prices are close to it. This change in trajectory is positive news for the sector and should prompt an uptick in house-building investment next year.

Future forecast

The cost of living crisis may abate, but the drag on the UK economy will remain as roughly two million households are due to re-mortgage this year. Even if interest rates fall more sharply, these borrowers will move from a low legacy rates to potentially double, possibly triple that, undoubtedly impacting their spending. This is one of the fundamental reasons the Bank of England predicts 0.5% growth this year.

The lower income bracket may not be hit as hard this year. The cost of living crisis was potent for this group because two of their main expenditures — food and fuel — drove inflation. Energy prices and food inflation are falling, and the minimum and living wages have increased, reducing the pressure on these households.

Another considerable challenge this year will be the government spending tax policy. The budget deficit is shrinking, and this will likely cause tax revenues to rise and government spending to drop. Over the next two years, considerable fiscal consolidation is pencilled in, limiting economic growth. The consolidation is necessary as the budget deficit is at an unsustainable level of almost 5%. The question is when it happens; will it be evident in the March budget, or pushed back to 2025 and potentially the next parliament?

On a positive note, we can expect another significant fall in inflation in the spring, which will then average around 2.5% in the second half of the year. Wage growth will remain significantly above the rate of inflation. Therefore, households' real earnings will increase, which should feed through to consumer spending. Given the rise in borrowing, business investment has also been more resilient than anticipated.

> "While the potential impact of any general election is substantial, the UK's is expected in autumn, and so its influence will unlikely be felt until 2025."
>
> **Tom Pugh**
> UK Economist, RSM

As current economic conditions dictate government policy, we aren't seeing hugely different economic policies proposed by the Conservative and Labour governments.

While we aren't forecasting a recession, it won't take a powerful headwind to tip the economy into negative territory. Unfortunately, we are unlikely to see significant sustainable economic growth in the UK until at least 2025.

Section 05

Cyber

Risks Remain but Businesses are Better Prepared

Last year followed a few tumultuous years for the cyber insurance market. It's no secret that 2020 and 2021 were not profitable for cyber insurance providers across the world. Headlines were littered with high-profile cyber attacks; the SolarWinds supply chain attack showcased the devastating and extensive impact of a breach.

As a result, some insurers stopped writing new policies altogether, others reduced the coverage offered for renewals, and everyone tried to figure out what made for a truly "good" risk.

A consequence of these challenging conditions was the need for businesses to implement new cyber risk management measures to secure insurance. Now that the market has significantly improved and levelled out in terms of requirements, it is time for businesses to be more proactively aware of the exposures their organisations face and consider insurance as part of their risk mitigation strategy.

Georgia Price-Hunt
Head of Sales, Global Cyber Risk Management, Gallagher

Sam Cheshire
Head of Cyber, Gallagher

Future forecast

The risks that businesses have been managing are likely to persist in 2024 and beyond. AI is impacting the threat landscape significantly and has made the access point to become a malicious actor far wider.

Anyone can use language models (such as ChatGPT) to write code to hack into a specific piece of software, whereas in the past this would have involved detailed training and access to the dark web.

AI has also exacerbated social engineering risk; it allows people to gather information on businesses and people with little effort. Phishing emails now look substantially more legitimate than ever before, and businesses need to look far more carefully for the tell-tale signs.

An example we saw this year was a campaign targeting new employees at a firm with an email from the CEO asking them to purchase Amazon vouchers. Cybercriminals can employ language models to find out everyone who has recently posted their new job role on LinkedIn for a particular company, for instance, and this tactic of pinpointing vulnerable employees with a seemingly legitimate request can be very effective.

Misinformation is also a concern with language models. Those aiming to spread misinformation can use generative AI to create fake content at little cost, and experts say the output can do a better job of fooling the public than human-created content. AI imagery allows for the creation of fictitious imagery and footage, which can look uncannily real. Labour leader Sir Keir Starmer and London Mayor Sadiq Khan have both recently been impersonated in damaging and realistic AI-generated deep fake audio clips posted and shared on social media.

The mid-level corporations are particularly vulnerable to attack as they tend not to have the budget for protective measures like dark trace monitoring. More positively, businesses now have stronger backups, somewhat reducing the likelihood of paying ransoms.

> "Sectors reliant on critical infrastructure such as healthcare, energy, and manufacturing, are still most at risk of ransomware."
>
> **Georgia Price-Hunt**
> Head of Sales, Global Cyber Risk Management, Gallagher

Where should businesses channel their cyber energy?

Investing in robust risk management will mean insurers are more comfortable in offering lower premiums.

> Insurer data shows that roughly **two-thirds** of cyber claims are a result of human error.

Therefore, employee training undoubtedly offers the best return on investment. Yet risk management alone, cannot offer 100% loss prevention, and insurance should be in place to respond to worst-case scenario that could potentially impact any business. Insurance premiums are likely to plateau, but businesses will still be expected to fulfil a certain level of risk management, and insurer requirements such as Multi-Factor Authentication (MFA) are here to stay.

Nevertheless, businesses are much more in tune with cyber risk, and consequently, they also want more education.

Section 06

Directors' and Officers'

Stabilisation Offers Clients the Opportunity to Reconsider Options

After 15 years of soft D&O market conditions, substantial claims in 2015 and 2016 seemed to prompt a market hardening (when premiums increase and the supply of insurance cover to meet demand decreases). Then COVID-19 hit, causing a huge spike in D&O premiums and leaving insurers reluctant to take on any new business.

The market emerged from this challenging period towards the end of 2021. The following year saw many of the premiums for clients worst impacted by COVID-19 reduce quite dramatically and capacity (insurance supply) started to return to the market.

This theme carried into 2023. However, as the year progressed we saw insurers who were under competition start to walk away from risks, indicating the market is nearing a level of unsustainable premiums, leading to stabilisation rather than further reduction.

Steve Bear
Head of Sales and Distribution, D&O
Gallagher

Future forecast

We believe the vast majority of D&O insurance programmes will likely stay flat this year at similar prices to 2023. In 2024, Gallagher's challenge is to encourage our clients to help create a more sustainable environment in the wider marketplace.

> "In a cyclical market such as D&O, long-term relationships must be forged with insurers, with brokers on hand to facilitate and give advice. Clients should get to know their insurers and form a bond of trust rather than move broker or insurer every couple of years for minimal savings."
>
> **Steve Bear**
> Head of Sales and Distribution, D&O
> Gallagher

ESG will continue to be a hot topic in the D&O space. ESG has been discussed as an emerging risk for some time, but it's not emerging anymore and is a live risk for any business.

There are sizable claims coming out of these risk exposures. Whilst governance has always been a key D&O risk (as D&O claims have long originated from breakdowns in the governance and controls of companies) environmental claims, such as greenwashing, and social claims, like modern slavery and a company's social impact on the surrounding environment, are the sorts of claims that are on the increase.

In terms of regulation, a new audit regulator, the Audit, Reporting and Governance Authority (ARGA) was intended to replace the Financial Reporting Council (FRC) last year. ARGA is expected to do two things: separate the role of the auditor in response to the failures of the larger auditing firms, such as the collapse of Carillion, and place more responsibility on the directors for the quality of their financial reporting. However, the audit bill was not mentioned in the King's Speech in November, and, with a general election looming, a potential change in legislative priorities could delay ARGA further.

The Economic Crime and Corporate Transparency Act 2023 received royal assent in October 2023. Although the act is law, the changes are likely to be rolled out over a year or more. Once in force, it will be an offence for organisations to profit from fraud committed by their employees. It's an interesting piece of legislation for D&O; it falls between exposures because it focuses on the company itself rather than individuals. D&O policies historically and understandably do not cover fraud. Commercial crime insurance covers the company's loss if they fall victim to fraud, but that isn't designed to pick up this kind of exposure. Gallagher is currently working with D&O and crime insurers to ascertain where this exposure sits and how we can best tailor our products for clients.

D&O is important for all businesses, regardless of size.

Cover could be even more essential in smaller businesses where they might not have the balance sheet to survive a D&O claim. In contrast to a claim, for example, to rebuild a factory following a fire, which is finite and can be fairly accurately estimated in cost. D&O is subjective, and claims can run for five to six years. Investigations can develop into prosecutions after a very long time, which can spiral and the cost can become many multiples of a company's cash or assets.

In terms of limits of liability, many clients whose premiums rose dramatically during the pandemic chose to reduce their limit. Now premiums are becoming more competitive, it's time for these clients to build back those limits to where they should be.

Section 07

Mergers and Acquisitions

Uptick in Activity Anticipated

The M&A market has had a bumpy ride in recent years. Activity in 2020 dropped off a cliff due to the pandemic, while 2021 saw a spike as the world reopened for business. However, Q2 2022 experienced another sharp decline due to high-interest rates, inflation, strikes, potential recession, and regulatory and geopolitical uncertainty.

Economic volatility tends to slow M&A down, but it is also when valuations become attractive and opportunities emerge. Nevertheless, in the current deal environment, processes are taking longer, and financing cannot be taken for granted.

Transformative mega deals have slowed due to financial and regulatory constraints, but small to medium M&As are increasing, as are cross-border M&A deals for growth-focused companies, concentrating on digital transformation, innovation, and decarbonisation.

The UK M&A market has fared worse than other developed countries due to lower growth forecasts, and deal volumes were down by 30% from Q1 2022 to Q1 2023.[1]

George Minoprio
Executive Director, Mergers and Acquisitions, Gallagher

[1] "Deloitte Mergers and Acquisitions Market Outlook", Deloitte.

Future forecast

While M&A activity was quiet in 2023, increased activity is expected in 2024 as interest rates top out and inflation continues to decrease.

While challenging economic conditions are likely to persist, there is only so long businesses can delay these transactions. The general election may fuel further uncertainty, but it could also prompt a flurry of deals, with businesses anxious to finalise transactions before a potential change of government.

In terms of UK sectors, technology, energy, healthcare, and mining are expected to experience the highest M&A activity. These industries stand to benefit from the current economic climate, and they will be more attractive to buyers in the longer term.

The legacy of COVID-19 has left businesses keen to domesticate the supply of critical components and lessen reliance on cross-border suppliers, and many are looking at M&A as a method to diversify and strengthen their operational resilience. For example, automotive and industrial original equipment manufacturers are acquiring mining companies to secure supply to the minerals necessary for battery production and energy storage.[2]

> "As companies strive to meet net zero goals by 2050, M&A is being considered as a vehicle to satisfy growing ESG agendas. AI talent is an extremely scarce resource that also influences M&A as corporates and PE firms make strategic purchases or exit them to monetise returns."
>
> **George Minoprio**
> Executive Director, Mergers and Acquisitions
> Gallagher

How can businesses considering a transaction in 2024 mitigate their risk?

With so much uncertainty ahead, we'd recommend businesses entering any transaction to only do so after they have considered what protection they have in place.

Insurance due diligence involves a thorough assessment of the target's insurance programme, and is an opportunity to confirm that the target business' coverage is legally compliant and fit for purpose in relation to its business activities. It will address what policies can survive completion, and in view of the change in ownership, specifically focus on the ongoing and runoff D&O. Therefore, it is a main priority for companies going through an M&A.

Businesses should also keep warranty and indemnity (W&I) insurance top of mind. Traditionally, the seller provides warranties or statements about the business, which the buyer relies upon to make an offer. In the event of a breach of warranty, the buyer could potentially sue the seller. Increasingly we now see the seller limit their liability, to say £1, leaving the buyer to take out a buy-side warranty and indemnity (W&I) policy to protect themselves.

[2]"PwC Global M&A Indsutry Trends: 2023 Mid-Year Update", PwC.

Section 08

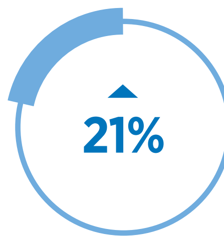
Trade Credit

Understanding the Impact of Insolvency

Last year businesses operated in a sustained, challenging environment. The UK teetered on recession due mainly to the energy crisis, supply chain disruption, rising raw material costs and wage inflation.

This led to persistently high-interest rates that placed those in debt under enormous stress. Many businesses, including some notable sector giants and high street names, succumbed to these challenges and ceased trading in 2023.

PWC has estimated that over 30,000 businesses will collapse in 2024, indicating that there will not be any immediate economic recovery.[2]



Figures released in November last year showed insolvencies to be up 21% compared to the same period in 2022.[1]

Tim Fisher
Managing Director
Trade and Credit Surety, Gallagher

[1]"Monthly Insolvency Statistics", GOV.UK (www.gov.uk), November 2023.

[2]"The Good, the Bad, and the Optimistic: PwC UK economic predictions for 2024", PwC.

Future forecast

Economic conditions in 2024 are unlikely to deteriorate further, but recovery will be slow. It will still be difficult for businesses operating against a backdrop of continued geopolitical uncertainty, likely to be further exacerbated by the upcoming general election. Recent events have demonstrated how volatility in certain regions can escalate and swiftly impact the global economy.

Although they are reducing slowly, UK interest rates are still uncomfortably high, and continued pressure on the financial borrowing market is likely. The lengthy period of low-level interest rates saw a proliferation of low-productivity/low-profitability companies — sometimes referred to as zombie companies. These companies make just enough money to continue operating and service their debt but not to invest in growth. The ending of the government's COVID-19 support measures prompted the downfall of many of these companies. Those that have managed to cling on, are unlikely to survive sustained high-interest rates, therefore this trend is expected to continue into 2024 as those companies hanging on finally succumb to continued economic pressures.

Any borrowing on a fixed rate has been somewhat insulated from rising interest rates. However, these rates will eventually expire, and new deals will be negotiated at significantly higher rates. A key economic indicator is the mortgage market which was a consistent reference point in economic commentary throughout last year and will remain so until mortgage rates significantly reduce.

Until we see through this period of high borrowing rates combined with high inflation, we will continue to see pressure on consumer purchasing habits.

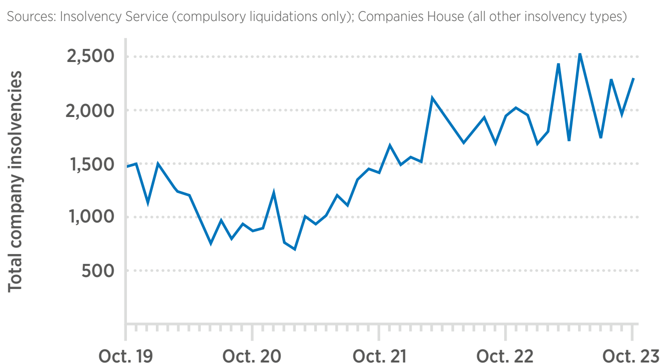
Some raw material prices have reached their peak and are starting to drop, but overall these costs remain high compared to pre-recession, and it has been difficult for manufacturers and retailers to pass these costs on to customers. Therefore, some businesses will struggle to stay solvent, let alone make a profit.

While no sector is immune, some stand out as high risk for business failures in 2024, namely: hospitality and leisure, retail, and construction.

> "Economic conditions in 2024 are unlikely to deteriorate further, but recovery will be slow."
>
> **Tim Fisher**
> Managing Director
> Trade and Credit Surety, Gallagher

Company Insolvencies, England and Wales, October 2019 to October 2023

Sources: Insolvency Service (compulsory liquidations only); Companies House (all other insolvency types)



Insolvency statistics show there has been a steady rise in insolvencies last year. The number of registered company insolvencies in November 2023 was 2,466, 21% higher than in the same month in the previous year (2,032 in November 2022).[1]

A year-to-date comparison shows 2023 to be 14.5% up on 2022 (20,162 vs 23,094).[2] According to Allianz's Insolvency Heat Map, the UK's 2024 expected insolvency level compared to 2019 is very high, at +20%, while its cumulative change over 2023 and 2024 is noticeably increasing between +15% and +30%.[3]

[1]Monthly Insolvency Statistics, GOV.UK (www.gov.uk), November 2023.

[2]Monthly Insolvency Statistics, GOV.UK (www.gov.uk).

[3]"Global Insolvency Outlook 2023-25: From Maul to Ruck?", Allianz, 18 October, 2023.

The impact of insolvency

The impact of insolvency is still largely underestimated. When a construction company with a turnover of £700 million became insolvent last year, creditors listed 1,250 companies that were owed a total of £150 million at the point of failure. This example highlights the potential for the domino effect; the headline insolvency may act as the trigger, but how many businesses that were owed money were not able to absorb this debt?

The domino effect of insolvency can also create extensive and unwanted consequences. If a customer goes into administration, there might be a risk of unpaid invoices. If a supplier goes bankrupt, a business could face a significant increase in supply chain costs. Similarly, if a competitor goes bust, it may seem like good news, but it can be harmful if both businesses share the same supplier who relies on that income to stay afloat. Every change can have a ripple effect and therefore significantly impact the entire chain of events. It is expected we'll see this 'domino effect' be the cause of many more business failures this year.

Insurers' claims ratios (the % of claims paid in relation to premiums earned) are increasing but not enough to raise undue alarm within the standard underwriting business model. There are pockets of concern, such as construction, where insurers' risk appetite is becoming more selective. While trade credit insurance remains in demand, insurer risk appetite and underwriting capacity could become more restrictive if the rising trend in overdue and claims continues. Identifying capacity within the market could become more challenging in the future, requiring a robust broking strategy and approach to ensure adequate protection.

Section 09

Claims

The Claims Landscape

Last year was a busy one in the world of claims. Businesses faced the increased risk of extreme weather, while cyber and underinsurance remained uncomfortably high on the agenda. Motor claims have been in the news for all the wrong reasons, and businesses remain cautious about the future risk exposures posed by electric vehicles.

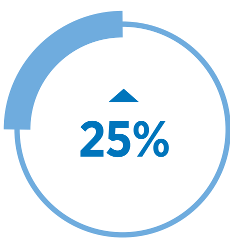
Phil Daly
Claims Director
Gallagher

Climate Change

According to the Met Office, 2023 was the warmest year on record globally.[1] While the UK did not endure any natural catastrophe losses, last year's weather was noticeably volatile. After an abnormal September heatwave, the UK experienced an unusual number of storms.

Extreme weather has a direct impact on property claims. Conversations regarding clients experiencing repeat weather-related losses have become very live with insurers as we focus on actions to help mitigate the impact of those losses in the future.

Future forecast



Summer rainfall is likely to become more intense. The latest State of UK Climate report found that rainfall from an event that typically occurs once every two years in summer is expected to increase by around 25%.

This will impact the frequency and severity of surface water flooding, particularly in urban areas.[2]

For clients who are exposed to extreme weather risk, our priority is maintaining cover, at an appropriate premium level. We are also collaborating with a number of insurers on optimal service levels so clients are able to receive quicker settlements when they need them most.

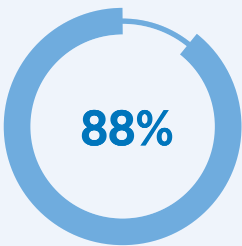
[1] "2023: The warmest year on record globally", Met Office, 12 January 2024.

[2] "UK and Global extreme events — Heavy rainfall and floods", Met Office, accessed 16 November 2023.

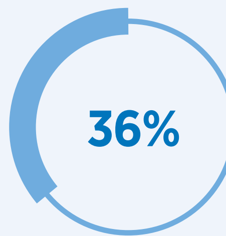
Underinsurance

Underinsurance is a subject that has been well-documented, and one that could be exacerbated by extreme weather. The potential impact of underinsurance when making a claim can be very significant; it can lead to a repudiation of the claim or reduced settlement amounts. For context, if a client is underinsured by 50%, then any claim they make could, in theory, be reduced by 50%, even if it's weather-related.

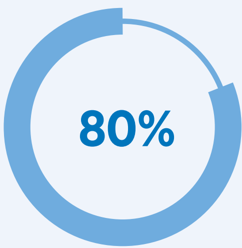
In December 2022, Gallagher's research found that 40% of commercial properties were underinsured.[3] According to Charterfields' 2023 Underinsurance report, the situation is far from improving.[4]



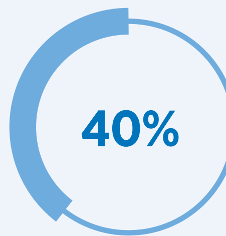
of locations surveyed were underinsured.



of locations surveyed showed building values underinsured by more than 50%.



of locations surveyed showed plant and equipment were underinsured.



of locations surveyed showed plant and equipment values underinsured by more than 50%.

Future forecast

Underinsurance will continue to be a hot topic in respect of claim settlements in 2024.

However, Gallagher is working with clients to embed good risk management and reduce the likelihood of claims arising and would encourage all businesses to do the same.

The impact of underinsurance is going to continue whilst we still see inflation in the reinstatement and building sector. Any significant development to commercial property — such as having solar panels fitted — will likely impact its consequent value. As a broker, Gallagher is focused on having the right conversations and tools available to help our clients adequately and regularly identify their sums insured.

[3] "Over 40% of commerical properties currently underinsured", Gallagher, 5 December 2022.

[4] "Charterfields Underinsurance Report 2023"

Cyber

In 2022, cybercrime cost UK businesses an average of £4,200. The total cost of cybercrime to the UK economy is estimated to be £27 billion per year, and businesses currently absorb a significant proportion of this cost.[5]

Last year saw a concerning resurgence in ransomware attacks resulting in an increase in costly incidents. Although progress has been made, the ransomware threat continues to loom large. Between September 2022 and August 2023, the National Cyber Security Centre received 297 reports of ransomware activity.[6]

Future forecast

Stealing and encrypting data remains the primary tactic used in ransomware attacks. However, data extortion attacks, where data is stolen but not encrypted, are becoming increasingly common in the threat landscape.

Fraud will continue to pose a significant risk to businesses. Cyber-enabled fraud accounted for over 80% of all reported UK fraud in 2021, yet only 32% of UK citizens believed that they would fall victim to fraud.[7] Stats such as this still ring true and highlight the current gap between perception and threat.

Furthermore, as already reported, the use of AI is likely to amplify existing cyberthreats and will increase the speed and scope of attack.

[5] "UK Cybercrime statistics, Twenty four IT services", 1 December 2023.

[6,7] "NCSC Annual Review", National Cyber Security Centre, August 2023.

Motor

Last year, the claims environment for motor seemed to go from bad to worse: repair times for all vehicles increased, with commercial vehicle repairs particularly delayed. The availability of parts has been an enduring problem and there has been insufficient capacity in the UK to cater for all the vehicles in need of repair. Connected to this is a shortage of courtesy cars at the repairer networks, driven in large part by customers holding onto courtesy cars longer due to the delays in repairing their own vehicles.

Future forecast

While the problems relating to conventional motor repair show little sign of improving, the direction of travel for vehicles is undoubtedly electric; current requirements stipulate that commercial operators must convert to alternative fuel sources by 2040 at the latest.

Yet electric vehicles (EV) are also more expensive to repair and present a whole host of new issues. They are more frequently written off because of the cost of batteries and the need to replace them following even quite minor damage. There is still some wariness around how to deal with EV fires and they are often just left to burn out.

Insurers are keen to support EVs but are understandably cautious about the potential for a catastrophic thermal incident, however small this may be. Gallagher is working with insurers, industry stakeholders, and clients to facilitate conversations and awareness of these emerging risks, and their potential impact on claims.

"With aftershocks of world events still being felt by businesses of all sizes, when you add in extreme weather, a heightened risk of underinsurance and more sophisticated cyberattacks, organisations can expect a challenging year ahead where claims are concerned."

Phil Daly
Claims Director, Gallagher

Conclusion

2024 is gaining momentum already, and it's important to acknowledge that the risk landscape for businesses is evolving at the same pace. Although there is still political uncertainty, there are clear indications of where the economy is headed. It's likely that businesses will continue to face challenges, but there are also opportunities to grow and succeed.

Your business will already have specific goals and plans for the year ahead. However, there may be areas where you feel more vulnerable to risk. It could be related to mergers and acquisitions, the security ramifications of organising a public event, or safeguarding your supply chain from customer default.

The good news is that Gallagher is here to help you as your trusted risk partner. With our expertise and knowledge, we can support you in navigating the risks and opportunities that lie ahead. Whether you need help with risk assessment, insurance coverage, or risk management strategies, we've got you covered. So, you can focus on achieving your goals and facing your future with confidence.

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