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whiteboard

Keeping you informed about risk and insurance

July 2011

# What next for the insurance market?

There are a multitude of conflicting dynamics at work in the insurance market at the moment. The question is whether they will manifest themselves in higher premiums, and if so, how companies can prepare themselves. By Nathan Skinner

For the past eight years an abundance of capacity and fierce competition have contributed to cheap premiums and expansive cover in the insurance market. However, this is coming at a real cost to insurers. A tough combination of pressure to keep premiums low, rising claims and poor investment returns means margins are being continually squeezed. The question is whether this will result in rising premiums and more restrictive terms, and if so, what companies can do to prepare.

## Worrying signs

One of the most telling measurements of insurance pricing is the combined operating ratio (COR). This is the main measure of underwriting performance and compares the amount paid out in claims with the amount paid in premiums. Most insurers aim for a ratio between around 88% and 92%; at the moment most are north of that range.

So, for example, Aviva's general insurance and health group results are at 96.8% for 2010, RSA is at 96.4% and Lloyds at 93.3%. Over recent years, a number of companies have seen these ratios get considerably worse. Striking examples include Lloyds, which had a ratio of 84% in 2007 and 93.3% in 2010. Similarly, Allianz's property and casualty results saw a change from 95.4% in 2008 to 97.2% in 2010.

Insurers' results had been 'flattered' with reserve releases for a number of years. But in 2009 reserve releases dried up and in 2010 insurers had to make material reserve increases

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JLT

# news in brief

Rounding up the latest news and developments from the world of insurance

# Large claims do not have to be so painful

No need to be squeezed by large claims

The McTavish Report, *Corporate Risk & Insurance: The Case for Placement Reform*, highlighted that dealing with a large claim can be painful. "While I don't agree with the report's view that this is anything new, I wouldn't argue with the fact it can be difficult. However, with the right approach and resources, businesses can get a good result," says Candy Holland, Managing Director of Echelon Claims Consultants.

The report found that the number of claims disputes has increased – particularly those made by medium-sized firms. Holland says these insights reflect her experience and that as insurers are appointing more experts to carry out more investigations, this can lead to delays, challenges to coverage and protracted negotiations. She says the solution lies in three steps, which need to be taken before a claim arises.

First, the policy should be stress-tested: "Look at potential loss scenarios and walk through a hypothetical claim. Map that against the cover the policy provides, and make sure you establish whether it will respond as you expect," she says.

Second, the business needs a claims plan. Holland explains: "Organisations should have a clear understanding of who deals with each aspect of a claim, what resources they have, how communications will work and how necessary information will be captured. All this needs to be prepared in advance rather than at the point of claim."

Finally, a claims protocol should be agreed with insurers, clearly setting out the practicalities of how a claim will be dealt with. This should include the use of experts (by both insurer and policyholder), payment timescales, how policy provisions will apply, data provision and so on.

> "With the right approach and resources, businesses can get a good result."
>
> Candy Holland, Managing Director, Echelon Claims Consultants

Holland also comments: "Businesses will need to consider whether they bring in additional resources in the pre-planning stage and also whether they will require them in the event of a claim."

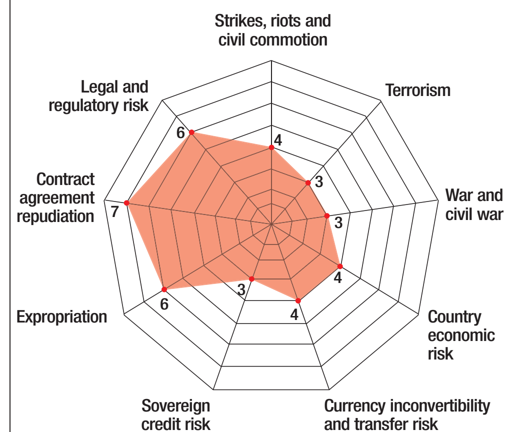
For more information contact Candy Holland on 020 7558 3230 or Candy_Holland@echeloncl.com

## China's risks in numbers

In each issue of *Whiteboard* we use analysis from JLT Specialty's World Risk Review™ to examine the global economic and political environment affecting companies that trade overseas. This issue we focus on China.

The research reveals contractual agreement repudiation as the biggest threat to foreign companies in China, with a risk rating of 7. The risk of expropriation is rated 6, while legal and regulatory risk is also rated 6.

For an explanation of each peril and for further country analysis please visit www.worldriskreview.com




## Machinery breakdown: a critically overlooked risk to business

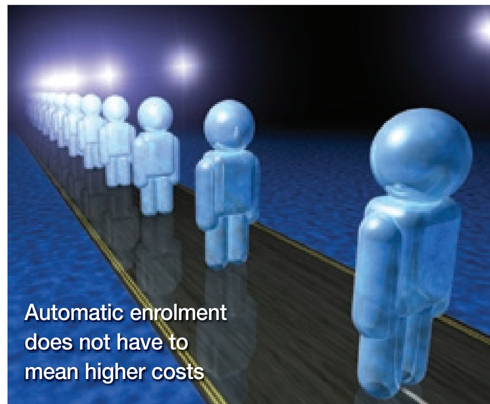
With food and drink companies increasingly operating on a knife-edge, machinery breakdown could deliver a killer blow to businesses if they are not properly covered, warns Jon Miller, an Associate at JLT Specialty

Food and drink companies may not be covered for their machinery breaking down and the resulting financial loss to their businesses. Organisations must understand the limitations of the policies they have in place. "Many food and drink companies are heavily reliant on machinery. There is often an assumption made that machinery breakdown would be covered by their material damage and business interruption policy, but in many cases it is not," he warns.

Standard All Risk policies exclude mechanical breakdown, so that the cost of repair, increased costs of working and the resulting interruption to the business will not be covered.

Miller says: "Companies are under tremendous pressure, with rising raw material costs and squeezed margins. They are potentially already running at full capacity, so have limited ability to withstand even relatively short interruptions to production. As such, an uninsured loss could be catastrophic." Machinery breakdown cover, offered by specialists, is essential to ensure this kind of loss is adequately covered.

# How will you meet the cost of auto-enrolment?


Automatic enrolment does not have to mean higher costs

The introduction of auto-enrolment into workplace pension schemes marks a significant step in achieving better retirement provision for UK employees, but will increase pension costs for almost all UK employers – both through mandatory/additional pension contributions and administration. Fortunately there are a number of strategies employers can explore to offset these additional burdens.

Where defined contribution (DC) pension contribution rates are currently higher than the qualifying levels these can be reviewed, although this may clearly disadvantage some employees. Other benefits should also be reviewed. Those which are considered expensive, but unappreciated by employees, provide an opportunity to redirect existing budget to more valued benefits, including the pension scheme.

Alternatively, instead of changing benefits, employers can implement a strategy of 'rebalancing' remuneration. The introduction of mandatory employer contributions is phased in 1 per cent increments and does not reach 3 per cent until 2017, which provides an opportunity to incorporate new employer pension contributions within normal pay increases. Also, employer pension contributions are not liable to employer national insurance (NI), making increased pension contributions more efficient than paying additional salary. However, this strategy can depend on a history of consistent pay awards and needs to be carefully considered against a background of flat wage growth.

The NI efficiency of pension contributions also makes 'salary sacrifice' a possibility. Pension contributions made by an employee qualify for income tax relief but do not attract any relief against employer or employee NI. As already mentioned, employer pension contributions are not liable to NI for the employee or employer, so if an employee chooses to 'sacrifice' a portion of their salary in exchange for pension contributions, the employer can make savings that can provide a valuable war-chest to fund auto-enrolment costs.

Whatever options are chosen, it is clear that employers must start thinking now about their approach to and strategy for managing auto-enrolment as soon as possible in order to achieve a favourable outcome.

For more informatin contact Simon Hazeldine on 01727 775 102 or Simon.Hazeldine@jlteb.com

" Many networks have more holes than a colander. Each employee accesses the internet, so there are a huge number of gateways in and out. "

Simon Milner, Partner and Head of Cyber and IT Risk, JLT Specialty, decodes cyber risk on page 8

# Echelon launches CBI knowledge centre

Recent world events, such as the earthquake and tsunami in Japan, have brought to the forefront the vulnerabilities of modern day supply chains. An increasing number of businesses with sophisticated supply chains are suffering significant and unexpected losses due to incidents with second, third and fourth tier suppliers.

Contingent business interruption (CBI) insurance covers a company for its loss of business arising from physical damage at a supplier or customer's premises.

Echelon Claims Consultants has put together a comprehensive knowledge centre which looks at the issue of CBI and provides resources and advice about the best ways to prepare for a major CBI claim.

You can access the knowledge centre at www.echeloncl.com/cbi-claims

# High streets rise to the real estate challenge

The British high street is fundamentally changing, so commercial property owners and managers must manage new operational risks. This was the conclusion of a JLT event at the House of Commons involving Mark Field, MP for the Cities of London and Westminster, Paul Morrell, the government's Chief Construction Adviser and Professor Barry Gilbertson, property insolvency expert and independent consultant. Gilbertson outlined that the high street was under pressure from out-of-town shopping centres and online shopping, so thousands of shops now stand empty.

After the event, Bill Gloyn, a Partner in the European Real Estate practice at JLT Specialty, concluded: "These trends create new risks for property owners and managers. However, there are also opportunities. There is great demand for residential property, and if they can change the use efficiently and quickly, they can manage the risk of significant void periods."

He added that the scale of the challenge means looking beyond insurance when considering risk: "They need to consider the bigger picture and formulate adequate risk management strategies. That will be a particular problem in high flood risk areas after the insurers' agreement with government to maintain flood insurance comes to an end in June 2013. This is something that the real estate team are working on, so our clients can still access adequate cover in the future."

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# What next for the insurance market?

*Cover story continued*

>> for the motor fleet market, says Catherine Thomas, Director of Analytics at AM Best.

This has led some commentators to speculate that we could be at an inflection point, and that rates could go up from here. In a recent report Fitch Ratings said it expects UK non-life insurance premium rates to rise more quickly over the next 12 to 24 months as insurers seek to improve returns on capital. However, there are a number of different dynamics at work in the market, pulling in different directions.

## Pressure to keep rates low

On the one hand, there is an abundance of capacity in the market. Several insurers, for example, are investing in new teams, products and distribution centres to grow their share of the mid-market business. American insurers like Liberty and Travelers, along with Bermudan underwriters Aspen, have recently announced that they are building regional teams and offices.

Aspen has established offices in Bristol, Birmingham and Glasgow; Liberty is opening new operations in Birmingham and Manchester; and Travelers put together a new underwriting team at its Glasgow office. By conservative estimates, the trio could pump an extra £300 million capacity in the next couple of years into what is an already crowded space.

Meanwhile, companies are putting pressure on insurers to keep premiums low. The economic environment and the knock-on effect of government cuts are depressing profits, and businesses are looking to cut all their costs. Insurance is not immune from the potential cuts.

While the competitive market is constraining their ability to put premiums up, insurers are having to change their underwriting attitudes and favour those companies that manage their risks best. "There is more focus on the quality of a risk and the risk management that a company has," says Gary Beck, a Partner at JLT Specialty. Subsequently, there is an increased competition amongst insurers for these risks.

## Pressure for rising premiums

On the other side of the coin, there are a number of factors creating pressure for a market hardening. The frequency and magnitude of certain types of claim are increasing in the current economic environment. Simon Cooter, Director of Market Management and Regional Operations at Brit Insurance UK, says fraudulent claims and property-related claims under professional indemnity policies are particular growth areas. Meanwhile, personal injury payments are creating pressures of their own, with rising payments pushing claims inflation up even faster than general inflation.

Recent natural catastrophes have also added substantially to payouts. Patrick McMillen, Head of Marketing & Sales at Amlin UK, says: "These are having a wider impact on the market than just catastrophe reinsurers. There are substantial domestic insurance losses retained in Australia, New Zealand and Japan. Contingent business interruption losses from the Japan earthquake in Europe and North America

## 4 tips … on how you can prepare if the market hardens

1. Lock in rates whilst they are still attractive – evaluate the benefits of long-term deals, paying attention to specific wordings
2. Increase your efforts when presenting your risks to insurers – undertaking a broking survey can prove valuable in terms of providing the right level of detail to insurers and allowing them to price your risk accurately
3. Assess your appetite for retaining more risk – creative programme design, such as using cross-class deductibles, can reduce premium spend, but you need to ensure that the reduction is worthwhile for the additional risk assumed
4. Review risk management procedures, particularly in high-risk areas of your business and where you have suffered claims or had near misses

## What happens next? The insurers' views

Ask five insurance professionals what is likely to happen to prices in the insurance market and you are likely to get five different answers. But some experienced individuals are pointing to strong signs of a return to the hard market. David Smith, Managing Director, Commercial Broker at Zurich UK General Insurance, says that current market conditions are remarkably similar to the late 1990s, when the market turned after "years of underpricing of risks by insurers". "Moreover, for sections of the market, particularly casualty classes, there had been little recognition of the enhanced risk environment caused by new (and in some cases retrospective) legislation, and by the extra legal pressures that were beginning to mount on companies and their directors… Similar pressures are building in the market now."

**Will it take a catastrophe?**

Lloyd's Chief Executive Richard Ward warned recently that the next big natural catastrophe will hit the insurance industry's capital, not just earnings, unless rates rise significantly. "For the last two years we have been lucky," says Ward. "At some point our luck will run out." Lloyd's announced claims in the North Atlantic region of £2.4 billion as a result of natural catastrophes there in the first quarter. Ward points out that these claims have occurred in just one quarter of the year and that they already exceed total losses for the whole of 2010, saying: "The next big catastrophe could well be a capital event." Ward calls strongly for rates to harden, arguing that it is the responsibility of both underwriters and brokers to ensure pricing reflects the risk. "Rates should rise," he says. "Prices are dangerously low at present."

**Will Solvency II be the catalyst?**

Solvency II, the new European risk-based capital regime for insurers, could be a factor in changing rates, although it is not yet clear if capital restructures will have an effect on capacity output. By some estimates Solvency II could result in UK insurers having to retain millions of pounds more in reserves and this would dramatically affect the price of their products. AM Best suggests that Solvency II could force captive insurance companies to quadruple the amount of capital they hold in reserve. Added to this, there's also the significant cost to the insurance industry of implementing the new regime, which the FSA has estimated will be at least £100 million. Insurers may pass these costs on to their customers.

**Will insurers grasp the nettle?**

Another possibility is that there will not be a single catalyst, but a series of events that finally persuades one or two major insurers to put up rates and lead the market. Simon Cooter, Director of Market Management and Regional Operations at Brit Insurance UK, says: "We have always believed that hardening was most likely to be a consequence of the determined action of two or more key players when their results were no longer acceptable. The longer negative rate movements and claims inflation exceed the movement in sums insured, turnover and wages, the greater pressure there will be for a market-wide rate correction."

Smith concludes: "Rates are beginning to rise in the UK, most notably in motor fleet business, and other lines will follow. Even with the excess capacity in the market there is an inevitability that a market hardening is on the way."

> "Even with the excess capacity in the market, a market hardening is on the way."
>
> David Smith, Managing Director, Commercial Broker, Zurich UK General Insurance

also look set to be substantial. These losses will therefore have a knock-on effect on insurance as well as reinsurance pricing, especially in the loss affected areas."

A second pressure which will eventually have a major effect on the market is interest rates. These have been at historic lows for some time, which means investors have looked further afield for profit and have sought the solid, dependable returns provided by insurance companies. This means there has been an abundance of investor capital. Once interest rates begin to rise, investors could return to the capital markets, leading to a withdrawal of this capital.

Combined with this, insurers are less able to supplement their underwriting with investment income as they have done in the past because interest rates are so low.

**quick facts!**

- ✓ On one hand, capacity and competition are keeping rates low.
- ✓ On the other hand, claims performance, natural catastrophes and falling investment returns mean rates could rise.
- ✓ Buyers should prepare for possible increases.

## Prepare for rises

Calling the next move in the market is therefore fraught with difficulty (see box above for predictions from insurers). However, with so much talk of rising rates, it is vital to prepare for the possibility. "Companies should start to think about how they present their risks to the market," says Beck. "From a risk management point of view they need to be taking steps to improve the quality of their risk."

"Companies need to ensure all the positive aspects of their risks, in terms of their risk management investment, are outlined to their broker and their broker needs to sell that risk to the insurer," adds Ted Pearce, an Associate at JLT Specialty. He suggests companies interrogate their claims experience and present it to insurers so that it is a "fair reflection of their business and how it's run".

In addition, with the help of their broker, companies can optimise their insurance spend. The simplest way to reduce premium costs is to increase deductibles. But companies that do so need to be confident in their risk management abilities. When the market gets very hard, some companies have to take higher excesses. "When it gets very tough there are all kinds of things that companies can do," explains Pearce. "Early planning of the renewal is essential, the longer time you have as a lead-in the longer you have to consider your options and deal with your insurers."

A good broker should be able to sell their client's risk, even if the company is in a high-risk sector. But companies can do their bit to help by demonstrating a decent loss record. "What will always show good risk management is quality documentation regarding health and safety and solid risk assessments," adds Pearce. "A good understanding of how a loss event could disrupt the business and how you plan to deal with that is also essential. If the client has these issues in mind and they are showing that to their insurers, then whatever happens to the market they should be able to get the best possible deal for their business." ■

To discuss any of the issues raised in this article contact Ian Scott on 0113 203 5832 or Ian_Scott@jltgroup.com

# talking points

## Jargon buster

### Claims made policy

While a PI insurance policy is in force it will cover you for claims made against you during that period of insurance rather than the professional services or advice you provide during that period. This means it is important to maintain cover while there is still a risk of a claim, even if you no longer provide the professional services that prompted the initial purchase.

### Retroactive date

Claims will only be covered for work that is carried out after the retroactive date stated on the policy. When you first take out PI cover this will usually be the inception date of the policy. After this, providing you maintain cover, the retroactive date will remain the inception date of your first policy.

### Civil liability

A broader policy wording than on a standard negligence-based PI cover. This covers areas such as infringement of intellectual property rights, libel and defamation – but do check the exclusions.

### Condition precedent

This is a condition that must be met in order for the insured to receive the benefit of the policy. A common condition precedent is the timeframe in which you must notify the insurer of a claim after your first awareness. In that example, failure to comply with the specified timeframe would allow insurers to decline a claim even if their position has not been prejudiced by the delay in notification.

## Master class

Chris Stanley, Partner, JLT Specialty

# How to get PI cover right

### Q What is PI cover?

Professional indemnity (PI) insurance is a form of liability cover, giving you protection in the event of claims by a third party for professional negligence. This will cover things such as design, advice and specifications, and differs from product liability in that it covers claims arising from the provision of professional services rather than the sale of physical products. As well as negligence, claims could include error, unintentional breach of intellectual property rights and loss of documents or data. It covers damages and the legal fees and costs incurred in the defence of a claim.

### Q Do I need it?

PI cover should be purchased by anyone providing professional advice or services, from traditional professions such as lawyers and architects, to more recently emerged professions like IT and management consultants. Sometimes it will be a requirement to have PI insurance. This could be the case where you work in a regulated profession, or a minimum level of cover could be stipulated in a contract, for example JCT construction contracts.

### Q How do I work out how much cover I need?

This depends on a number of factors, including the type of work you do; the risk that someone will take legal action against you; the potential size of a claim; and any requirements stipulated by a contract or professional body. Three times annual fee income is a good starting point, but also consider the worst case scenario and the likelihood of it happening. You also need to think about how long you need cover for. PI is written on a 'claims made' basis, so while it is in force it will cover you for claims made during the policy period rather than just covering the services you provide in that period. As claims can occur long after you provide the service, you should keep cover in place for several years: typically six, although some contracts specify up to 12.

### Q What pitfalls could catch me out?

It is essential to disclose all material information otherwise claims could be declined. Buyers must complete a proposal form, which becomes part of the policy contract. These forms are designed to capture all the relevant information but, if you feel an important part of your professional service has not been disclosed, speak to your insurer or broker. Whoever is completing the form should check with all senior executives that what is on the form is correct to their knowledge.

Consideration should also be given to retroactive cover. When you take out PI cover for the first time you may be able to buy retroactive cover to give protection for future claims that arise from professional services performed prior to the inception of your first policy. If organisations are established and have not bought cover before, they must consider existing exposures and whether they need retroactive cover back to when they started trading.

There is also a claims disclosure clause that must be carefully observed. The company must disclose any potential claims, or circumstances that may give rise to a claim, to insurers within a specified timeframe. In some policies this is worded as 'immediately'. In other policies the notification requirement is 'as soon as is practicable', which allows the policyholder a far higher degree of latitude.

> "Consider the worst case scenario and the likelihood of it happening."
>
> Chris Stanley, Partner, Financial Risks division, JLT Specialty

### Q What are the implications of getting it wrong?

Getting it wrong can be hugely expensive. Failing to disclose material information could mean a claim is declined. Likewise, if you do not take out sufficient cover you could find yourself having to meet the additional costs.

Organisations also need to think about the damage to their reputation when a claim is made. They need to establish a plan as to how to minimise the damage, and put in place protocols with the insurer to ensure claims are handled in a timely and efficient manner.

### Q How do I go about getting it right?

While smaller businesses in some professions may be comfortable buying 'off the shelf' cover direct from insurers at relative low premiums, bear in mind that PI can be a complex and unfamiliar class of insurance. For many professions, the risk of being sued is an occupational hazard and damages and defence costs can run into the millions of pounds. Larger companies should always utilise the services of an insurance broker with a specialism in PI to ensure that the most appropriate cover is arranged for the exposures faced.

# Did you know...

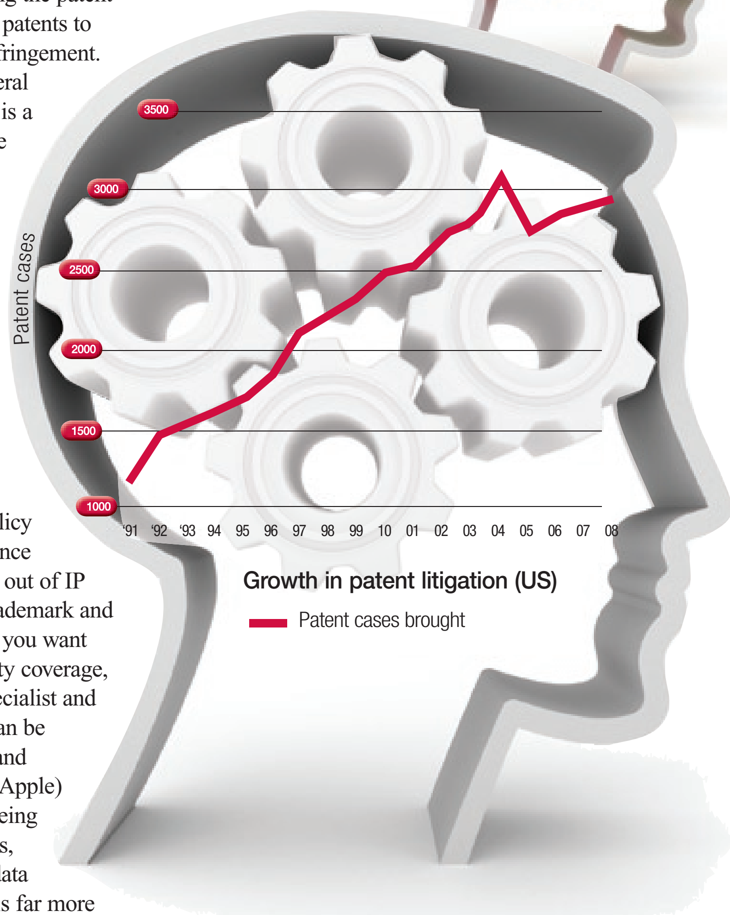
## You may be at risk from intellectual property infringement

Protecting your intellectual property (IP), whilst also ensuring you do not inadvertently infringe someone else's, is a complicated business. The legal landscape is not straightforward. Although there are some international treaties in place, every country has its own IP law. Often, companies trading internationally will only register their IP in key markets such as North America, Europe and parts of Asia.

Patents are of particular concern. Although you can carry out a search of existing patents before registering your own, there is no guarantee that you will not inadvertently infringe an existing one. Infringing a patent presents problems. Unlike infringement of a trademark or copyright, which can typically be resolved simply by correcting the offending matter, if you infringe a patent there may be issues about anything relating to it that you have already sold. Unintentionally infringing a large company's IP can result in an expensive legal battle – one that few smaller companies can afford to fight.

A worrying trend is the growth in aggressive patent lawsuits. For now this is predominately confined to the US, where 'patent trolls' buy up patents from bankrupts and garden shed inventors. They have no interest in manufacturing or marketing the patent invention, but will use the patents to pursue cases of alleged infringement. As settlements can be several million dollars or more, it is a lucrative business for these companies and their lawyers, who often work on a contingent basis for a percentage of any award. This industry is increasingly obtaining funding for its battles from venture capitalists and hedge funds.

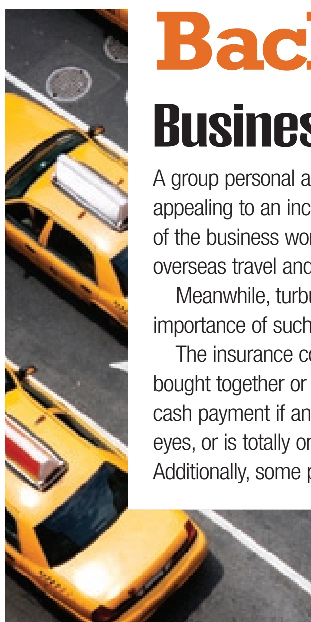
Insurance can cover many of these risks. An errors and omissions or a professional indemnity policy can provide cover for defence costs and damages arising out of IP infringement, including trademark and copyright infringement. If you want patent infringement liability coverage, this is available from a specialist and limited market. The risk can be 'catastrophic' (see Nokia and Qualcomm, or Nokia and Apple) and, with so many cases being settled behind closed doors, there is not much claims data available. However, there is far more coverage available to non-US headquartered mid-market businesses.




SOURCE: REPORT & US COURTS; JUDICIAL FACTS & FIGURES

# Back to basics

## Business travel



A group personal accident and travel insurance policy is appealing to an increasing number of companies, as globalisation of the business world means employees are involved in more overseas travel and secondments.

Meanwhile, turbulence around the world has increased the importance of such policies.

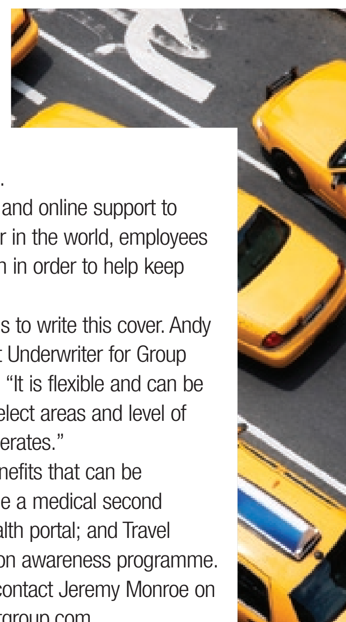
The insurance combines two types of cover, which can be bought together or separately. Personal accident cover provides a cash payment if an insured employee is killed, loses limbs or eyes, or is totally or partially disabled as a result of an accident. Additionally, some policies provide rehabilitation support, signposting treatment and helping an employee manage their recovery.

Travel insurance, meanwhile, covers areas such as cancellation, delay, loss of baggage and other items, hijack and kidnap, and legal and medical expenses.

Some policies also include telephone and online support to ensure that whatever happens, wherever in the world, employees can easily access advice and information in order to help keep them safe.

JLT Specialty has a facility with Chartis to write this cover. Andy Hallouma, Senior Business Development Underwriter for Group Accident and Health at Chartis, explains: "It is flexible and can be tailored to your needs, allowing you to select areas and level of cover, as well as the regions where it operates."

The policy also includes additional benefits that can be accessed without claiming. These include a medical second opinion service; an interactive online health portal; and Travel Angel, an e-learning security and situation awareness programme. For further details on this policy please contact Jeremy Monroe on 020 7528 4078 or Jeremy_Monroe@jltgroup.com



# Decoding cyber risks

Businesses face a growing number of cyber risks. Many think they have the security measures in place to protect themselves, but as recent high-profile victims of hacking have shown, this may not be enough. By Sarah Coles

Many directors will have seen the fallout at Sony after its network was hacked at an estimated cost of £105.5 million this year, and breathed a sigh of relief that their own business network is secure. However, they should not be too quick to dismiss cyber risks. Whatever your business, your size or sector, you face serious IT risks, and many leaders have not taken sufficient steps to protect themselves.

"Every business needs to understand its exposures," says Simon Milner, Partner and Head of Cyber and IT Risk at JLT Specialty. Companies carrying out key processes such as trading, purchasing or managing suppliers online will be concerned by threats to their online connection. Those housing significant client records or employee data will be concerned by inadvertent disclosure of data. Any company developing new products or services will be concerned about security breaches leaking this information. For those in politically sensitive sectors there is the added threat from foreign governments seeking to disrupt the business.

## Understanding the threats

Threats can come from any number of quarters. At its most simple there is the risk that things will just go wrong. Someone could download a piece of software or a patch and it will conflict with something else. It does not have to be a sophisticated attack, it can just be an accident.

There are also risks from within the business. In the 1990s, Milner says, the main threat was perceived to be from rogue employees, sub-contractors or temps who were inside the fortress walls, and had access to all or part of the network.

Now, the pendulum has swung and companies are most concerned about threats from outside. Whether you are an online company or an old-economy firm, you are a potential target for cyber criminals. Somewhere you will have something of value to the cyber criminal, who can use it to turn a profit or disrupt your business, and it is not necessarily all that hard to access it.

**quick facts!**

- ✓ No network can be entirely secure.
- ✓ Measures such as firewalls, policies and procedures all help.
- ✓ Organisations need specialist cyber insurance to sit alongside this, and can select the modules that suit their business best.

> "If someone really wants to get into your network, there's very little you can do to stop them."
>
> Simon Milner, Partner and Head of Cyber and IT Risk, JLT Specialty

Milner explains: "If you ask the IT director what risk you face, he's going to say the network is safe, but that can never be true. Many networks have more holes than a colander. Each employee has a computer and each will access the internet. That means there are a huge number of gateways in and out of the organisation. The IT department may be able to give things a cursory look before they come into the business but they won't be able to spot many of the risks – especially if they are new viruses or malware. If someone really wants to get into your network, there's very little you can do to stop them."

## Manage the risk

This does not mean that risk management is not key. Organisations should have security software and firewalls in place, along with policies and procedures to protect data where possible. They also need good disaster recovery and continuity planning in case something goes wrong.

This should be augmented by insurance. Cyber risks are not covered by property policies, which are triggered by a physical event. Equally, public liability offers little assistance, as it is intended to cover bodily injury and property damage. There is some cover available under professional indemnity policies, which cover wrongful acts committed by employees.

However, for comprehensive coverage, a cyber risks policy is usually needed. This is set up in modules. At one end of the spectrum this includes damage to data, the cost of reconstruction and lost revenue. Then there is security and privacy and cyber terrorism. Depending on where you are based, this will cover PR, credit monitoring and notification. There is also a multi-media option, which covers content on websites for everything from libel to copyright.

Businesses will struggle to get total security. As Milner says: "You can't lock everything down or you couldn't trade." The answer is to combine robust security with insurance and planning, so that if you were to suffer a Sony-style attack, while you may not be breathing a sigh of relief, you will not be going bust either. ■

**find out more**

For information on JLT Specialty's cyber risk insurance, visit www.jltgroup.com/it-risk-assessment or contact Simon Milner on 020 7558 3647 or Simon_Milner@jltgroup.com

# Product recall squeezes food and drink industry

As product recall incidents increase, food and drink manufacturers who are already facing financial pressure must consider specialist insurance. By Celia Mather

The number of product recalls is on the rise. In 2010 the Food Standards Agency (FSA) recorded 1,505 incidents in the UK – an increase of 300 from the previous year. The financial consequences of a product recall can be devastating for a food or drink manufacturer. The costs of recalling products and destroying them, coupled with the expenses of advertising the recall, mounting a PR campaign to address a damaged reputation and loss of profits can be astronomical. With food and drink manufacturers under pressure from all sides, the cost of a recall could ruin them.

Product recalls are increasing. Three high-level incidents were handled in 2010, compared with one in 2009. Incidents in 2010 included a Salmonella Bareilly outbreak associated with bean sprouts and amnesic shellfish poisoning in whole king scallops. Emerging risks include new technologies, such as genetically modified food and animal cloning, where there may be unknown risks. Meanwhile, longer and more complex global supply chains increase the risk of contamination or damage to the product outside the manufacturer's control.

## Need for protection

Food and drink manufacturers are already under pressure from increasing raw materials costs, rising property and credit risks in a tough economic environment and pressure from retailers to reduce margins.

Product recall insurance can protect manufacturers from the financial fallout of a recall. The insurance covers product contamination, extortion and malicious tampering. It can also include consequential costs, such as loss of profit, crisis containment and brand damage. It can help to manage a potential crisis and protect the policyholder's reputation, in addition to covering the costs relating to the recall.

Yet these policies are not considered essential by many manufacturers. It is estimated that under 10 per cent of manufacturers have specialist cover, attempting to rely instead on product liability cover. Ian Edwards of JLT Specialty's Food and Drink practice, says: "Standard product liability policies provide protection for liabilities arising from injury or property damage caused by the products supplied – recall expenses are not covered."

This position should be reconsidered as the market for this insurance has changed. "Traditionally, product recall has been seen as being costly, restrictive and not relevant by many food and drink manufacturers," says Edwards. "However, it is much more widely available now and market competition means that premiums are reducing." Where a broker makes insurers fully aware of supply chain risk management standards, it can help ensure competitive terms and costs.

> "Cover is widely available and competition means premiums are reducing."
>
> Ian Edwards, Leader of JLT Specialty's Food & Drink practice

## Limitations of cover

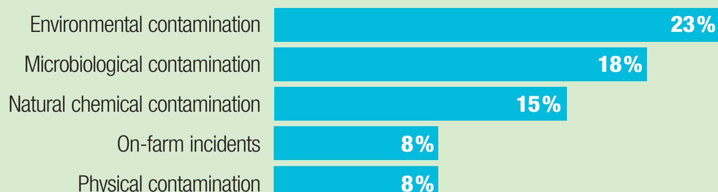
There are limitations to the cover. The policy does not provide long-term cover in the way that liability insurance does but responds to immediate problems. For example, the red food dye Sudan 1 resulted in the FSA recalling 418 products in 2005, including ready meals, pizzas and sausages, from all the major supermarket chains. However, as the ill-effects of this allegedly carcinogenic substance are not likely to manifest as a tangible injury within the period stipulated by the policy (usually 365 days) the product recall cover was not triggered. Further, most recall policies specifically exclude issues arising from carcinogens as standard. It therefore must fit within a broad risk management strategy.

Edwards advises: "It's important that companies evaluate their potential risk to product recall and consider how their business would cope in such a situation. Product recall insurance is becoming increasingly valuable to manufacturers and can play a key role in a firm's risk management strategy." ■

## Food Standards Agency investigations

In 2010 the FSA investigated 1,505 incidents in the UK. Where needed, action was taken to ensure consumers were protected from eating unsafe food.

### The major categories of incident in 2010 were:



For more information contact Ian Edwards on 0121 626 7804 or Ian_Edwards@jltgroup.com

Focus on

# Engineering and manufacturing

Natural disasters across the world may not have directly affected many UK engineering and manufacturing businesses, but they highlight growing risks within the sector.

Risks for engineering and manufacturing firms were brought sharply into focus by the events in Japan earlier this year, which demonstrated a number of increasing risks within the sector, says Andy Bear, Industry Practice Head Transport, Engineering & Manufacturing at JLT Specialty.

## Supply chain risk

Following the Japanese earthquake and tsunami, production was halted in many manufacturing facilities. In the country that pioneered 'just in time' production methods, supplies of components to companies such as car manufacturers and technology companies dried up. This forced some companies to reduce their working weeks, or even stop production altogether. There were then knock-on effects for other companies elsewhere in the supply chain. For instance, when car production stalled, manufacturers of other car components also saw demand slow. It meant that many firms entirely unaffected by physical damage in the region were forced to shut down their production lines.

This goes to show just how complex and interlinked supply chains have become, and how important it is for manufacturers to map their supply chain and understand their risk exposure. Tim Cracknell, Partner in the Risk Consultancy practice at JLT Specialty, says it pays to work through the supply chain considering scenarios of what would happen if one or more suppliers could not deliver. Businesses can then use this to determine the best approach for improving their risk profile.

## Check cover

The increasing complexity of supply chains means it is also essential to understand the cover that the business has in place, and its limitations. Many insurance policies would have been stretched by the type of supply chain claims that resulted from the Japanese earthquake and tsunami.

There are solutions available. A business interruption policy can include a suppliers' extension, which would provide cover for problems with supply chain, and a customers' extension, which covers problems that may arise when a customer is affected and this impacts on your business. Cover can be specified, where suppliers or customers are named, or unspecified, where it will cover any supplier or customer. However, if you go for this broader cover, the limits will be lower.

## Cyber risk

As manufacturers depend increasingly on technology, they must also consider cyber risks. Systems are increasingly interconnected, with the factory floor providing multiple links to supply chain management systems. In manufacturing sites, machine-to-machine connectivity has improved efficiency, which is essential to competitiveness. However, it has also left businesses exposed to accidental mistakes and deliberate cyber attacks. It is essential that businesses understand their specific risks, take steps to improve security of their technology and consider cyber insurance should anything go wrong.

> "What would happen if one or more suppliers could not deliver?"
>
> Tim Cracknell, Partner, JLT Specialty

## Differentiate your risks

Although every company in this sector is different, many insurers do not differentiate between them from a risk perspective. This means companies also need to work with their brokers to differentiate themselves in the eyes of insurers, explaining their risk profile and highlighting the risk management processes and policies they have in place in order to ensure competitive rates and terms.

As an example, we look at the engineering and manufacturing sector by 'subsector', to allow genuine differentiation of companies' risk profiles. On top of this we encourage individualisation. Even if two companies are producing exactly the same item, it is unlikely they will have the same risk profile. ■

**quick facts!**

- ✔ More complex and interlinked supply chains mean companies should map their supply chain and understand their risk exposure.
- ✔ They should work through the effects of scenarios and consider how to improve their risk profile.
- ✔ Businesses must consider cyber risks including exposure through machine-to-machine connectivity.
- ✔ Businesses must understand their existing cover and its limitations. They can consider solutions such as business interruption or a customers' extension.
- ✔ Companies should ensure their broker is working to present their risk profile in full to ensure the insurer differentiates effectively and offers them the best possible deal.

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# About JLT

JLT Specialty Limited (JLT) is the largest member of Jardine Lloyd Thompson Group plc, a company listed on the FTSE 250 index of the London Stock Exchange. The Jardine Lloyd Thompson Group is a risk management adviser, insurance and reinsurance broker and provider of employee benefit administration services and consultancy advice.

JLT provides market-leading industry knowledge and expertise in specialist fields to some of the world's largest companies. What sets us apart is the quality of our people and the environment we have created. It allows individuals to work together as a cohesive and focused team without internal boundaries, promoting personal accountability and responsibility for the benefit of our clients and other stakeholders.

Our Regional Partnership division provides risk and insurance services for mid-sized to large corporate clients. Clients benefit from a blend of deep sector knowledge and technical expertise, coupled with the ability to translate options and recommendations into a language that is clear and easy for all to understand.

We have offices in Birmingham, Leeds, Liverpool, London, Maidenhead, Manchester and Southampton. This means we have an in-depth understanding of regional issues and that clients benefit from informed advice and support on their doorstep. This local service is backed up by additional expertise at the centre – a unique combination that guarantees best in class solutions.



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# and finally...

Editor's letter

## A bold prediction

Warren Downey: Sees a hardening market

In the cover story of this issue we headline the state of the insurance market, which seems an apt phrase on a number of levels.

The current dynamics of the insurer market mean that in some areas we are experiencing some of the softest conditions ever (by which I mean low prices and high flexibility). These circumstances seem incongruous with many of the fundamentals in the market, including substantial catastrophic losses in Japan and New Zealand, reinsurer pressure, low interest rates and long term unsustainable loss ratios approaching 100% (see page 1). Pulling in the other direction, capital flows to insurers, increased appetite of existing players, particularly in the UK mid-market, and the pressure on all insurers to hit growth targets, have combined to keep substantial downward pressure on rates.

It was not that long ago that a famous British politician declared an end to boom and bust and this editor is not going to make that mistake. In fact he will take the equal and opposite risk and predict that we will see a hardening of the global insurance market in the coming 12 months. Change will come and in motor rates is already being felt. However, for the reasons outlined above and covered more comprehensively throughout this issue of *Whiteboard*, the UK corporate market will be one of the last areas to be affected.

It is in these inevitably changing and challenging conditions that JLT's risk advisory and insurance placement competencies really come to the fore. We are of course working hard with clients to position insurable risks in the best possible light and simultaneously working closely with insurers to develop and encourage consistent, supportive, secure relationship-driven supporters to respond to the needs of our current and prospective clients. By this combination we will be able to work with you to navigate the changing world that is the cyclical insurance market.

Warren Downey
Managing Director,
Regional Partnership

# Timber frames – the risks are building

Timber framed buildings are increasingly popular, but they come with their own risks, which need to be properly understood.

Green credentials, lower costs and changes to legislation have fuelled the construction of timber framed buildings in the UK over the past ten years. This is throwing up a number of challenges.

Compared with more traditional building methods, timber framed properties are regarded as being more susceptible to extreme damage when exposed to a fire, so the estimated maximum loss may need to be set at a higher level.

Additionally, because of the more intense radiated heat in fires in timber framed buildings, there is a greater risk that it will damage neighbouring properties. There are also concerns that these buildings may be more susceptible to storm damage.

Until a greater understanding of the risks involved is gained, insurers are likely to take a cautious approach to underwriting this business. To ensure you have the right insurance cover, talk to insurers early in the project.

"Bringing insurers into the process during the design stage is advisable so they are aware from day one what materials are going to be used and what fire detection systems are in place," says John Searing, Head of Risk Management for JLT Specialty's Real Estate practice. "Insurers will also be able to offer advice and guidance on the most appropriate fire detection systems."

Enhanced risk management will also be important to secure the right cover on the right terms. ■

To read this article in full please go to www.jltgroup.com/insuring-timber-framed-buildings

SOURCE: FIRE STATISTICS MONITOR: APRIL 2009 – MARCH 2010, COMMUNITIES AND LOCAL GOVERNMENT DEPARTMENT