

# whiteboard

Keeping you informed about risk and insurance

December 2011

## Fraud the unseen threat

UK businesses are focused on dwindling revenues as the downturn bites. Employee fraud is too often the 'corporate F word', a neglect that leaves businesses open to hefty losses.

By **Sam Campbell**



**E**stimates suggest businesses are under siege. The National Fraud Authority's data put the cost of fraud to the UK economy at around £38 billion every year.

Better protective measures and increased awareness are having some effect, says David Broom, JLT Group Chief Risk Officer. But cases are increasing in some areas, most notably internal fraud.

The vast majority of such frauds are committed with the collusion of employees or by staff but fraud is inherently clandestine so even estimating the extent of internal fraud is fraught with difficulty, explains Mike Lea, Head of Management and Transactional Liability at JLT Specialty. "No company wants to ruin its reputation by broadcasting to the world that its employees are filling their own pockets from the

company's working capital without being prevented," he says. "Only 27 per cent of staff fraudsters were reported to the police in 2010, according to CIFAS."

### Insider threat

What data there is makes for worrying reading. According to a leading international accounting firm Insure Hedge: 80 per cent of workplace crime is carried out by employees; 25 per cent of employees have either committed or witnessed workplace fraud and abuse; and 25 per cent of employees committing fraud against their employer have been with the company for more than 10 years.

Lea, who advises global corporations on

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# news in brief

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

## JLT produces whitepapers to help companies expanding overseas



Low UK growth forecasts and a weak pound are encouraging UK businesses to explore international trading and cross-border investment opportunities. Traditional markets, such as the US and Europe, remain important but with emerging markets forecast to contribute 62 per cent of global growth 2010-15, according to the Economist Intelligence Unit, companies are increasingly looking at ways to enter these markets.

Growing internationally requires companies to deal with a broader and more complex range of risks, as global trade is progressively more susceptible to what used to be thought of as local events. The earthquake and tsunami in Japan is

an obvious example; the Sony data loss debacle a less evident but equally relevant case.

JLT has written a series of 'Business Across Borders' whitepapers to help UK companies understand, evaluate and manage key insurance and risk issues faced by companies trading overseas. The first series of papers focussed on political unrest, cross-border insurance programmes and supply chains and are available to download from [www.jltgroup.com/business-across-borders](http://www.jltgroup.com/business-across-borders). The second series of papers focus on preparing for a major loss, risk financing and cyber crime, and will be available to download from January.

## HSE to recover reparation costs after breaches

Details have been published of a new system for recovering costs from those who break health and safety laws. The Health and Safety Executive (HSE) has already agreed the underlying principle with the government and the new scheme could come into force as early as April 2012.

Gordon MacDonald, the HSE's programme director, says: "The government has agreed that it is right that those who break the law should pay their fair share of the costs to put things right, and not the public purse. These proposals provide a further incentive to operate within the law, levelling the playing field between those who comply and those who don't. Compliant firms will not pay a penny in intervention fees."

The HSE already recovers its costs in a range of industries, MacDonald says, so has considerable experience of making such schemes work.

Although the changes put no new health and safety duties on businesses, they do for the first time place a duty on the HSE to recover the costs of their interventions in certain circumstances.

Costs would be recovered if a material breach – a failure to adhere to health and safety law identified by an inspector as requiring formal action – is discovered during an inspection or investigation and an enforcement notice is issued. These costs would be recovered directly and in full from the company against whom the Enforcement Order was made. Fees would apply up to the point where the HSE's intervention in helping the business to rectify matters has concluded, at current estimates of £133 per hour. Costs of any specialist support needed by the HSE would also be passed on. Invoices will need to be paid within 30 days.

These costs would not be covered under a company's insurance policies as the material breaches would not include instances where there has been bodily injury or property damage. Companies should be aware of this change in HSE procedure as a potential additional risk exposure and ensure that all work practices comply with health & safety legislation, particularly as HSE Inspectors are currently increasing the frequency of their "on-spec" site visits.

## JLT gains second place in UK's list of top brokers

JLT has climbed to second place in the *Insurance Times* Top 50 Broker list, in the first change to the top three since 2008.

The listed international group of Risk Specialists and Employee Benefits Consultants achieved growth of 17 per cent despite the tough economic environment, something IMAS, which provides the data for the annual survey, described as a "great achievement". Profits after tax grew by almost one-third last year to £90.7

million for the full year of 2010 compared with the 2009 figure of £70.9 million.

Chief Executive Dominic Burke says JLT's culture and ethos has helped to bring in high-calibre recruits, something he cited as being a significant contributor to the company's ongoing success.

Further proof of JLT's industry-leading excellence came when JLT Specialty was shortlisted for National Broker of the Year at the 2011

*Insurance Times* Awards.

JLT Specialty won the prestigious award in 2010. At the time Warren Downey, Managing Director of JLT Specialty's Regional Partnership Division, said the award was "testament to the hard work and client focus in particular of our regional offices and teams. Our approach of specialist expertise combined with local knowledge and experience continues to provide clients with the service they want and need."



JLT Specialty was the Insurance Times Broker of the Year

## Value of remuneration sacrifice

The increase in National Insurance contribution (NIC) rates from April this year means the potential savings from remuneration sacrifice, whereby an employee gives up pay in exchange for an employer pension contribution, are greater than ever.

With compulsory pension provision on the horizon, remuneration sacrifice is an effective way to mitigate the costs of having to auto-enrol nearly all employees into a workplace pension and contribute for them.

Implementation can be straightforward but there are some pitfalls for the unwary so the latest advice should always be sought.

JLT Benefit Solutions has considerable experience of implementing and operating salary sacrifice for pensions and other employee benefits. Their expert advice is available in a new *Practical Guide to Remuneration*.

The guide explains in detail how remuneration (salary/bonus) sacrifice in exchange for an employer pension contribution works, or other non-cash payment, paying

Sacrifice helps build a pension nest egg



particular attention is paid to 'automatic' salary sacrifice schemes.

The guide can be downloaded at: [www.jltgroup.com/content/s2/jlt-eb-practical-guide-to-remuneration.pdf](http://www.jltgroup.com/content/s2/jlt-eb-practical-guide-to-remuneration.pdf).

“ In the event of a major disaster with significant loss of life, the low level pricing structure of global aviation insurance may increase overnight. ”

Steve Turner, Partner, JLT Specialty Aerospace team, page 10

## JLT cyber risk articles available to download

Information technology is now an integral part of business, but vital information and web-based applications are increasingly vulnerable to outside attack from cyber criminals. The loss of data can be catastrophic, and organisations face regulatory enforcement where privacy and security-related controls are breached.

In addition to this, cloud computing, a

general term for anything that delivers hosted services through the internet, is increasingly popular but also introduces numerous different risks into a business. The loss of control associated with using the cloud should give its users a great deal of concern, but is often overlooked.

Traditional insurance policies rarely cover these types of threat. Changes in regulation

and technological advances can quickly render policy wordings obsolete.

JLT's experienced Cyber and IT team recognises these problems and has written two papers offering advice on how these risks can be managed within a business and how to ensure cyber insurance policies are fit for purpose.

They are available to download from [www.jltgroup.com/it-risk-assessment](http://www.jltgroup.com/it-risk-assessment).



## Real estate legal indemnity guide

Traditionally, legal indemnity insurances have been handled by a lawyer directly with an insurer, with little in the way of price or coverage comparison.

However, with the increasing demands of regulation this mode of operation has come under some scrutiny. In particular, the preparation of a demands and needs statement, with accompanying evidence of market research, is not a matter that usually falls within the client's brief.

A new JLT guide seeks to simplify the process. It identifies the main types of legal indemnity insurance and explains the information required by insurers for them to provide a quote. The key types of cover are explained, while quote checklists help illustrate clearly what is needed.

There are clear explanations of terms such as: restrictive covenant; lack of access or easement for services; defective title adverse possession; mineral rights; judicial review; and rights of light, together with checklists of items that are needed to get a quote if any of the terms apply.

The guide is available to download at [tinyurl.com/legal-indemnity-report-jlt](http://tinyurl.com/legal-indemnity-report-jlt)

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## Fraud The unseen threat

Cover story continued



>> executive liability and crime exposure, points out that fraud carried out by dishonest employees has grown by 40 per cent since 2008, according to CIFAS.

It's not just major multinationals who should be worried. Lea notes that a recent report from the Association of Certified Fraud Examiners (ACFE) found that 31 per cent of all occupational frauds were committed against small businesses (the highest rate of any category) with a median loss of \$155,000 per case. Small businesses are favoured targets because they tend to have far fewer anti-fraud controls than larger organisations, he explains.

### A crime of opportunity

A variety of factors increase the risk of fraud says Broom, "A company with a weak control environment presents an opportunity for fraud. Companies that have been doing badly or are failing give a significant motivation to management to commit accounting fraud. In the last few years there has been an increase in fraud from staff and management – asset theft, payroll fraud, corruption, theft of intellectual property and selling sensitive company information have all become more common."

Even trustworthy employees affected by adverse changes in circumstances might be tempted to commit

fraud given the opportunity. Targets can put excessive strain on employees – some may choose fraudulent means to appear to meet them.

In his experience, Lea says, most cases involve personal problems, debt, illness, gambling, adultery or simple greed. "There's a saying that the life of a fraudster usually involves fast women and slow horses," he jokes.

Cutbacks mean that fraudsters are often more likely to go undetected, Lea adds. "Redundancies mean that a reduced number of the personnel employed on internal controls make it more difficult to spot and detect suspicious activities and fraudulent transactions."

Anyone doubtful of the potential costs need look no further than Enron and Barings comments Broom, "Companies should be very concerned – fraud can bring a company down."

But the impact goes far beyond the direct cost of the financial loss, with the simple

financial loss more minor in comparison to the loss of reputation. Case studies have shown that the management time that gets absorbed after a fraud is not to be underestimated.

Lea says the bad publicity of a fraud can discourage investors, adversely influence suppliers, customers and potential recruits, and affect relations with regulators.

### Prevention

Prevention is certainly better than cure. Indeed, recruiting honest people and then keeping them honest is an obvious way to eliminate the majority of employee fraud.

Auditing is very useful as an independent assessment of the control process says Broom, "Auditors provide a deterrent effect but we also have the skill set to investigate a fraud once it has happened and make recommendations to ensure that there are no future repeats." He recommends careful planning of each audit, making adequate resources available and getting the

## Fraud in numbers

**£38 billion**  
is the cost of fraud to the UK economy every year, according to National Fraud Authority data.

**27%**  
of staff fraudsters were reported to the police in 2010, according to CIFAS

**\$155,000**  
per case is the median loss of staff fraud for small businesses, according to the Association of Certified Fraud Examiners (ACFE)

**31%**  
of occupational fraud is committed against small businesses, which have fewer controls

## JLT's anti-fraud measures

- Implement segregation of duties (ie dual control procedures) so that no one person is permitted to control a transaction from beginning to end
- Apply digital forensics to laptops, PDAs, cell phones, memory sticks, burned CDs, MP3 players and other electronic storage devices
- Install software systems that require users to change their passwords at regular intervals
- In critical areas, implement a practice of short term job rotation and ensure that employees take a holiday of at least one full week (preferably two consecutive weeks) every year
- Ensure that the Head of Internal Audit reports directly to the Board regarding financial irregularities
- Institute robust background checks, including references and social media.

cooperation of senior management.

Such preventative measures are best combined with tailored insurance cover.

### Insurance

Fidelity insurance for internal fraud or crime insurance for internal and external fraud are the usual choices, says Lea. These policies protect a company from the financial consequences of employee dishonesty. "Crime-related losses are not normally covered by property insurance policies. Since any organisation in any sector can suffer a fidelity loss and fund transfer fraud is on the increase, crime protection insurance is necessary for companies to protect themselves."

Despite evidence of increased fraud activity since the financial crisis, the crime insurance markets are currently very competitive, he adds, with currently over £500 million of capacity available.

But policyholders should be aware of the requirements of the policy, says Adrian Brennan, a Partner at Echelon Claims Consultants, part of JLT Specialty. "We don't see a huge number of these claims each year but, if something does happen, the onus is on the employer to collect the evidence to demonstrate a loss," he adds.

Few companies have the internal resources or expertise required so it's often essential to hire a team of experts. Investigating a loss can thus be expensive – in excess of £100,000 even for straightforward cases.

These expenses will usually be covered under a crime policy but there are often

conditions attached. "You do need to be careful that a crime has actually been committed," says Brennan. "A company could spend £150,000 investigating a loss only to find it was caused by poor business practice such as a badly set up contract. If this happens, they'll be liable for the cost of the investigation."

Companies should also be mindful of the extent of the loss when they begin investigations. "Some policies will be worded as the loss excluding fees so it can be particularly important to assess the

“Asset theft, payroll fraud and selling information have become more common.”

David Broom, JLT Group Chief Risk Officer

quantum loss as early as possible in the process," adds Brennan.

Policyholders need to pay attention to the notification terms, typically 30 or 90 days. This can cause problems, especially where someone at a lower level or in a remote subsidiary is aware of a problem but hasn't informed the insurance department. It can be prudent to define the information holder, so the notification period starts only when they become aware of the issue.

Lea says many companies are woefully

underinsured, not realising that cover of £1 million is insufficient against fraudulent fund transfers at group treasury level. Proposal form requirements that internal policies be disclosed to insurers give the immediate potential for disputes, he says – the nature of fraud means that controls have failed or been successfully bypassed. He stresses that crime insurers should understand the culture of the organisation, and thus appreciate the true nature of exposure. "Losses are stressful enough without arguments with an insurer."

Market selection should not be determined solely by price and coverage – claim paying approach, security rating, flexibility, experience, service and an understanding of the company's business should also be taken into account when selecting a crime insurer.

Lea concludes: "JLT's general approach is to move away from a list-based approach over what is covered, towards broader cover and brevity of the policy wording. We work particularly closely with certain insurers who have established JLT coverage endorsements according to our bespoke wish list for enhanced cover." ■



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## Master class

Adrian Lamasz, Regional Managing Director, JLT Specialty

# Mergers and acquisitions

Companies involved in a merger or acquisition and management buy-out teams purchasing a business use a variety of insurance and risk management services. These are designed to help them identify any potential employee benefit or general insurance related issues that could attract additional cost post acquisition and to transfer potential risks that could otherwise prevent the deal from proceeding.

### Q What are these services?

These services fall into three key areas:

- 1 Insurance and risk management due diligence
- 2 Pensions and benefits review (see opposite)
- 3 Insurance to protect against liabilities that may be assumed under the sale and purchase agreement (see opposite).

Items 2 and 3 are commonly a requirement for banks, private equity and other lenders financing the deal, although companies should always consider these services as best practice, regardless of any financing obligations.

### Q What does the insurance and risk management due diligence do?

It analyses the target company in terms of their:

- Insurance arrangements - including property, business interruption, liabilities (including management and environmental), motor fleet and all of the other insurances classes purchased
- Risk management strategy - including health and safety, business continuity, supply chain, risk retention capability and contract

“ Benchmarking a company's insurance against businesses of similar size allows an informed comparison. ”

- Claims record, loss profiling and forecasting. The purpose is to assess how accurately the insurance programme reflects the risks of the business. It also considers whether there are any risk exposures that are not appropriately insured or financed which may represent a real risk to the business, post-completion.

The exercise will examine the cost of the insurance for the target business and flag any issues associated with the change in ownership.

### Q What are the benefits?

As well as identifying potential insurance related deal-breakers and cost implications for the transaction it helps the purchaser to:

- Forecast insurance premium costs, potential self insurance liabilities and risk management capital expenditure requirements
- Identify any hidden or underinsured liabilities or exposures which could be insured
- Minimise their reliance on contractual warranties

- Consider potential pre-emptive risk management measures that could preserve deal value.

### Q What insurance issues should buyers be aware of?

Compliance with insurance regulations is important for a business with sites in different countries and must be checked by experts.

Historic liabilities can also be a key issue, particularly from industrial disease-related exposures, for example deafness, hand/arm vibration-related injuries or mesothelioma and other asbestos illnesses, or environmental liabilities.

The vendor may have chosen to have a high excess on its policies, but if it is selling off a non-core business, the purchaser should understand there might be hidden costs because of the higher amount of retained risk.

Classes of insurance should also be taken into account. Professional advice businesses will have a big cost line for professional liability insurance, the cost of which can be quite volatile depending on the economic cycle and the amount of capacity available in the insurance market.



# Did you know...

Teresa Jones, Partner, JLT Specialty

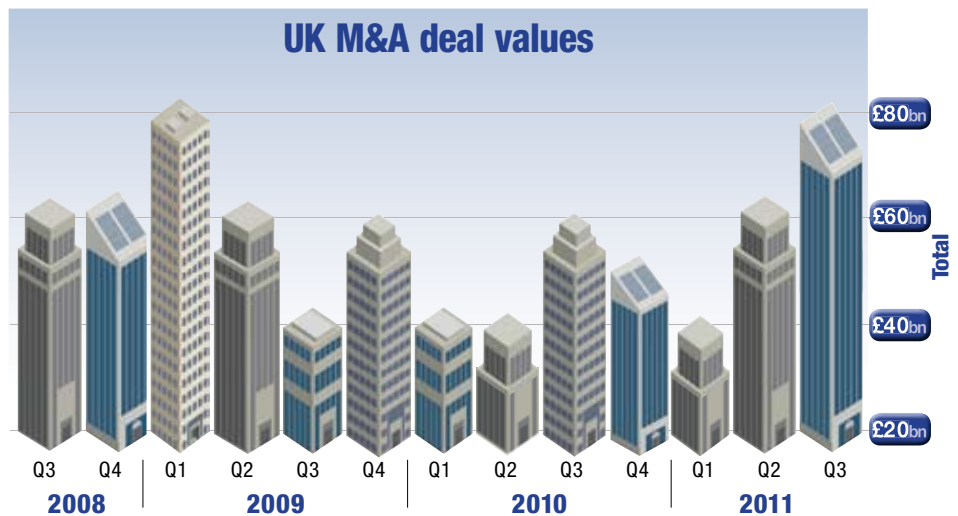
## M&A insurance products are deal facilitators

Mergers and acquisitions (M&A) insurance products are increasingly being viewed as deal facilitators and strategic tools. Awareness of these products is key – if you are unaware of their existence you can lose a deal that otherwise might have been successfully closed.

Escrow arrangements, often set in place to protect against unforeseen financial risk arising from M&A transactions, can be costly and can be eroded by warranty claims. The reduced pricing of insurance solutions on the other hand can now offer a more cost effective route in a wide range of transactions.

Although these products are becoming commonplace, many companies are still not familiar with the suite of bespoke products for M&A-related liabilities. Products such as warranty and indemnity (W&I), tax insurance, litigation buyout and prospectus liability insurance were only previously used where other forms of security were unavailable or not cost-efficient. Over the past three to five years, they have increasingly emerged as deal enablers. Despite this, insurance is designed to supplement the usual commercial negotiations, not replace them.

Such deal enablers are all the more relevant for parties during the current downturn. Sellers looking to dispose of distressed assets may not wish to incur further long-term liability by providing warranties. Equally, distressed sellers may not be around for six years (or however long the term of their contractual obligations) so



buyers might look for additional protection. A buyer unable to get the financial warranty limits it wants from the seller can get protection from M&A insurance. Its use is also prevalent in private equity deals or other disposals by financial institutions where, due to fund structures, there is no party to provide any meaningful warranties.

There are benefits for sellers: a seller asked to give higher financial warranty limits than it is comfortable with can consider M&A insurance to ensure a clean exit.

Insurance is also commonly used by buyers in auctions, trying to differentiate themselves. They might choose to lower their required warranty cap to enable them to put forward a more attractive bid to the seller.

Increasing demand has led to a significant rise

in the numbers of insurers writing business and the pricing of these products has fallen around 60 per cent over the past two or three years. Average prices on UK W&I policies are now around 1 per cent of the limit purchased.

Underwriters for M&A-related products are now predominately ex-corporate lawyers familiar with the procedures and language involved, so the underwriting process has become simpler and shorter, with better cover and policies more closely matched to the requirements of the underlying deal.

It is important to use a broker with a specialist team, who can guide you through the process and advise you on issues relating to timing and coverage implications, and can provide an early heads-up as to what is achievable.

## Back to basics

### Employee benefits during a merger

During a merger or acquisition, one employee benefit is likely to be at the forefront of the dealmakers' minds – the pension. Such concern is hardly surprising, given the difference a generous final salary pension with a large legacy membership can make to the overheads of a business.

However, while the pension is clearly a major consideration, it is not the only aspect of the benefits package that requires attention. No two companies offer precisely the same package, and merging them is fraught with difficulty. Unless everything is levelled up, businesses are faced with cutting benefits. At a time when employees are already having to deal with uncertainty, this can be the final straw for engagement. It means most companies put this in the 'too difficult' pile and let the different packages of the newly formed business sit side by side.

However, differences in benefits can themselves lead to disillusionment, particularly where a company has been on the acquisitions trail, creating myriad confusing benefits that leave everyone feeling they are losing out.

There is an alternative – flexible benefits. Richard Roper, a Partner at JLT Benefit Solutions, says: "Flexible benefits can be structured so that employees receive a core package and additional sums to spend on buying back their previous package, or buying benefits that suit them better."

Flexible benefits are no longer the expensive option they once were. There are schemes that can be run cheaply and easily through technological solutions such as JLT's BenPal. "People imagine that flex will require a huge amount of additional work or administration and extra cost, but this is no longer true," Roper says. "In fact, if the scheme is aligned with salary sacrifice, flex may even be run at no additional cost to the business."



## How do I get my PI cover right?

- Are all my professional services covered?
- Do I have the benefit of first party cover to rectify professional errors before handover?
- Are my vicarious subcontractor liabilities covered?
- Will I have cover for liabilities that arise out of joint venture activities?

Potential damages associated with a claim could include: rectification, which can be significantly higher than original construction costs; consequential financial losses, which are generally the most significant portion of a loss and have little direct correlation to contract value; and, in certain instances, third party bodily injury and third party property damage. The policy also covers legal costs.

But the policy only responds to claims made during the period of insurance, defined as a legal demand from a third party such as a writ (rather than insurance claims made under the policy).

Contractors can also find themselves responsible for the rectification of professional errors and omissions prior to handing over a project. Such costs will normally be borne by the contractor directly but a liability claim will not be made. A standard PI claims made policy will not cover this; an extended PI policy to cover this first party exposure requires specialist drafting.

Third party liability insurance and contractors' all

risks (CAR) insurance can cover professional liabilities but coverage is limited. For example, a CAR policy only provides coverage for physical loss or damage during the construction or defects periods, so liabilities for rectification costs where there is no physical damage are not covered. Third party liability only covers third party bodily injury and property damage, so rectification costs and associated financial losses will not be covered. ■

# Design and build PI cover

Design and build professional indemnity insurance is expensive and the frequency of claims is low. But when liabilities do occur, the premium proves to be worth it. By Nathan Skinner

**P**rofessional indemnity insurance (PI) is designed to provide indemnity for liabilities incurred as a consequence of the professional acts, errors or omissions of the insured and/or parties for whom the insured is vicariously liable.

Traditionally, such coverage was purchased by professionals such as lawyers and accountants, and by construction consultants such as architects and engineers, explains Andrew Harrison-Sleep, Partner at JLT Specialty. "But for many years, contractors have also been purchasing PI insurance to cover liabilities they may incur due to professional services conducted internally or by subcontractors and consultants."

A standard PI policy for a contractor includes a list of covered professional

activities and duties such as architectural, engineering, quantity surveying and land surveying. The list must be comprehensive.

"The demand for one-stop shop services expands a contractor's service offerings and their professional liability exposures," says Harrison-Sleep. "This is particularly the case where contractors become involved in non-traditional construction activities, such as property services, development consultancy and associated legal and financial activities."

One solution is to use a wording that covers all professional activities and duties, rather than named activities only.

### Vicarious liabilities

Contractors will typically purchase PI to protect their balance sheet from potential claims made by a third party (such as employers and financiers) and/or to satisfy contractual requirements.

Harrison-Sleep says that, as a class of business, PI is often undervalued by contractors. "PI claims have a low frequency and therefore insureds will often have no experience of the benefits of PI coverage. But when professional liabilities do occur, the quantum can be large and are often not directly related to the size of the contract value, especially on subcontracts which could form part of a much larger project."

“When liabilities occur, the quantum can be large and often not directly related to contract value.”

Andrew Harrison-Sleep,  
Partner, JLT Specialty

### quick facts!

✓ A PI policy traditionally needs a comprehensive list of covered activities.

✓ Professional liability exposure is increasing as contractors begin to offer one-stop shop services.

✓ A solution is contract wording that covers all activities, not just named ones.

### find out more

To discuss any of the issues raised in this article contact

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# Insurance after the event

After the event (ATE) insurance offers a low risk route to settling legal disputes, at little or no cost. By Stuart Collins

Companies are increasingly using ATE insurance to remove risk from commercial litigation. In the current economic climate, this is proving to be an attractive way to recover bad debt or access much needed funds through legal action.

The potential financial risk can discourage companies from pursuing litigation but, by using ATE insurance, companies can reduce these risks and protect themselves against the costs of losing a case. The plaintiff's legal costs are not paid by the insurance but under the Conditional Fee Agreement (CFA) with the solicitor, so no costs arise, meaning companies have little to lose.

## Powerful deterrent

Many solicitors will litigate a claim that has a good chance of being successful under a CFA – also known as 'no win, no fee' agreements. A combination of a CFA and ATE insurance can potentially put a company in a no-lose situation, says Chris Hammond, Partner, JLT Specialty. "It can be daunting and expensive to take a claim to court, but ATE insurance in combination with a CFA can swing the balance in your favour."

CFA and ATE in combination are a powerful deterrent – an out of court settlement is the usual result. Insurers and solicitors will only offer ATE combined with a CFA if they are confident of a successful outcome.

If a case is brought to court and the plaintiff loses, the ATE premium will pay the defendant's legal costs and the plaintiff's disbursements, such as the costs of counsel opinion and other experts. It will also pay the cost of the insurance itself.

If the plaintiff wins, the defendant pays the ATE premium and all the plaintiff's



“ Combined CFA and ATE can potentially put a company in a no-lose situation. ”

Chris Hammond,  
Partner, JLT Specialty

legal costs, which are elevated to include a success fee – which can be as high as 100 per cent under the current rules.

The fact that insurers have covered the risk can also encourage early settlement and avoid the stress of going to court. Costs escalate through the different stages of proceedings leading up to the court case, so a defendant that pursues a case to

court will face much higher costs than one that settles early. "The vast majority of defendants will settle early," Hammond says.

## Major changes ahead

Lord Justice Jackson's proposals for legal reform – many of which are being adopted through proposed government legislation – may bring substantial changes in the cost and manner in which civil claims are litigated in the UK.

Jackson recommended an end to the recoverability of ATE premiums and CFA

success fees, although he endorsed the use of commercial litigation funds in principle. ATE insurance is increasingly used by such funds: investors that provide funding for large and small claimants.

The Jackson proposals, should they be implemented, will have the greatest impact on ATE insurance for bodily injury claims. However, the reforms are not expected to make ATE insurance any less relevant for commercial litigation.

ATE premiums will continue to be important in removing financial risks for most claims, but ATE and success fees from damages on smaller claims will be harder to justify, Hammond explains.

Lord Jackson's proposals do not give enough consideration to commercial litigation, says Hammond. Good claims may not be pursued by insolvency practitioners looking to recover funds from errant directors on behalf of creditors and tax authorities. "If ATE insurance premiums are not recoverable, as is proposed, premiums are likely to bring higher levels of transparency to the market," he says.

Companies considering legal action should contact a specialist like JLT or ask their solicitor to do so. Experts can decide whether there is a case and if a counsel's opinion is required – often it is not. ■

## ATE considerations

The biggest pitfall that ATE insurers and solicitors face is whether the defendant is able to pay in the event of the case going to court and their losing – therefore having to pay the plaintiff's legal costs and the ATE insurance premium. Insurers will sometimes waive the ATE premium should this happen, but this is negotiated on a case-by-case basis and it would certainly not be waived on every occasion. Insurers will also look closely at a defendant to make sure they are not about to go into administration.



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## Focus on

# Aerospace industry

Changing risks and the pressures of the downturn are taking their toll on the aerospace industry. Assessing insurance cover is more important than ever.

**M**any people equate aviation with the airline industry, says Steve Turner, Partner in JLT Specialty's Aerospace team. However, it is important to differentiate between national airlines, independent low-cost airlines, general aviation, such as executive aircraft, and suppliers, such as manufacturers, airports, ground handlers and all the associated industry companies.

Airlines have the largest exposures in terms of the number of passengers being carried and the high value of the aircraft themselves. Therefore the airlines bring the largest amount of premium to the aviation insurance marketplace and are the focus of the industry overall. However, the aerospace insurance market also provides protection for airports, air traffic control, ground handling agents, manufacturers, refuellers, maintenance, repair and service companies and others. Each has a different risk profile.

### Safety and security

Post-9/11, heightened awareness of safety and security – combined with fewer flights – has seen a decline in accidents involving Western-built jets, meaning the industry is safer as a whole. But more sophisticated, and thus more expensive, technology means potential losses are higher. Greater capacity requirements mean larger aircraft but risk exposures of hundreds of millions

#### quick facts

- ✓ More advanced technology and greater capacity means potential losses are higher.
- ✓ Airlines need insurance that fully covers legal liability and contractual obligations.
- ✓ M&A are likely to bring benefits as larger airlines attract premium discounts.

of dollars for each plane, plus any passengers aboard, so the aviation insurance market is very much a catastrophe market.

Security is currently heightened for passenger and cargo operators. For example, the US Federal Aviation Administration (FAA) has identified the potential of lithium batteries, widely used in portable consumer electronic devices, to ignite within aircraft, leading to increased scrutiny for passenger and cargo carriers.

### Flow down of risk

The increasing 'flow down' of responsibilities established by contracts from manufacturers to airlines is affecting more service suppliers within the airline support industry. Aircraft accidents are usually caused by a number of circumstances combining together. Plaintiffs' lawyers now try to draw as many parties as possible into litigation to spread compensation across them with the aim of increasing awards, says Turner. Suppliers and manufacturers of small sub-components need to be aware of long tail liability and the potential for large claim awards. "A company overlooking its contractual obligations to a customer can be put at risk of having insufficient aviation product liability coverage, with significant consequences."

### Cloudy horizon

The disruption caused by the eruptions of the Icelandic volcanoes Eyjafjallajökull in 2010 and Grímsvötn in 2011 was unexpected. These events, combined with the extreme wintertime weather that partially paralysed London's Heathrow airport, also caused major headaches for the airline sector, both operationally and financially. Airlines had to pay high compensation levels to passengers for accommodation expenses against tickets costing only a few pounds, even though airlines do not purchase business interruption coverage

associated with the operation of their aircraft.

As climate change makes weather patterns more unpredictable and regulators continue their 'safety first' approach, the need for new insurance products like business interruption coverage for airlines is likely to rise.

“Plaintiffs' lawyers now try to draw as many parties as possible into litigation”

Steve Turner, Partner, JLT Specialty Aerospace team

### Insurance

With 70 to 80 per cent of airlines' aircraft leased or financed through third parties, legal liability to financial partners is an important consideration. Airlines should have insurance that fully protects legal liability and contractual obligations. Therefore it is vital the insurance broker's contractual advice is focused on the overall

risk exposure of the company and on individual contractual indemnity language.

Mergers and acquisitions will bring benefits in terms of insurance products, because larger airlines tend to achieve a greater degree of premium discount. The aviation insurance market is highly reactive and is broker-driven, explains Turner. "In the event of a major disaster that causes significant loss of life – and therefore compensation levels – the current low level pricing structure of the global aviation insurance market may increase overnight."

The low level of profitability for insurers may change the available global capacity. Airlines should assess the quality of their insurance provider, Turner warns, especially as the ongoing recession may restrict some companies' ability to meet any claims that arise. ■



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# About JLT

**J**LT 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.

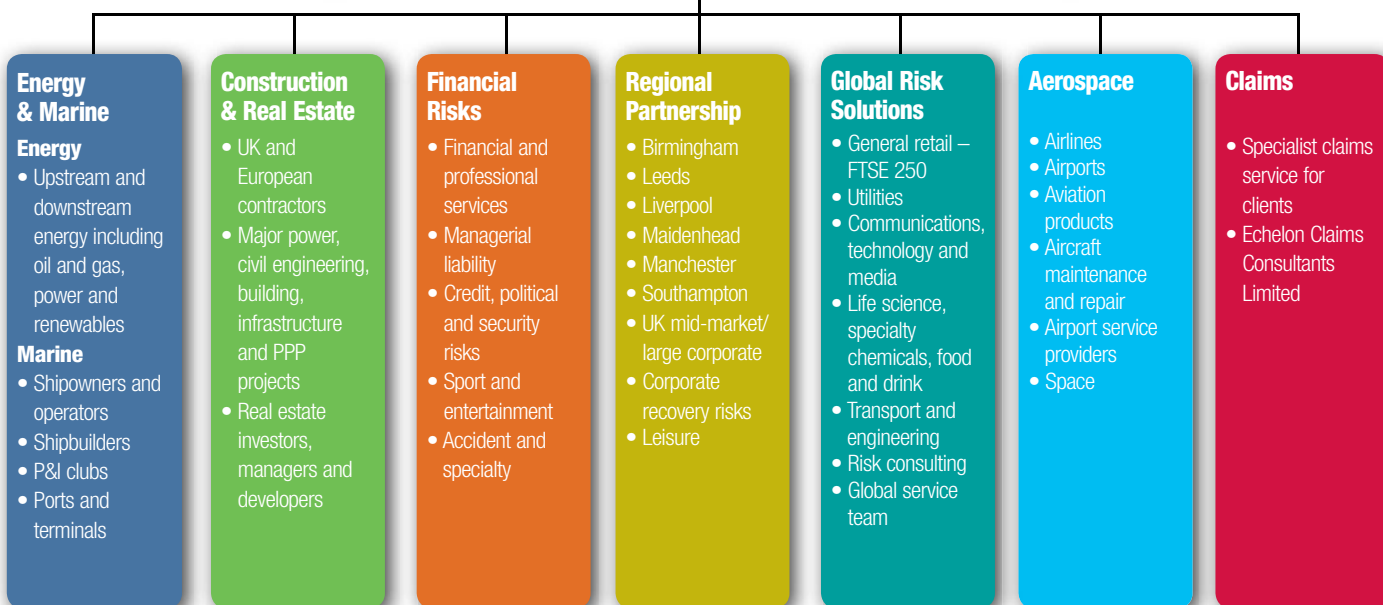
Our Regional Partnership division provides risk and insurance services for mid-sized to large corporate clients. Clients benefit from a blend of deep sector knowledge and technical expertise, coupled with the ability to

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 our 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.

## JLT Specialty Limited

Global specialty insurance broking and risk management services



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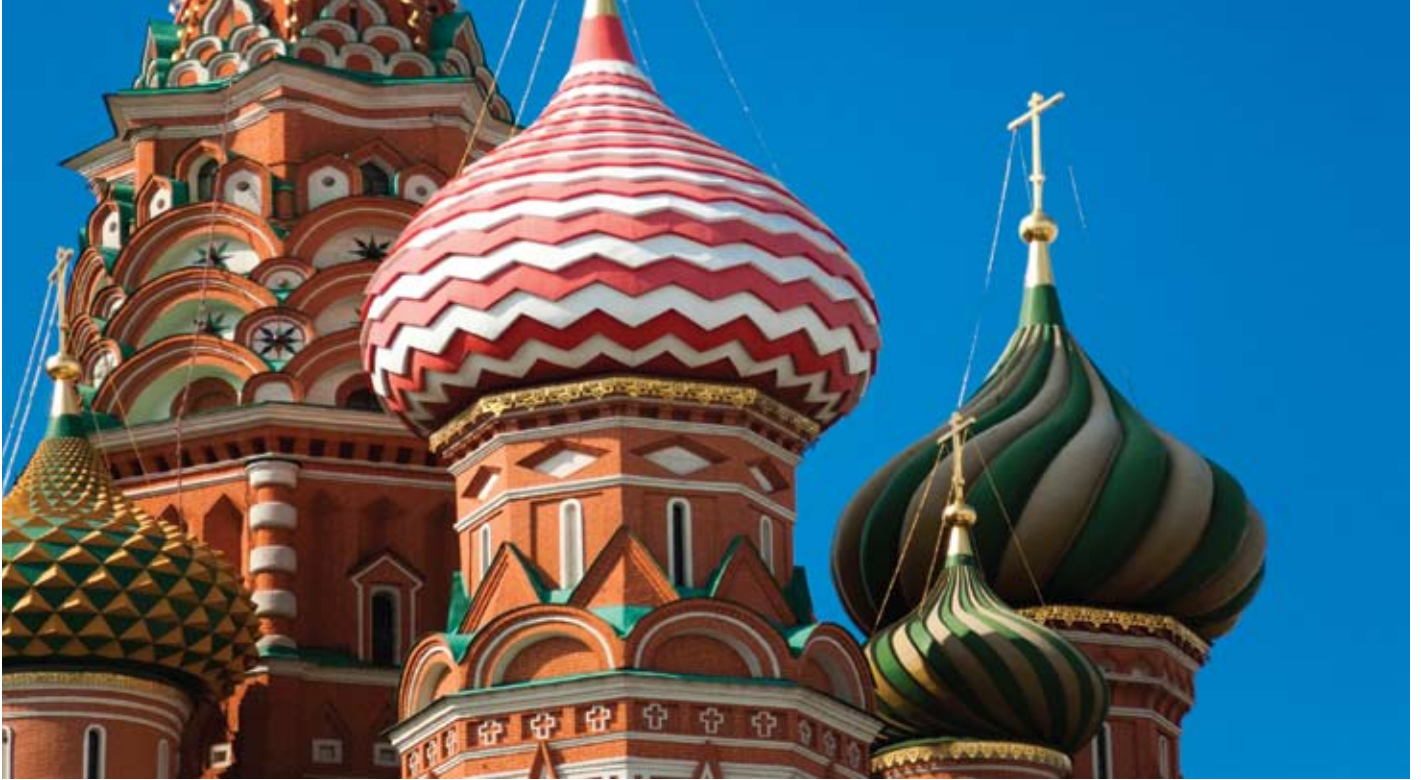
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## Russia's risks in numbers

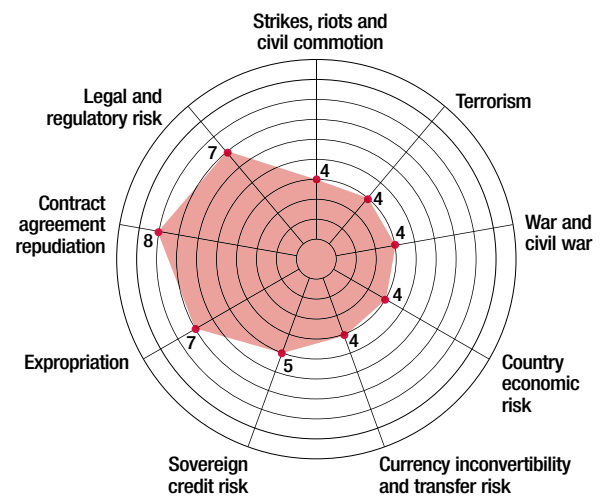
In each issue of *Whiteboard* we use analysis from JLT Specialty's World Risk Review™ to examine the global economic and political environment affecting companies that trade overseas. In this issue we focus on Russia.

**P** rime Minister Vladimir Putin suffered a political setback on 4 December when the results of the parliamentary election demonstrated a significant decline in support for United Russia (UR), the pro-government party. UR won 49.6 per cent of the vote and secured 238 seats in the Duma (parliament), well below expectations. As UR support across Russia is between 35 and 40 per cent, this result, though well below the 64 per cent won in the 2007 election, is indicative of vote rigging.

Angry demonstrations in Moscow in response to the 'flawed election' are an unusual feature of Russian political life and unlikely to become widespread. Protestors came from the more educated strata

of Moscow society who have grown increasingly frustrated with the constraints imposed by the current political system and endemic corruption. At most, this group accounts for 20 per cent of the population, while many of those outside Moscow are happier with the political system and the state assistance they receive. As a consequence, the protests are unlikely to become more frequent or widespread.

In the absence of the two-thirds majority UR held in the last parliament, if Putin goes on to win the presidential election on 4 March, he will need to secure consensus for the passage of legislation, in contrast to the rubber stamping that characterises the current legislative process. ■



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