A JLT Specialty Limited publication

July 2011 www.jltgroup.com

Risk Specialist

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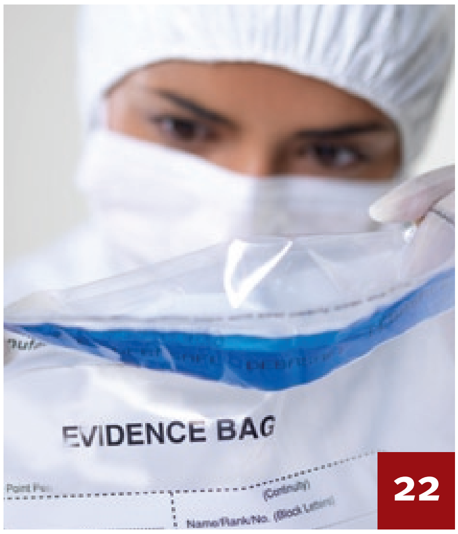

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Risk Specialist is the client publication of JLT Specialty Limited, a specialist insurance broker providing market-leading industry knowledge and expertise to some of the world's largest companies.
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Paper sourced from well-managed and sustainable forests.

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Port authorities eye opportunities

Many port authorities that put expansion plans on hold over the past two years are considering how they might capitalise on new trade flows and recovery in their core markets. However, they must be aware of the risks involved.

One popular model of expansion is concessioning, under which the partnership between the authority and the concession holder is cemented by legally binding long-term agreements. Port authorities are exposed to a number of risks through these agreements which, if not handled correctly, can lead to substantial losses. There are at least two areas of risk to consider here: risks around the decision-making process itself and operational risks.

Most of these agreements are for at least 20 years and place strict obligations on the concessioning party to provide a high level of service to its concession holders. Having provided a service level agreement, any non-performance can be the cause of a loss to the concession holder and thus a claim from them.

If a claim arises, an authority will quickly discover if it has the resources to mount a defence and an insurer willing to help. The cost of insuring against such liabilities need not be high but, in a tough business climate where the mentality is skewed towards finding fault and apportioning blame, ensuring the right cover is in place becomes essential so that the risk can be adequately transferred.

• *For more information, please contact Andrew Webster on +44 (0)20 7558 3428*

Concessioning can expose port authorities to substantial liabilities

GOSH, we helped raise £250,000!

JLT Specialty was delighted to sponsor a charity golf day in aid of the Great Ormond Street Hospital's Children's Charity. The event raised £250,000 towards the appeal.

This was the second charity golf day, with the aim of raising the final funds towards the Theatres for Theatres appeal at Great Ormond Street Hospital, which is raising money to help fund two new operating theatres within a new children's centre for neurosciences.

The appeal has been inspired by Oscar Bearman, a patient at the hospital. The Neurosciences Unit is the largest paediatric neurosciences centre in the UK providing care for children with disabilities, tumours and diseases affecting the central nervous system (such as epilepsy, craniofacial disorders and cancers).

JLT Specialty's golf day raised £250,000

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-chain management, 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 loss of business arising from physical damage at a supplier's 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.jltgroup.com/CBI-Claims

Employers' liability database goes live

Since April this year, employers' liability (EL) insurers have had to provide information to the Employers' Liability Tracing Office (ELTO) for every policy they write. In April 2012 the obligations will increase, and it pays to be prepared.

The database is designed to help employees trace old insurance records and track down the relevant employers' liability policy if they suffer from injury or disease caused at work.

Previously, if the employer had ceased trading, was untraceable or could not identify the relevant policy, employees often had little recourse. In 2008, there were some 3,210 claimants who could not trace their employer or insurer.

As of 1 April this year, EL insurers have been required to provide the full name and correspondence address of the insured and, if applicable, its subsidiaries, plus the inception and expiry date, if different from the policy period.

From 1 April 2012, they must also provide the employer registration numbers (ERN) for the insured and all subsidiaries. Many EL

insurers are requiring brokers to supply this information now, as part of renewal, to help ensure the required information is in place in plenty of time for when supply does become a legal requirement.

Insurers who fail to provide the required information to the ELTO may be financially penalised. Where a broker holds delegated authority on behalf of an EL insurer, that insurer is likely to be able to pass any penalty resulting from a delegated risk on to the broker in question.

• *For more information, please contact Graham Terrell, on +44 (0)20 7528 4089*

Risk Specialist readers have their say

To celebrate the 10th issue of *Risk Specialist*, JLT Specialty is launching a short reader survey, to help us make the magazine even more relevant to your business and your needs.

We'd like to know your opinions of the magazine: what you think of the publication, what you particularly like or dislike, what you would like to see from future issues, and whether it answers your most pressing questions.

The questions should take no more than ten minutes and can be completed online at www.gristonline.com/services/reader-survey/jlt

> "The escalation of civil commotion into insurrection and civil war shows that comprehensive political violence insurance is essential in the emerging world."

Nick Robson, Head of Credit, Political and Security Risk, JLT Specialty considers trends in the Middle East. See page 6.

New World Risk Review™ website

JLT Specialty has launched a new version of the World Risk Review™ website – an enhanced risk assessment tool where users can benchmark the nine types of peril and level of risk between countries and across regions.

It is based around each user's personal ratings table, where they can filter current and historical data by country and peril, add their own ratings, and run printable reports through from charts and heat mapping tools.

Furthermore, JLT Specialty has looked to provide more country and industry risk insight to subscribers through regular risk reports, blogs and email communications.

This is initially being launched in beta and will be regularly updated around users' needs. On every page of the site, there is a feedback tab, to allow users to shape the future of the site.

If you are interested in participating in the beta, simply fill in the form at the following web link indicating your wish to get involved: www.worldriskreview.com

Broker and client scale peak

Mike Wellsted, Director at JLT Asia and Account Director for Jardine Matheson in Hong Kong and Ray Mattholie, former Group Risk Manager at Jardine Matheson and Adviser to the group, put into practice the idea explored on page 12 of this issue of risk managers and brokers working together as a team.

Wellsted and Mattholie

They joined forces to climb Mount Kilimanjaro in March, successfully reaching the 19,341-foot summit, with Mattholie raising £4,500 for African charities.

Mattholie says: "I thought having my broker along would mean he could carry my bags! That didn't quite happen, but we provided mutual support to each other."

Sector insight

Expert insight on the outlook for the insurance market

Credit, Political & Security Risk

The wave of political upheavals across the Middle East and North Africa, combined with the natural catastrophes in Japan, have exerted a profound impact on the insurance market, says **Nick Robson**, Head of Credit, Political & Security Risk, JLT Specialty.

The escalation of civil commotion into insurrection and civil war proves that comprehensive political violence insurance is essential for certainty of cover in the emerging world. Following the earthquake in Japan, we are expecting credit claims as companies find their supply chain disrupted and future contractual obligations unfulfilled. The impact of such events on the market will be felt next year and could be even more severe if there is a natural catastrophe in the US in the remainder of 2011.

Claims in one class of business often have a knock-on effect across other classes. If reinsurers increase their capacity for property and casualty risks, it will shrink the available capital for the credit and political risk market. The likely result is a reduction in the cover offered for certain countries and perils and an increase in pricing.

Topical tip for buyers: Understand that risk is asset and country specific. Drill down into your levels and types of exposure and figure that into your risk management. Political risk insurance must always be bespoke. It acts as a final safety net; it will not fix a deficient contract.

Rail

Ian Thompson, Partner, Global Risk Solutions, JLT Specialty, observes that there is still plenty of capacity and competition in the market for good-quality rail risks. Most international railways are heavily investing in infrastructure, rolling stock and train protection technology. As a consequence, there has been a major improvement in the risk profile for rail operational and safety risks. For rail-related liability risks, an increasing number of clients are carrying out exposure studies to assist with selection of appropriate policy limits.

Some insurers are excluding terrorism from liability policies. The exclusion can be avoided with appropriate insurer selection.

Topical tip for buyers: Make sure your market submission demonstrates your improving risk quality and consider an estimated maximum loss (EML) study to assist with selection of policy limits.

Leisure

An unexpected hardening of rates for piers earlier this year could indicate that the leisure sector market will start to harden over the next couple of months, believes **Stefan Puttnam**, Partner, Leisure Practice, JLT Specialty's Global Risk Solutions. It is too early to say if there will be an impact from events in Japan. It is likely to depend more on the hurricane season. With the market in its current state, insurers are getting into the sector who might withdraw promptly if losses mount.

Topical tip for buyers: Discuss whether you can tie in current rates and conditions for a longer period.

Energy & Marine

Relatively few of the ships damaged by the Japanese tsunami or indeed other recent natural catastrophes were insured directly in the international market, so prices remain fairly stable, with healthy competition for new business, says **Martin St Pierre**, Divisional Managing Director, Energy & Marine Division, JLT Specialty.

Rates for energy property and liability risks, however, have firmed between 5 and 20 per cent across the board, and even more for some liability risks, as underwriters absorb the impact of natural catastrophe losses. Meanwhile, capacity has returned to the Gulf of Mexico for named windstorm coverage, with higher limits being purchased, but the longevity of this market depends on the 2011 hurricane season. Sidecars are already sitting ready and waiting to capitalise on another withdrawal of capacity. Current pricing and capacity in the energy market could change quickly "if the earth shakes or the wind blows", says St Pierre. The erosion of insurers' surplus capital over the past few years, combined with low investment returns, has focused attention on underwriting results and raised concerns about insurer stability.

Marine returns have been steady, albeit modest, attracting new players into the market, whereas the more volatile energy market is only for the brave and is more likely to be challenged by new capital if and when it is deployed.

Topical tip for buyers: Maintain a good relationship with your insurers and keep them informed about your business. The more you communicate now, the easier you will find it if the market becomes increasingly volatile.

Construction

The construction market in London is currently very robust. In the past five years, capacity has more than tripled, with around a dozen new companies and Lloyd's syndicates entering the market, according to **John Thompson**, Head of Broking and International for the Construction and Real Estate Division of JLT Specialty. Rates, therefore, have been driven down to a very competitive level but the market in London has maintained its discipline on policy terms and conditions. Following a number of very high-profile civil engineering losses, London has also increased its focus on the risk-management strategy of project owners and how they interact with their construction and engineering teams.

It is too early to tell what impact the catastrophe losses in Australia, New Zealand and Japan will have, but there could be a knock-on effect after the main reinsurance treaty renewals. Early indications are that the principal effect will be on insurance costs associated with projects and contractors working in natural catastrophe zones. Clients should be careful about security and long-term pricing, particularly in catastrophe areas, as the rates currently offered by some markets may not be sustainable.

Topical tip for buyers: Demonstrate to underwriters that you have a very robust risk management plan and, just as importantly, prove that you will implement it to get the best terms and conditions.

Globalisation has increased the number of overseas subsidiaries that companies operate and so has multiplied the number of directors and officers who need protection for their personal liabilities. In these compliance-conscious days, giving corporate decision makers the comfort they want demands a careful approach.

"A truly global policy across more than 100 jurisdictions would rarely be either practical or economical," states Michael Lea, JLT Specialty's Head of D&O Liability. "It is a question of finding the right balance between coverage, complexity and cost, while achieving as close as possible to compliance."

The first line of defence for directors and top executives is usually an indemnity from the company, but this isn't possible in many jurisdictions. One of the biggest differences is between civil-code and common-law countries. Lea explains, for example: "A directors' and officers' (D&O) policy always assumes that the company will indemnify the directors to the fullest extent possible by law, but civil-code countries such as France, Sweden and the Netherlands tend not to be specific about whether the company can indemnify the directors and so we don't know to what extent it will be possible."

Almost all countries do, however, permit the company to insure its senior people, but each will have distinct laws and regulations governing the liability of directors and officers, says lawyer Ed Smerdon, Head of the London office of Sedgwick, Detert, Moran & Arnold. George Melides, Head of Commercial D&O at Zurich Global Corporate UK, adds: "As companies expand, they find they are dealing

> "A truly global policy across more than 100 jurisdictions would be neither practical nor economical."
>
> Michael Lea, Head of D&O Liability, JLT Specialty

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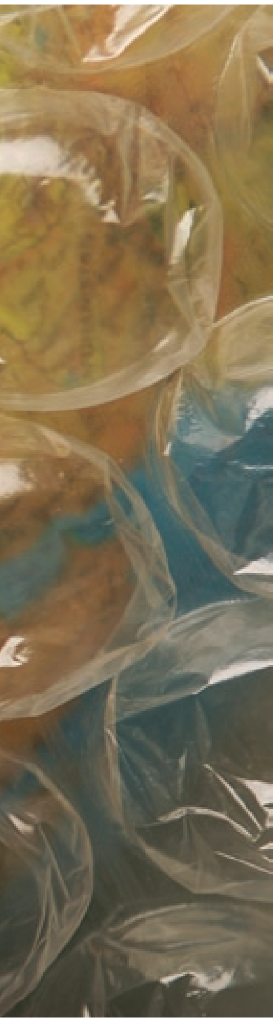

Protection for D&O liability

Protecting the directors and officers of international businesses involves a balancing act between coverage, compliance, complexity and cost.
By **Lee Coppack**

with a number of new parties and stakeholders, particularly regulators. They have to adjust to different types of financial reporting, tax and labour laws. They vary for each country and from one another, and management styles are different. So if it comes to the question of how to deal with all local reglatory, legal and tax requirements, it becomes immediately apparent that a single, one-size-fits-all policy doesn't do the trick."

Locally admitted policies

In addition many countries will require the coverage to be placed with a locally admitted carrier. The global policy is usually issued in the country where the parent company is domiciled and incorporated and includes subsidiaries in any jurisdiction where non-admitted policies are allowed, such as within the European Economic Area through freedom of services.

"Once you go outside these areas, you run into increased complexity as to how such policies are best arranged and issued," states Gary Everson, Head of Financial Lines at Allianz Global Corporate & Specialty.

Through their global networks, insurers like ACE, Allianz, Chartis and Zurich can write admitted business in many jurisdictions, and they have established partnerships with local carriers in other, less-developed territories. Some global businesses can also take advantage of the licences that Lloyd's has that allow syndicates to write direct business in a number of countries, especially Commonwealth countries such as Australia, South Africa and Canada, according to Lea. "However, to keep the costs down as well as being compliant, a global company is likely to need to use a global carrier."

Changing shape of coverage

The exposure of directors to personal liabilities in territories where the company cannot indemnify them is helping to reshape D&O coverage, says Melides. Typically, D&O policies contain two or three insuring clauses. Side A covers directors and officers directly if the company cannot indemnify them. Melides says: "We are seeing an increasing number of buyers interested in Side A DIC (difference in conditions) policies and international programmes written on legally admitted paper. This is particularly true where they are worried about their personal exposure in territories where it would be difficult or impossible for the parent company to indemnify them."

Meanwhile, Side B reimburses the corporate entity when it does indemnify its directors and officers. From about the mid-1990s, companies also started buying coverage to protect the company itself for its exposure in securities claims, Side C.

Everson explains that it's also possible to insure differences in conditions to get consistency between the global policy and what is available locally. "It's a complex situation because any document has to be compliant in the territory where it is being issued. We try to make the coverage as close as possible to the parent but there may be »»

local legal reasons why it's not possible to do this exactly." Smerdon points out that if a territory requires the insurance to be placed with an admitted carrier, using non-admitted carriers on top of the local policy, to try to build limits, may look attractive but is not necessarily effective. "If the carrier isn't recognised locally, it's unlikely the local court would recognise the policy."

Exposures

The D&O insurance programme must also take into account the considerable differences in legal regimes in each country, whether the liabilities are covered under the global or separate policies. Each country also has idiosyncrasies. In Italy, for instance, it is illegal to insure gross negligence. Spain and other Hispanic countries may require a bail bond to be posted. In Germany, directors of publicly traded companies also have to buy their own coverage for a per loss exposure deductible from the corporate insurance.

In small territories where it's only possible to insure with a local insurer, the company will probably take a view on the balance between cost and exposure. It may be possible in these cases, according to Smerdon, for the parent company to indemnify the local directors and claim on the global policy. However, this apparently elegant solution isn't always straightforward, he explains, because of the issues involved with moving funds across borders.

The fundamental principle, all agree, is to understand the risks in the given territories. "All decisions about the D&O programme have to go back to basics based on the relative exposures," says Lea. Melides advises that companies are likely to get the most cost-effective terms and conditions if they help their underwriters understand their business.

For underwriters, Everson says important factors are the company's revenue, turnover, fee income, type and extent of its activities in a particular territory. Historical knowledge and experience, including the litigation climate, and average costs and settlement levels, provide a degree of comfort to the insurer. "We build up a model of the overall environment," he says.

> **"Even if a subsidiary is wholly owned, the local companies must still behave in compliance with local regulations and laws."**
>
> Gary Everson, Head of Financial Lines, Allianz Global Corporate & Specialty

Although holding company directors and officers have more exposure, local directors still have personal liability, says Everson. "Even if a subsidiary is wholly owned, the local companies must still behave in compliance with local regulations and laws and, when it comes to issues like bribery and corruption, there is a growing focus from global authorities. We would not expect the loss history to be so significant but, from an attritional perspective, these companies can have a tangible exposure."

Although D&O claims can be a matter of legal expenses in many cases, Everson says this situation continues to change. For example, Canada has picked up the pace with class actions, the US and Germany have very established claims environments, Australia has significant activity and the UK has plenty of claims against corporate decision makers. It is a myth that D&O does not have claims.

"There have been an increased number of notifications over the past three to four years, and because D&O is a long-tail class of business, it takes some time for claims to play out. We are expecting claims frequency and severity to increase. We also see an increased focus on self-reporting of potential breaches of regulations, with the resulting costs of representing directors at investigations." RS

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Lee Coppack is editor of *Catastrophe Risk Management* and *InfoRM*.

Lost in the D&O insurance maze?

Are you stuck in a maze of Directors' and Officers' Liability insurance legislation, compliance, taxation and local jurisdiction issues?

D&O exposures to stakeholders, regulators, environmental agencies or the general public have led to a growing trend in the frequency and severity of lawsuits. Insurers have responded with new policy forms and endorsements.

No two D&O policies are the same. Adequate cover will only come from designing a policy around your specific needs.

JLT Specialty Limited has a team of D&O specialists who are experienced within the US, Asian, European and London markets. Using our expertise and knowledge we have developed a comprehensive health check process that we apply when designing D&O policies.

At JLT Specialty Limited we don't have off-the-shelf policies, they are bespoke, tailored to your needs and encompass the widest form of protection available.

For a free no obligation health check on your existing D&O policy, please contact Michael Lea on +44 (0) 20 7558 3686 or Ian Nichol on +44 (0) 20 7528 4481

JLT

The big issue: risk manager resources

Demands on risk managers have been increasing as risk has gained a higher profile within organisations. However, the economic environment often means they need to achieve more without additional resources. Their networks offer a vital solution. By **Stuart Collins**

Experts in your extended network are in a position to help

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The global financial crisis woke many organisations up to the level of risk they were taking. However, this was just the beginning. Subsequent crises from Deepwater Horizon to the Japanese tsunami and nuclear threat are revealing just how much risk businesses are exposed to.

Kip Berkeley-Herring, Partner, Global Risk Solutions at JLT Specialty, says this has pushed risk management up the agenda. Boards have come to recognise the importance of risk management and many risk and insurance managers are seeing their roles change, with an increasing focus on risk management rather than on risk transfer.

Increasing demands

Former Airmic Chair, and Group Risk Director at auction house Christies, Nicola Harvey, says this has led to increasing demands on risk managers. Globalisation, the uncertain economic climate, changes in corporate governance and increasing levels of regulation are also all adding to workloads, she says. “We are operating in an ever increasing global regulatory and legislative environment. The role of risk managers is changing. In my own experience, the more senior you become in an organisation the more you will become involved in all the aspects of business and risk, and the more your remit changes.”

While greater awareness is generally viewed as being positive, this means risk managers are being stretched increasingly thin, as they are expected to achieve so much more either with the same resources, or in some cases with fewer resources. Berkeley-Herring points out: “We have seen many clients reduce the size of their risk management departments at a time of increased demand for their services.”

Using networks

The solution to this resourcing issue often does not lie within the business, but outside it, through the extended network. “Risk managers need to be »»

“For many risk managers their instinct is to protect their team. However, they need to be confident and trust partners.”

Ray Mattholie, Non-Executive Director, JLT Canada

GETTYIMAGES

»» innovative and cutting edge in their thinking. They can pool or share resources with other organisations, and there is much more outside help available than many realise," says Berkeley-Herring.

There is a recognition among brokers and insurers that they can step into the breach. JLT Specialty, for example, has brought on board a number of high-profile risk managers and insurance buyers in order to further strengthen the team's capabilities: "There is now a real opportunity for risk managers to collaborate with us and come up with innovative solutions to their particular issues," says Berkeley-Herring, himself former Group Risk Manager at BT Group.

JLT Specialty has a track record of partnering with clients to provide innovative risk and insurance solutions, but a collaborative approach has particular poignancy in the current environment. "We have been working alongside a number of client risk management teams to meet the increasing demand for strategic risk management and reporting, as well as manage the peaks in demand for resources," says Berkeley-Herring.

Developing risk managers

However, in order to properly exploit the potential of their networks, risk managers must develop their project management and leadership skills, says Ray Mattholie, Non-Executive Director at JLT Canada and former Group Risk Manager at Jardine Matheson. "Many risk managers feel vulnerable and their instinct is to protect their team. However, they need to be confident and trust partners. It is a leap of faith to use an outside resource and take on a different role – but it is the best way forward."

In this environment, risk managers have to be business savvy and focused, says Harvey. "They need to understand the broad business, in detail, and the effect of issues on the business as a whole. A risk manager needs to be influential within their organisation, and to be able to lead people in a strategic way," she says. "Risk managers need to have the traditional skills of risk engineering, loss control and hazard spotting. But they also need to be strategic thinkers, looking at the wider risks associated with the direction of the business, whether it is expansion into China or a new product line."

The right partners

Finding the right partners is essential. Risk managers can turn to outside organisations for advice and assistance. Harvey warns: "Many insurers tend to be focused on risk transfer, and so only offer assistance to risk managers in the areas of insurable risk. Many brokers say they can offer a broad spectrum of risk advice, but it often comes back to what they know best, risk transfer." However, there are partners who can offer broad support across all roles, including risk financing, insurance purchasing, claims management and risk management support. With some clients, JLT Specialty's collaborative approach has gone even further and the company has taken on responsibility and people to provide almost a virtual risk management function.

JLT Specialty client Jardine Matheson adopted a collaborative approach to support its lean group risk management function based in Hong Kong. The group, which includes interests in construction, transport, property, retailing and insurance broking, worked with JLT to agree claims protocols with insurers, and automate premium allocation and collating renewal information.

The two companies also worked together to create rolling contracts for the group's main property and casualty programmes. These have the advantage of substantially reducing the amount of work required at renewal, says Mattholie. "Negotiations are far less demanding, and there is far less volatility – the contract allows for a wide scope of cover that would not be taken away in a hard market. This innovation could only have been achieved through collaboration. What is often needed is a less short-term and more long-term way of thinking. And you can only achieve that if you develop a partnership."

Virtual risk management would also suit the many organisations that do not have a dedicated risk and insurance manager. "In these instances responsibility for risk

> "Risk managers need to have the traditional skills of risk engineering, loss control and hazard spotting. But they also need to be strategic thinkers."
>
> Nicola Harvey, Group Risk Director, Christies

Risk managers are taking a leap of faith and using external expertise

management typically resides with the chief finance officer, but they may feel out of their depth, says Berkeley-Herring.

For those organisations that have their own in-house risk management skills, the use of a partner means internal resources can be deployed most effectively. "Risk managers are the best source of risk information in their companies, and this is what they should spend their time on, rather than on plain vanilla risk transfer where they can easily find external help," says John White, Partner at JLT Specialty Risk Consulting.

For example, the dramatic shift towards overseas operational environments creates an increasing exposure that needs a skilled on-the-ground resource. "JLT Specialty operates partnerships, which provide us with best of breed skills, enabling our risk consultants to add most value," says White.

Automated reporting

This can be accompanied by the introduction of externally sourced skills and reporting structures, in an automated and efficient way. JLT Specialty worked with a US company to put in place automated reporting for its operations in China. JLT Specialty provided the project management and worked with its alliance partners to put in place the people and systems around the world. The project was such a success that the US company rolled out the system across all its operations. "Co-ordination and automation of the reporting processes involved provides the management oversight required at board level and allows the risk manager to sleep at night," says White.

Claims

Claims are another resource-hungry area for risk managers. Large claims are a labour-intensive, lengthy and time-consuming process that can cause a sudden increase in workload for risk managers, says Candy Holland, Managing Director of Echelon Claims Consultants. "There is a huge amount of work for the policyholder to do, such as compiling information, quantifying the claims, assessing the coverage and communicating with the insurers."

Risk managers can save time and money, as well as ensure they maximise their recovery from insurers, by preparing for a large claim in advance, says Holland. "They can plan in advance and establish a process for dealing with large claims that is efficient and reduces the burden on the risk manager." Echelon has worked with companies such as BT to work out the best claims processes and help streamline their business. This can involve testing claims scenarios, establishing claims protocols with insurers and looking at what information would need to be captured to evidence a loss and how it should be presented to insurers.

Good preparation will also assist the risk manager after a loss, making sure that the right resources are available, says Holland. "At Echelon we have been working with companies and their brokers to take on part of the burden when a large loss hits, allowing the risk manager to focus on the business and its customers, rather than spending time gathering information and dealing with loss adjusters."

Fortunately for most companies a large loss will be a relatively infrequent occurrence, but risk managers will want to be well resourced and look for a partner to assist, for example with information gathering and presenting it in a claims submission. Holland explains: "Large claims require considerable resource and expertise, and a stretched risk manager may need extra support in order to obtain the right settlement. The investigation process needs expertise and careful handling, and the risk manager will need his own armoury when sitting down at the table with their insurer."

Partnering and collaborating with a broker will create a flexible risk management function that will foster long-term relationships and encourage innovation, says Berkeley-Herring. "Risk managers should be looking to collaborate with their risk partner to reduce their workload so that they can focus on areas where they add most value – such as establishing an enterprise risk programme or reporting risk information to the board." RS

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Oil and gas take centre stage

Oil and gas companies in Central and Eastern Europe are seeing their stock soar, but they must carefully consider the risks they are exposed to and how they manage them. By **Sue Copeman**

Since the USSR dissolution in 1991, the independent states have joined their Central and Eastern European neighbours in exploiting their valuable oil and mineral resources. In the oil and gas sector, the result is some fast-expanding energy companies which are taking their place on the world stage as profitable and innovative businesses.

However, as Richard Scott, Partner, JLT Specialty, Energy and Marine, says: “The evolution is not without challenges. Before the former Soviet Union broke up, all assets were generally handled and insured centrally, if at all. Now the companies in the new independent states have to address the need to adopt international standards for insurance and risk management.”

In the fast-moving energy sector, the issues for companies are greater today from an insurance perspective than they were ten years ago. “With many of these relatively new companies acquiring international stock market listings and stakeholders, it is an ongoing challenge to ensure that international best practice is adopted for risk transfer mechanisms and to optimise the coverage and premium spend appropriate for fast-developing organisations,” says Scott.

Many are also taking an increasingly active role in Western Europe. Having initially focused on selling energy to external markets, they have expanded into investing in other European energy businesses and forming joint ventures with them. As a result of this growth and diversification, some are becoming truly global players. With effective risk management viewed as an intrinsic part of good corporate governance, companies have to demonstrate that they are taking a sophisticated attitude to risk and fully understand their insurance needs.

Increasing risk

At the same time, developments in the energy insurance industry mean oil and gas companies are facing increasing risks. The energy insurance market has seen a substantial increase in asset values over this period. Meanwhile, many operate in very testing environments. As part of its international network, in this region JLT Specialty partners with Central and Eastern European specialist broker GrECo, a

> “Oil and gas companies now seek liability coverage of up to $1 billion for each loss, which requires the support of the international reinsurance markets.”
>
> Shavkat Mingaliev, GrECo

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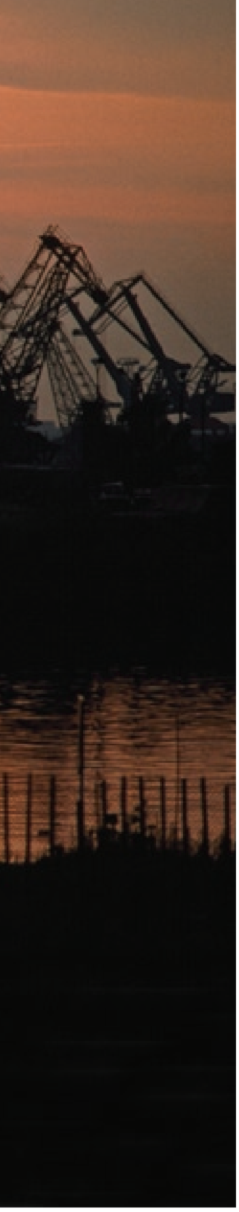

The Baltic port of Swinoujscie and the Achinsk oil processing plant in Achinsk

company part owned by JLT. GrECo's Shavkat Mingaliev explains the risks: "Rigs may operate in hostile environments. In the case of offshore rigs, they may operate in seas where the waters are covered by ice for six months of the year, so the rigs and their risk management processes need to be robust."

The area of third party liability is particularly important. The Deepwater Horizon spill flowed for three months in 2010 and was the largest accidental marine oil spill in the history of the industry. It caused extensive damage to marine and wildlife habitats as well as the fishing and tourism industries. The financial implications of an incident like this are huge. In addition to the costs involved in stopping the leak and cleaning up damage, payments to support local economies and a commitment to channel $500 million to a ten-year independent research programme that will examine the environmental impact of the oil spilled and dispersants used, BP has set up a $20 billion fund to cover compensation claims. The incident resulted in a total pre-tax charge in BP's 2010 annual accounts of $40.9 billion in relation to the accident and spill.

Higher limits

This incident has been an eye-opener for oil companies and their insurers alike. Mingaliev says that previously the focus for insurance was the physical assets involved. "Companies with offshore drilling rigs would insure these, but they paid less attention to third party liability, for example to fisheries and the citizens of a country.

"The limits of liability purchased for pollution clean-up costs and liability have generally been fairly low, perhaps just $100–$200 million for each and every loss, compared with the rig's insurance of $600 or $700 million. The incident in the Gulf of Mexico showed that this can be vastly inadequate. In addition to the huge cost to BP, it has been estimated that it will take some 20 years to deal with the legal cases and possible complications following that disaster," he explains.

It means oil and gas companies with offshore rigs are now looking to buy much higher liability limits. Traditionally, the domestic energy insurance industry has not offered products with such high limits. "We are teaming up with some of the world's largest insurers and reinsurers to develop specific products which will cater for the new needs of oil and gas companies in the region," says Mingaliev. "Oil and gas companies now seek liability coverage of up to $1 billion for each loss, which requires the support and leadership of the international reinsurance markets to secure the appropriate capacity."

Risk management

A structured approach to risk management is a relatively new concept for some Central and Eastern European energy companies. "We see our role as helping them identify the risks they are exposed to and advising them on how they can manage or transfer these risks. It's important to consider the total cost of risk here in order to find the most cost-effective solution. Clearly, there is a cost to

»»

Companies that gain from combining local knowledge with international expertise

- Companies based in Central and Eastern Europe but now operating internationally need to consider the allocation of risk in their contractual arrangements and how they structure effective risk management.
- Long-established international oil and gas companies seeking to expand in Central and Eastern Europe need local knowledge in terms of national regulation and culture.

Above: oil pumps in Baku, Azerbaijan. Right: oil pipeline Druzhba, Szazhalombatta.

»» transferring risk to the insurance market, but a company retaining a risk for its own account also has to take into consideration the additional expenses it may incur in the prevention measures associated with managing that risk. Our aim is to help our energy clients achieve the optimum balance," says Scott.

Benchmarking

He stresses that an effective risk management programme is very much a living process. "It has to be constantly reviewed, scrutinised, refined, benchmarked and stress tested. There is a tendency for companies to sit back once they have established their risk management programme and assume that the job's done. We encourage them to regularly take a fresh look at their risk management and transfer arrangements."

Benchmarking is an important aspect, comparing best practice, risk transfer programmes and limits, and premiums paid. Most international businesses consider this a 'must have' but for Central and Eastern European energy companies that may previously have had little experience in operating on the international stage it makes particularly good sense, says Scott.

For these organisations a combination of local knowledge and international expertise is essential. The strategic partnership between JLT and GrECo provides companies with access via GrECo's local office network to the London insurance market.

Mingaliev says that transferring risk from domestic markets to the international insurance market in London is an important consideration for Central and Eastern European energy companies. "It's a matter of pride to buy insurance in the most highly respected markets. It demonstrates that a company has evolved into a major international player in the energy field," he explains.

Planned future investment in the energy sector is substantial and will result in further major developments of the energy insurance market. Against this backdrop, it is important for Central and Eastern European energy companies to check that their insurance and reinsurance programmes are structured to obtain the best possible deal. And, over the long term, strategic input into risk management and risk transfer strategies – including captive development – will enhance their risk profile to ensure that risk management strategies are aligned with challenging corporate objectives. RS

Case study: Lukoil Oil Company

Professor Andrey Yelokhin, Head of the Insurance Department, Lukoil Oil Company, says: "In the last ten years energy companies in Russia have significantly grown and modernised their operations – making considerable investments. The fixed assets value of Lukoil, for example, increased from $29 billion in 2003 to $82 billion in 2011.

Part of this modernisation is a real focus on good risk management. We are also careful about insurance buying. For us, and the majority of companies, the main objective is to secure reliability of coverage rather than focusing on minimal price.

We work constantly to benchmark to compare best practice, risk transfer programmes and limits, and premiums paid with those of others in the industry. So, for example, the BP Gulf of Mexico oil spill affected our operations, and we increased the amount of liability insurance cover by three times. Such work is complicated without an effective consultant.

"A programme has to be constantly reviewed, benchmarked and stress tested."

Richard Scott, Partner, JLT Specialty

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Sue Copeman is editor of *StrategicRISK* magazine.

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Shelter in a storm: protecting your

Recent natural disasters have highlighted just how vulnerable supply chains are in a global economy. Organisations need to take swift action to ensure they are protected. By **Sue Copeman**

The earthquake, tsunami and subsequent nuclear disaster in Japan affected a far wider area than that immediately hit by the disasters. Damage to infrastructure, power cuts and evacuation of personnel from potentially dangerous radioactive zones had widespread repercussions, reducing manufacturers' ability nationwide to produce goods. There was then a major knock-on effect for international businesses, particularly in the motor and electronics industries. This was just one of the natural disasters in recent months that have tested the resilience of many companies' supply-chain risk management.

Not only Japanese motor manufacturers were affected. Some European vehicle manufacturers buy parts from Japan and had to close production for several days. Further, with Japan producing around 40 per cent of the world's technology components, the effects of the disaster were equally devastating for the global electronics industry. The full extent of the impact for both sectors may not be apparent until later this year.

In the meantime, a number of companies, including electronics manufacturer Toshiba and set-top box maker Pace, have issued profit warnings that have had an impact on their share prices. Toyota Motor Co cautioned that it will cut US vehicle production and might have to lower its sales targets for the year if parts shortages continue.

While Japan's disaster hit the headlines, it was just one – albeit the largest – of a number of events in the past few months. These include Australia's flooding, New Zealand's earthquake and the tornadoes in the US. It has highlighted how essential it is to protect your supply chain.

Assess risk

"It's hard to second guess what disaster might happen next, so it's best just to assume that the supply you would normally obtain from a company in a particular territory may become unavailable," says JLT Specialty Partner Tim Cracknell. However, he adds that, when assessing supply-chain vulnerabilities, it is prudent to consider whether any key suppliers are in major hazard zones.

Adrian Brennan, Partner, Echelon Claims Consultants, points out that suppliers of key commodities in certain industries are often clustered in countries such as Taiwan, China and Korea. "These are potential natural catastrophe zones so a serious incident can cause a major issue in a particular industry,

> "How a company responds to crisis can define it. Companies that have been most proactive are usually the ones that succeed."
>
> Adrian Brennan, Partner, Echelon Claims Consultants

Claim handling strategy

1 Establish a project management team, with external experts as required, to manage the process and determine/implement claims strategy.

2 Organise the systematic collection of information as it becomes available.

3 Fully engage insurers and their representatives. Seek the loss adjuster's agreement on key decisions at the time those decisions are taken.

4 Prepare best/worst case cost estimates as soon as feasible.

5 Review the potential for recovery from third parties and assess the impact of a recovery action on existing contractual relationships.

6 Ensure that critical dates and time limits for the notification and/or presentation of claims are identified and complied with.

7 Ensure that all documentation passed to loss adjusters is accurate.

8 Communicate any problems to the loss adjuster immediately they become apparent.

supply chain

such as electronics," he warns. Further, component prices may increase with scarcity.

Companies are well advised to make site visits to potential suppliers, says Cracknell. Not only will they be able to assess the robustness of risk management practices at first hand but they may also avoid the reputational fall-out that can result where a supplier fails to observe ethical standards, such as the employment of under-age workers.

Managing the risk

An in-depth study of the supply chain will highlight any particular risks associated with suppliers and key dependencies, he explains, stating that there are a range of strategies to mitigate potential loss. These include pre-validating alternative suppliers for crucial products or components, increasing the amount of stocks held, using strength of purchasing power to impel a supplier to improve loss protections, and even purchasing a key supplier to gain maximum cost benefits and assure risk-management standards.

Understanding supply-chain risks enables quantification of potential loss which will influence the type and amount of insurance coverage required. At the same time, demonstrating a thorough understanding of supply-chain risks, the locations where goods are sourced and the values of products handled at different sites is helpful in negotiating optimum insurance price and terms.

However, Cracknell warns that business interruption cover in respect of some natural perils in particular parts of the world may be limited, as insurers are concerned about their accumulations of risk. "If the insurance protection is likely to be insufficient, companies will need to do more in terms of risk management to mitigate that exposure," he advises.

Should a claim occur in the supply chain, Cracknell warns that the supplier may be less than candid about the extent of its problems. "For example, an Asian supplier may not want to lose face so will often give a very positive response when the reality is that the business is in real trouble." Brennan agrees and adds, "Suppliers are sometimes wary about providing full information because they may be concerned about litigation under the supply contract."

Brennan advocates establishing claims protocols in advance of any losses. "Having an agreed methodology, for example in respect of loss valuation and interim payments for undisputed claims, can speed up settlement as well as helping cash flow. There can be some specific challenges with contingent business interruption claims, but mapping and agreeing them up front removes potential problems post loss," he explains.

Effective supply-chain risk management can give companies a competitive edge. Cracknell says that good risk management can reduce the level of insurance needed and therefore premium costs. "Also, a company that has arranged alternatives, in the event of its primary supply source being disrupted, comes across to stakeholders as a well-run business. It has the opportunity to increase market share if its competitors prove less flexible," he comments.

Brennan cites the example of those companies affected by the Japanese disaster that have had to issue profit warnings, affecting their share price. "How a company responds to crisis can define it. Experience shows that the companies that have been most proactive are usually the ones that succeed. Those that have sat back are the ones that wither and die," he concludes. RS

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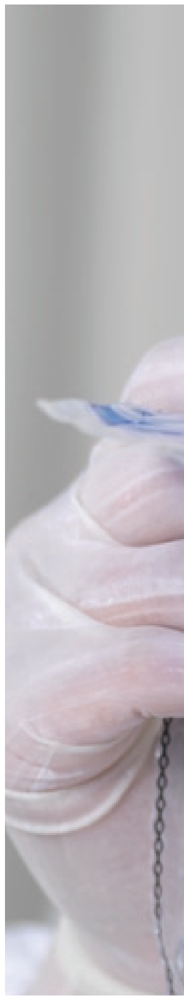
Sue Copeman is editor of *StrategicRISK* magazine.



Financial crime is far from elementary

Financial crime against an employer is a costly and complex business. The right processes must be put in place to prevent attacks where possible and deal with them when they strike. By Sam Barrett

Cases of employees stealing money from their employers, colluding with suppliers to cut themselves a kickback, or banking the salaries of ghost employees can cost employers millions of pounds. Recent high-profile examples include the Sainsbury's IT worker who stole more than 17 million Nectar points and an assistant bank manager in Edinburgh who was jailed for 13 months after taking £31,000 from customer accounts. It is often suggested that the frequency of white collar crimes increases in times of economic hardship such as those prevailing at the moment, so it is essential for employers to be on their guard.

"Although it's possible to insure against the loss, if something does happen, the onus is on the employer (the insured) to collect the evidence to demonstrate a loss," says Adrian Brennan, a Partner at Echelon Claims Consultants.

Pulling together the evidence to support a claim can be time consuming. This is further complicated by the fact that the insured can find themselves involved in criminal and civil actions. In addition, insurers will require proof of the loss, together with an assessment of the amount stolen.

Many organisations find it invaluable to use a specialist to direct and advise on claims strategy. Ideally this individual will also have a loss adjusting and forensic accountancy skillset. Often there is a need for further resources incorporating expertise in law, IT and auditing, which, providing these are combined with high-level technical insurance claims knowledge, results in a team capable of understanding the often highly complex web of fraudulent transaction. They are then able to gather the relevant data to prepare and present an insurance claim.

> "A complex case where an employee has covered their tracks can take a year to unravel."
>
> Flemming Jensen, Managing Partner, Matson, Driscoll & Damico

An involved process

"Establishing what's happened can be a very involved process," says Flemming Jensen, Managing Partner at forensic accountants Matson, Driscoll & Damico. "With a simple case, such as an employee forging cheques, it might only take a few months to pull the evidence together, but a more complex case, where the employee has covered their tracks by destroying or deleting evidence, can take a year or more to unravel."

The time and expertise required means investigating a loss can be expensive. Even for the more straightforward cases, costs can hit £100,000 or more. These expenses will usually be covered under a crime policy, but there are often conditions attached. "You do need to be careful that a covered loss has been sustained," says Brennan. "A company could spend £150,000 investigating a loss, only to find the alleged crime was caused by poor business practice such as a badly set up contract. If this happens, they'll

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be liable for the cost of the investigation." Additionally, companies need to be mindful of the extent of the loss when they begin their investigations. Deductibles of £100,000 or more are common, so the loss must exceed this if it is to become an insurance claim. "Some policies will be worded as the loss excluding fees so it can be particularly important to assess the quantum as early as possible in the process," adds Brennan.

Notification

Policyholders must be careful to adhere to the notification terms. Insurers will require a company to notify them within an agreed timeframe, typically 30 or 90 days, from the date they become aware there is a problem. This can cause problems, especially where someone at a lower level or in a remote subsidiary is aware of a problem but has not informed the company's risk and insurance department.

Even where there is a clear reporting line in place, there can be issues establishing what, if anything, has happened and whether the insurer needs to be notified. As an example, a whistleblower might alert a policyholder to a problem but, without any evidence of a loss, there is the possibility that the tip-off is unfounded or even malicious. "I'd recommend alerting the insurer and conducting an investigation promptly to establish whether there is any evidence of a loss," says Brennan.

Policyholders also need to be aware that some associated losses are not covered by insurance. "Crime policies exclude consequential loss," explains Brennan. "If a company is seen to be lax in the way it runs its business, especially where customers' money is involved, this can result in reputational damage and a fall in the share price. Insurance cannot compensate for this."

Steps toward prevention

Given these risks, as well as the costs and time involved in collecting evidence to support a claim, prevention is certainly better than cure. "It's prudent to reduce the risk of this happening as much as possible," says Noel Campbell, a Partner at legal firm Holman Fenwick Willan. "An accounting or risk management consultant can audit a company's practices and point out any shortcomings. The dishonesty of employees is more difficult to guard against, but if you check their records and remove temptation, you're less likely to have a problem."

A variety of steps will help to reduce the risk of a financial crime. These include: segregating certain functions, for instance reconciling the bank accounts and writing cheques; requiring two signatures on cheques above a certain value; regularly changing passwords; and implementing reviews and controls around procurement to reduce the risk of collusion.

It is also prudent to have regular audits, both internal and external, to highlight any issue and catch any problems in their infancy. Additionally, Brennan recommends stress testing the insurance policy wording. "It's good practice to look at potential loss scenarios and see how your insurance would respond," he says. "Businesses, and risks, can evolve and doing this will ensure cover remains fit for purpose." RS

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Sam Barrett is an insurance specialist and former editor of *Health Insurance* magazine.

The risks of rising food prices

Rising food prices are putting poor populations under increasing pressure and have led to heightened business risk in the MENA region. The way regimes are tackling this unrest may be creating more problems for the future. By Elizabeth Stephens

Rising food prices were a catalyst for the wave of protests that swept across the Middle East and North Africa earlier this year. Beginning with the fall of Tunisian President Zine El Abidine Ben Ali, there have been popular uprisings in a dozen countries, culminating in regime change, civil war, rapid political reform and financial hand-outs designed to renew the social contract between the rulers and the ruled.

Rising prices

There are a number of factors contributing to soaring food prices. Economic prosperity is creating changes in global eating patterns and demand for soft commodities. It is not so much the billion additional mouths at the bottom of the consumption pyramid that are creating pressure, but the burgeoning middle class in China, India and Brazil. Significant rises in incomes over the past five years in India alone have created 220 million extra consumers of fish, meat, milk and eggs.

Combine this demand with adverse weather conditions leading to poor harvests in Russia and Australia and export embargoes from producing nations, and the circumstances are created for rapid price rises. The United Nations' Food and Agriculture Organization announced in early 2011 that food prices had surpassed 2008 levels.

Throw in a large measure of unemployment and poverty in the world's developing nations and the price rises are the final trigger for a wave of protests against the spiralling cost of living, dearth of economic opportunities and unrepresentative systems of government. The uprisings across the MENA region have heightened risks to business operations.

The root of the problem

The economics of commodities in the MENA region have changed dramatically. The region once known as the Fertile Crescent is now heavily dependent on imported grain. Almost half of the world's top 20 wheat-importing nations in 2010 are MENA countries. The list is dominated by toppled and faltering regimes: Egypt (1), Algeria (4), Iraq (7), Morocco (8), Yemen (13), Saudi Arabia (15), Libya (16) and Tunisia (17).

The US contributed to the situation through the provision of cheap wheat, which was seen as a low-cost way of keeping friendly regimes in power. Egypt's Hosni Mubarak was the main recipient, along with Iraq's Saddam Hussein, who received billions of dollars' worth of surplus American wheat through grants and loan guarantees during the Cold War. Jordan, Yemen and other Middle Eastern countries all received this cheap wheat.

In the long term, this has come at a high price: lack of investment in domestic agricultural production and a dangerous dependence on cheap imports from abroad. This means they are highly vulnerable to changes in the price of wheat.

> "Paradoxically, grain subsidies push up the cost of bread. Demand created by subsidies keeps prices high."
>
> Elizabeth Stephens, Head of Credit and Political Risk Analysis, JLT Specialty

The role of subsidies

Rising prices have created immediate problems for regimes in the region, because they have used food subsidies as a tool to buy loyalty and ensure stability for decades. As grain prices reach record levels and unemployment soars, those governments that lack a revenue stream from hydrocarbon reserves are finding the cost of subsidies

The political use of food is exacerbating supply problems

virtually unsustainable. Politically, however, they need to maintain and even increase subsidies.

In 2008, when the price of bread soared, a wave of bread riots broke out across the MENA region. Governments intervened by raising wages and providing cash hand-outs and increased subsidies. Egypt, Yemen and Jordan increased food subsidies, Algeria, Tunisia and Morocco lifted customs duties and import tariffs on food, while Saudi Arabia unveiled a multi-billion dollar spending plan. These were short-term remedies that proved unsustainable and had the unintended consequence of making more people dependent on subsidised bread.

The subsidies have distorted the market, creating yet more problems for the various regimes. By 2010, Egypt's bread subsidy bill topped $3 billion a year. Much of this took the form of selling subsidised flour to local bakeries, an inefficient system that lent itself to massive corruption. As global prices rose, bakers resold subsidised flour and bread into the black market, where they could go for five or more times the subsidised rate, pushing up the price of bread for consumers.

Paradoxically, grain subsidies, like export embargoes and price fixing, push up the cost of bread. In normal conditions, demand rises and falls in response to price. Demand created by subsidies keeps prices high.

Subsidies for political purposes are contributing to high prices that are causing malnutrition and food shortages in other areas of the world. Reducing dependence on food subsidies and imported wheat is a long-term process. It requires the international community to change its policy of using agricultural goods as a form of foreign aid and importing countries to restructure their economies and develop their own agricultural systems. In the absence of these reforms, food crises that create domestic and international turbulence will continue, irrespective of the system of government these countries adopt. RS

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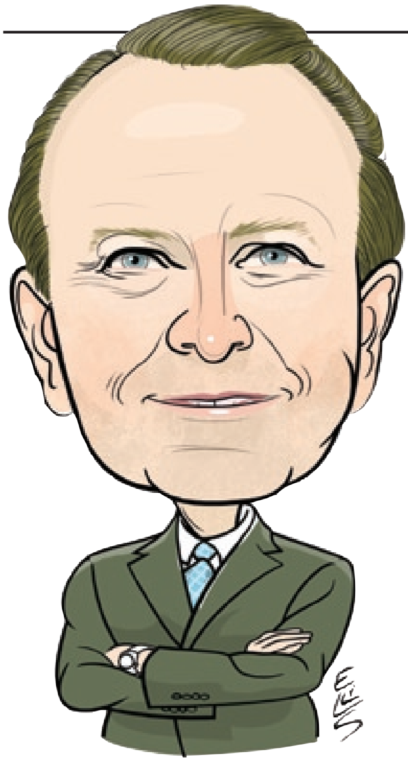
Thinking ahead



Standing out from the crowd

Mark Wood, Managing Director of the Financial Risks Division, has joined JLT Specialty after 25 years in the industry. He explains why he made the move, and his plans for the business.

I have been in the insurance business for a long time so I know that there's very little difference between what is being offered by some of the major players. JLT Specialty is different. Its starting point is to understand the needs of the client, only then will it build solutions to meet those needs. It can do this because it is highly focused around the industry sectors, product types and the individual clients themselves.

Financial Risks was already a good, vibrant business when I joined in January, but there was an opportunity to really deliver something different by focusing and specialising in certain segments. Segmenting the targets ensures we tailor our solutions to meet their specific needs. We started with insurance companies. We identified the targets. Then we worked on our value proposition. Putting people in place who are experts in the sector means that the dialogue we have with clients translates into policies that perform and means we understand and address their specific issues. Finally, we have been out there testing our proposition with clients and started building exclusive JLT Specialty products.

This is our model. We will continue to build this across other financial institution sectors and the other areas in the division (D&O for commercial companies, professional indemnity for the 'professions', credit, political and security risks and our impressive sports and entertainment capability). So, for example, we are in the process of launching an exclusive new D&O product for the UK market and our next phase is to tackle the needs of asset managers and wealth managers – an area where we already have enviable expertise and client base.

We've also set up a global mergers and acquisitions team, focused entirely on the needs of those involved in M&A activity. It will bring together warranty & indemnity, tax, litigation buy-outs and other deal-enabling insurance products. We have hired specialists who truly understand the needs of players in this fast-growing market and who will be able to tailor a proposition to meet the needs of every deal.

> "We have hired specialists who truly understand the needs of players in this fast-growing market."

Unique culture

JLT Specialty is attracting industry leaders and top practitioners. However, it is not just about the people who work here; it's also about the way in which they work. There is a focus on excellence and high performance, so people work hard. The business also gives them the freedom they need to do a good job.

I have some excellent people and they spend 100 per cent of their time developing products and working on the value proposition for clients. They're not bogged down by bureaucracy and red tape. It's an extremely powerful approach. Good people are treated like adults, and they work within a unique culture. It's a highly collegiate and social firm with very few barriers. People help each other, and when they all come together to deliver for the client it is a very powerful proposition. This is something that clients recognise sets us aside from others in the marketplace, and it's no surprise that, once people have worked with us, they want to do so again and again. RS

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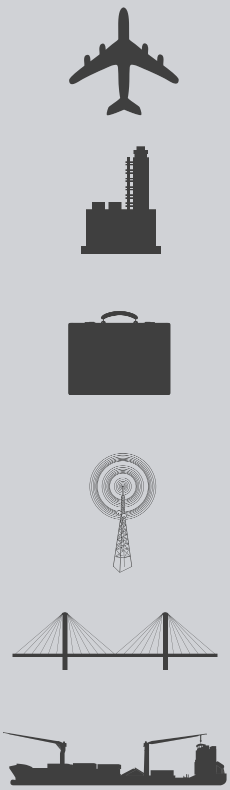

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By focusing on clearly defined industry and risk sectors we have become a strong global market performer with a distinctive culture and style of service that gives our clients the power of choice. Let us show you how choice creates the opportunities to help you make more profitable insurance and risk management decisions.

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