The economic problems of recent years have reduced insurance buying power and driven an increasing focus on price. This has resulted in the rise of the discounter at the expense of the big brokers – a phenomenon that seems to be irreversible in many sectors.
## CONTENTS

**JLT SPECIALTY LIMITED**  
**Q2 2015**

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AEROSPACE</strong></td>
<td></td>
</tr>
<tr>
<td>Aviation rates ease despite claims in Q1</td>
<td>2</td>
</tr>
<tr>
<td><strong>COMMUNICATION, TECHNOLOGY AND MEDIA PRACTICE</strong></td>
<td></td>
</tr>
<tr>
<td>Sustainable innovation and pricing needed for comm-tech firms</td>
<td>4</td>
</tr>
<tr>
<td>Cyber risk – a high priority in the boardroom</td>
<td>6</td>
</tr>
<tr>
<td><strong>CREDIT, POLITICAL &amp; SECURITY RISKS</strong></td>
<td></td>
</tr>
<tr>
<td>Xenophobic violence resurfaces in South Africa</td>
<td>8</td>
</tr>
<tr>
<td>Permitting issues cloud mining outlook</td>
<td>10</td>
</tr>
<tr>
<td>Regional report – Russia: a game of risk</td>
<td>16</td>
</tr>
<tr>
<td><strong>CYBER RISKS</strong></td>
<td></td>
</tr>
<tr>
<td>Cyber insurance not trusted by business, KPMG claims</td>
<td>20</td>
</tr>
<tr>
<td>The state of the cyber market – roundtable</td>
<td>22</td>
</tr>
<tr>
<td><strong>FINANCIAL INSTITUTIONS</strong></td>
<td></td>
</tr>
<tr>
<td>The growing cost of regulatory collaboration and investigations</td>
<td>30</td>
</tr>
<tr>
<td><strong>FOOD &amp; AGRI</strong></td>
<td></td>
</tr>
<tr>
<td>JLT expert sees opportunity in risk to world food supply</td>
<td>32</td>
</tr>
<tr>
<td><strong>JLT SPECIALTY</strong></td>
<td></td>
</tr>
<tr>
<td>Lost civilisations</td>
<td>34</td>
</tr>
<tr>
<td>AIRMIC calls for broader reputational risk cover</td>
<td>40</td>
</tr>
<tr>
<td><strong>MENA</strong></td>
<td></td>
</tr>
<tr>
<td>Marine, energy insurers await Iran’s return to international fold</td>
<td>44</td>
</tr>
<tr>
<td><strong>REGIONAL RISK PRACTICE</strong></td>
<td></td>
</tr>
<tr>
<td>Risk game is Sally’s forte</td>
<td>46</td>
</tr>
</tbody>
</table>
The direction of airline insurance rates remains unclear following the loss of the Germanwings A320 in March, although abundant capacity and an overall positive safety trend point to further market softening.

Last year was marked by a number of high profile aviation losses, a trend that continued into 2015. The largest loss in the first quarter of this year was from the Germanwings Airbus A320 crash, which came down in mountainous terrain over France killing all 150 passengers and crew on 24 March. It followed the loss in February of a TransAsia ATR72-600 plane that crashed in Taipei shortly after take-off, killing 43 of the 58 persons onboard.

According to JLT, the loss of the Germanwings A320 is likely to result in another substantial hit for the aviation insurance market, which was struck by a series of large losses last year, including two Malaysia Airlines Boeing 777 aircraft with 534 people on board.

“The respite from the large losses of 2014 has proved short lived as we witnessed a series of high profile and tragic losses in the first quarter of 2015,” according to Nigel Weyman, Chief Executive Officer Aerospace, JLT Specialty. “These events have reignited much debate on the subject of aviation safety and have the potential to bring about changes in legislation and airline procedures,” he said.

For example, following the crash, a number of authorities and airlines have introduced new aviation rules and recommendations that will require two people to remain in the cockpit at all times as a safety precaution, according to JLT’s latest Plane Talking publication.

Initial investigations suggest that the Germanwings crash was the result of deliberate pilot action, which would mean the hull claim is likely to be paid by the hull war market while the liability claim will be settled under an all-risks policy. The ‘all risk’ insurance policy is underwritten by a consortium of insurers led by Allianz SE, while the hull war policy is reportedly underwritten at Lloyd’s.

The Germanwings crash has resulted in a relatively high first quarter claims burden for insurers. Airline losses in the first quarter were around $460m, slightly lower than the same period last year that included the exceptional loss of Malaysia Airlines MH370, the largest loss of 2014 and a significant claim, explained JLT.

According to insurance broker Willis, the loss total for 2014 was $1.67bn, marginally above the five-year average. However, while 2014 experienced some of the largest and most high profile losses ever, the underlying positive safety trend continued, Willis said in its Airline Insight publication.

Despite losses in 2014, abundant capacity halted the market’s ability to achieve significant premium increases following large losses in 2014, according to Willis. While insurers had high expectations of change, premium increases in the final quarter were just 5%, with premium levels at the year-end barely changed from the previous year, the broker said.
“Significant premium increases were in reality not going to be achieved across the board when the majority of buyers approached their renewal with growing exposures, good loss experience and in the majority of cases a younger, safer fleet of aircraft,” Willis said.

As a result, the trend towards renewed market softening appears to have continued into the first quarter of 2015.

“The rate reductions seen in the first quarter appear larger than those we witnessed at the end of last year, with premium rates and premium volume down by around 10%,” said Mr Weyman. “At the start of 2015 it would seem that rating reductions were once again available for those risks with significant growth and good historical loss history,” he said.

The experience of the first quarter, however, is not a good guide to market conditions going forward, according to Mr Weyman. Only a small number of airlines renew in the first quarter and contracts would have already been negotiated prior to losses, including Germanwings.

“By the end of the second quarter we will be in a much better position to assess the market situation and gauge whether recent losses have had any effect on renewal pricing,” he said.

Willis also noted that first quarter renewals are of limited value when predicting the direction of the market. But given current capacity levels and claims trends it believes that 2015 looks set to be very much a continuation of the ‘buyers’ market’.

An additional factor that could come into play later this year is market consolidation, according to JLT. Recent months have seen a number of insurers engage in M&A activity, with falling rates, intense competition and low interest rates piling pressure on smaller companies.

“Whilst the impact of this recent insurer consolidation is still unclear, the greatest force driving current pricing is overcapacity, so ultimately the effect of these mergers could become an important factor in months to come,” said Mr Weyman.


JLT Specialty Contributor Nigel Weyman, CEO, Aerospace
The big challenges facing risk professionals in the communications, technology and media (CTM) sector came under the microscope this week at an invite-only conference hosted in Amsterdam by the global CTM practice of JLT. Speakers representing specialist underwriters, brokers and risk managers from around the world explored the diverse emerging risk issues affecting the comm-tech sector and specifically how well carriers can respond innovatively to a dynamic risk landscape when rates continue to spiral downwards.

According to David Ralph, the outspoken senior vice president in charge of risk management at diversified Hong Kong-based telecom group PCCW, the insurance industry is failing to keep up with the pace of change being experienced by its comm-tech customers.

“Our marketing people will come and tell us that we have just six weeks to get a product out and we need to be able to talk to you [insurance] guys so you can understand it,” Mr Ralph said.

On the broader question of pricing and market conditions, he described the continuing fall in pricing as ‘scary’ from a sophisticated buyer perspective. He said that comm-tech company board directors routinely benchmark insurance prices with their peers and then inevitably call on their risk managers to obtain 20% discounts.

“We need to get some stability around pricing. It isn’t right, it isn’t sustainable and we want to make sure we will get our claims paid,” Mr Ralph said. “At the same time, insurers need to maintain the resources to develop the technology and services that will support us in what we do. You need to stay relevant to us as we bring in new products and at a price that is sustainable.”

Andreas Berger, Chief Regions and Markets Officer for Allianz Global Corporate & Specialty (AGCS), told delegates that the insurance industry’s business model is under stress. Against a background of low interest rates it needs to stay focused on underwriting profits, he said.

“On the positive side the industry is finally beginning to move away from its ‘siloed’ line of business-based approach to a more cross-class and customer-centric solutions approach,” Mr Berger said. “But too many companies do still have a P&L approach that is based on LOBs.”

Fabrice Demonge, Managing Director for West Europe at AIG, said that the insurance industry urgently needs to improve and increase its use of data analytics in order to innovate in non-traditional risk areas while ensuring it better understands the risk exposures being assumed in areas such as cyber. “But we need to encourage new blood into the industry to introduce new perspectives,” he warned. “Insurance is an ageing industry and we need new people to tackle the issues facing us in a different way.”
Innovation is risky, said Jürgen Cherreck, Head of Underwriting Management for EMEA at XL Catlin. Mr Cherreck said that when insurers develop a new risk transfer product they need to be sure that the market will take it up.

“Getting the design right, along with the price and the distribution is a challenge. If you can’t price an innovative product adequately then it is hard to bring it forward. The investment that we make in people and in technology demands that there is a profit margin—otherwise it risks diluting the suite of successful products already on offer.” He said.

Held at the beginning of June, JLT’s Mastering The Risk Landscape conference replaced the broker’s longstanding Salzburg event. The firm’s CTM practice leader Sam Tiltman broadened the agenda to include a wide range of risk issues impacting the sector from credit risk to the evolution of D&O liability, as well as non-damage business interruption and political/terrorism risk.


JLT Specialty Contributor
Sam Tiltman,
JLT Global Communications, Technology and Media Practice Leader
89% of delegates polled at JLT’s Communications, Technology & Media (CTM) conference agree that cyber is becoming a bigger issue at board level.

JLT Specialty, the specialist insurance broker and risk consultant, found that 74% of delegates polled at their annual risk & insurance conference for CTM professionals have had more contact with their CIO, COO and CEO this year, as a result of their concerns around cyber issues.

In light of a number of high profile breaches in 2014, cyber risk has risen up the business agenda as it has become increasingly clear to companies that neither size nor sector is a guarantee of protection. There is a degree of scepticism that current cyber insurance policies offer a sufficient degree of cover and, by extension, payouts in the event of a claim. Nearly half (45%) of delegates’ worries about cybercrime were not offset by the insurance cover currently available. When asked what their dream cyber coverage endorsement was, unsurprisingly 43% responded that brand/reputation would be considered the most valuable endorsement, with coverage for non-damage business interruption also rated highly.

JLT Specialty found that 42% of delegates attending the conference continued to perceive cyber-crime as the biggest threat, with concern over the theft of funds or other intangible property by malicious hackers. The potential for privacy breach was also a worrisome area with over a third (38%) of those polled citing it as the next biggest threat that kept them awake at night.

In contrast, cyber-extortion and regulation fines & penalties were much lower down on people’s agendas, receiving only eight and 12% respectively of the vote for the single biggest cyber security threat. As regulation evolves and with a decision yet to be made on the proposed EU regulation on data protection, JLT Specialty expects this to significantly increase exposures and concerns in the medium term amongst insurers.

When asked what the insurance and risk consulting industry could do to help corporates ensure they have the best protection in place, half of the delegates (49%) thought the industry should focus on “increased risk understanding”, highlighting the need to better understand emerging areas of exposure through investing in human capital, technology and analytics for the clients’ benefit. Cyber/intangible risks continued to be the main risk category of concern for the respondents, securing 42% of the vote, with property, credit, political and security risk and product recall amongst the others risks, viewed as being of less concern than cyber.
Cyber terrorism and massive aggregated losses were both equally seen to be “the next big cyber trend” by insurers and technology companies polled. The systemic exposure of the insurance and risk industry is well known in terms of the potential for massive aggregated losses. Cloud computing is one example of this exposure, where one successful attack or failure could cause losses to hundreds of thousands of parties who hold their data within the cloud, putting insurers at risk for huge claims. Furthermore, cyber terrorism outlines the requirement and demand for these policy types to respond to evolving risks and ensure cyber insurance fits with other business lines where the insured is at risk.

Sarah Stephens, Head of Cyber, Technology and Media E&O at JLT Specialty, commented:

“There is still much work to do in enhancing the general insurance coverage available to better offset cyber risks and improve our industry’s ability to communicate where the value of cyber insurance lies. While awareness of cyber security and consequently cyber insurance has risen substantially in UK companies, those buying cyber coverage remain in the minority, leaving a number uncovered and exposed to the growing risks.”
XENOPHOBIC VIOLENCE RESURFACES IN SOUTH AFRICA

By Liz Booth, Johannesburg
Published 13 May 2015, Commercial Risk Africa

Risk managers have reacted with concern as at least five people have been killed and hundreds forced to flee their homes in one of South Africa’s worst outbreaks of xenophobic violence in years, during the past few weeks.

Most of the recent unrest occurred in and around Durban, where police reported two foreigners and three South Africans were killed, including a 14-year-old boy. Risk managers voiced concern that the unrest would be hard to stop. Back in 2008, some 60 people were killed in a similar outbreak of violence.

Speaking before this latest outbreak of violence, Beauty Mazibuko, a risk manager in the mining sector in Johannesburg, warned of increasing tensions among the employed and unemployed.

With such high local unemployment figures, she raised the question of the impact of so many foreign nationals “taking the jobs”. She said it was a particular concern for the mining sector because so many southern African nationals work in South African mines.

The South African government is on the verge of introducing stricter immigration rules, which will make it harder for immigrants to take jobs off South Africans.

Tezira Kulubya, HR Manager, Allianz Global Corporate & Specialty SA, says the government also has plenty of incentives to help previously disadvantaged groups. Combined with that, new immigration laws make it much harder for those without South African nationality to work in the country. “It is a hard argument to make for any firm, when formal unemployment in the country is around 26%,” she says. “The incentives are around employing local people and that is what we are doing.”

Michel Sauzier, based in Cape Town, worries about the security situation as a result of the growing youth unemployment. “Labour unrest is a big problem,” he warns. “We are a resource-dependent country so it is a major problem. We are all interlinked and there is a risk that the impact will spill over to all sectors.”

He fears many of the problems stem from the legacy of apartheid and, although the government is pumping money into education, it is the educational system where many of the problems start. Mr Sauzier urges risk managers to factor labour into their risk assessments.

Meanwhile, those outside the country have been urging the government to act decisively in the wake of the attacks. The West African group of Heads of State (ECOWAS) and government have “condemned the barbaric, criminal and xenophobic murder of innocent African foreigners in South Africa, urging the South African government to act quickly to stop the increasing wave of attacks across its country”.

And Elsie Kanza, Head of Africa at the World Economic Forum, said: “The negative connotations usually generated by the word ‘migration’ never cease to amaze me. In the past week, Africans have suffered in tragedies at opposite ends of the continent; in the streets of South Africa and in the seas of the Mediterranean.

“That these are horrifying and terrible hardly needs repeating. That they could be prevented by a complete rethink of how we address their underlying causes and the mindset we adopt when we consider the issue of migration, I believe, does.”
She added: “With a population already larger than one billion people and growing strongly, by 2040 Africa will have a workforce larger than China’s. This surge is causing massive challenges in the form of unemployment and social stability, which are showing no signs of letting up.

“That this huge spike in population is happening at the same time as a similarly unprecedented expansion of urban populations only makes the pressure facing leaders to find gainful, rewarding employment for people more intensive. When you consider that up to 60% of Africa’s youth are unemployed, according to the International Labour Organisation, you can get a sense of the size of the challenge.”

Analyst Amy Gibbs, Associate in the Political and Credit Risk team at JLT Specialty, said: “Competition with immigrants for manual labour and minimum wage jobs can often be an aggravating factor for the xenophobic violence as poorer South Africans struggle to compete with migrants undercutting wages, causing resentment.

“A broad unwillingness to embrace and tolerate ethnic and religious differences are also part of the problem. Yet the true reason why violent outbursts reoccur is the longstanding failure of the South African government to address the underlying problems behind the violence and to suitably enshrine in law a prohibition on hate crime.”

She added: “With South Africa’s economic outlook having deteriorated, the risk of protests and violence will remain heightened as anti-migrant sentiment intensifies. Weak GDP growth and rising public debt will continue to cloud economic growth in South Africa throughout 2015.

“Growing levels of xenophobia that have been allowed to simmer in South Africa further highlight the gulf of separation between the state and society that has become increasingly apparent in the past decade.

“The mining massacre in 2012 at the Lonmin platinum mine, where 30 striking mine workers were killed by black state security guards, was a watershed moment. The incident sparked a rise in anti-government feeling and simultaneously tarnished South Africa’s reputation among investors,” she warned.

Ms Gibbs said that, following the violence, President Zuma announced plans to host a series of meetings to discuss the country’s migration policy yet, in the short term, violent attacks on migrants could occur sporadically, and escalate quickly.

She explained: “If large numbers of migrant workers continue to depart South Africa, foreign investors could see an increase in labour costs if firms are forced to employ more expensive, unionised native workers for manual work.

“Furthermore, if the government implements populist policies that prioritise the labour rights of South African workers over migrants, that could in turn heighten legal and regulatory risks for investors and lead to further red tape.”

Turkey’s ascendancy in the mining industry over the past decade has been impressive, with the country boosting annual gold production from just 2t when its first formal mine opened in 2001 to an estimated 33.5t (64,300oz) in 2013.

Widely regarded as one of Europe’s best prospects for exploration, 2014 marked a blot on Turkey’s mining track record as the Soma disaster brought the woeful health and safety standards of the country’s mines into sharp relief. Separately, gold production took an uncharacteristic tumble last year after cancelled mining permits saw some of the country’s biggest gold mines shudder to a halt. In the run-up to the June 7 presidential election, the country’s miners are adjusting to a flurry of new legislation and hoping all the changes will be for the better.

Although gold production slipped 7% to 31.3t last year, there is still clear evidence of how important gold is to the Turkish economy, according to Alistair Hewitt, head of market intelligence at the World Gold Council. “Over the past 25 years about US$700 million has been spent on mine exploration in Turkey and from 2009-13 about $1 billion was spent by the largest gold mines on capital expenditure,” he said. “Those are really significant figures, but perhaps the most innovative element within Turkey is how they’ve teased gold out from under the pillow into the financial system. We estimate they’ve got around 350,000t of gold stored, which is very valuable, worth more than $10 billion.”

Although Turkey has fast become a role model to other countries looking to effectively manage their gold, Hewitt admitted certain challenges are blighting the country’s potential for exploration.

“For a number of years the government and policy-makers have been very supportive, but looking at how the Turkish mining sector has developed I think we need to focus on the Fraser Institute’s findings, where an exploration executive talked about how the industry has been affected by undue interference in the approvals process – licence applications, licence transfers, drilling approvals and so on – and he goes on to say that exploration has almost come to a standstill in Turkey. “So while the Turkish authorities have been incredibly supportive and we’ve seen an industry grow from absolutely nothing in 2000 to being a really solid, north of 30t industry, more recently there have been some obstacles put in place and we can see that partly coming through with the reduction in output in 2014.”

The most striking example has been the case of Turkish gold producer Koza Altın İşletmeleri, which has had a trying 18 months. In one instance, activities at the company’s Çukuralan gold mine in Aegean province were halted for at least four weeks after local authorities alleged the mine lacked the necessary environmental permits. Worse still, in Gümüşhane province Koza’s Mastra mine, which had already been subject to delays over issues related to the project’s forestry permit, saw its blasting permit annulled after it expired in April. Over a year on and the mine remains closed and the closure was largely to blame for the country’s fall in gold production last year.
More bad news came Koza’s way in March this year when its Kaymaz mine in Eskişehir province was shut down as local government classified the goldfield as grazing land.

The fact that Koza’s parent company is İpek Holding, which owns religious-leaning newspaper Bugün and anti-government television station Kanal Türk, has only raised further suspicions that Koza’s permitting problems have been just another manifestation of the government’s efforts to place pressure on domestic media coverage critical of the government.

Consequently, the Turkish miner has taken the opportunity to spread its wings further afield. In April 2014 the company established a wholly owned UK subsidiary to undertake mining activities abroad and a month later Koza signed a memorandum of understanding with South African platinum miner Lonmin to create a joint venture (JV) aimed at exploring for gold and silver in Northern Ireland.

In March this year Koza also reached an agreement with Canadian gold explorer Medgold Resources to acquire 75% of the company’s Boticas gold project in northern Portugal and in April the company signed a JV agreement with Scotland’s GreenOre Gold.

Despite these efforts to establish an asset portfolio outside of Turkey, it seems unlikely that many other Turkish companies will follow suit, according to Amy Gibbs, consultant at JLT Credit, Political and Security Risks.

“Koza Altın is the largest Turkish gold company and therefore it is unsurprising that it has looked to develop its mining capacities abroad,” she said.

“Turkish gold mining is a key emerging sector with great potential, as such we expect Turkish companies to continue exploration spurred on by recent mining laws that reduce long bureaucratic red-tape that have previously marred the operating environment.

“While various Turkish companies have experienced setbacks in the legal and regulatory environment, we do not expect to see a rapid uptick in Turkish companies moving operations abroad in the short term.”

Cem Çağatay Orak, partner at Çakmak Avukatlık Bürosu, an affiliated law firm of White & Case in Ankara, agreed Koza’s move was unlikely to spell a mass exodus.

“In highly-regulated sectors like the mining sector, it is obvious that sector players are very sensitive to the legal, political and financial developments,” he said. “This is not peculiar to Turkey. This is the case all around the world. Thus, it is very natural that mining companies may intend to restructure their investment plans and policy in line with global and local dynamics.

“Apart from this, we know that the Turkish government pays special attention to the mining industry including gold mining and this is being stressed in the short-term and mid-term investment programmes officially disclosed by the government. Accordingly, the sector should rather be evaluated as a whole instead of acts or actions of some mining companies.”
“THE NEW MINING LAWS IMPLEMENTED IN TURKEY PAVE THE WAY FOR A MORE COMPREHENSIVE AND INVESTOR-FRIENDLY LEGAL AND REGULATORY ENVIRONMENT IN THE MINING SECTOR.”

PERMITTING PAINS

In February, several changes to Turkey’s new mining law were passed by the Turkish Parliament and approved by president Recep Tayyip Erdoğan in a move that was hailed as a positive step for the industry and may help unblock the country’s notorious mine permitting logjam.

“The new mining laws implemented in Turkey pave the way for a more comprehensive and investor-friendly legal and regulatory environment in the mining sector,” said Gibbs. “Ground turnover will be further encouraged, reducing the number of areas currently sterilised to exploration as licence owners were previously allowed to hold ground at minimal cost by undertaking limited work.”

Historically mining companies in Turkey had their licences automatically revoked if they failed to meet permitting requirements in the required timeframe. However, the changes promise to usher in a greater level of flexibility: under the new law licence holders already in the process of applying for but have not yet obtained the necessary operating permits will not have their licences revoked. Instead they will be subject to a TL30,000 (US$7,368) fine and will then be obliged to pay up to TL50,000 ($12,280) for each year of delay.

However, companies which have not already applied for an operating permit and fail to obtain the permit within the relevant timeframe will not have their licences extended beyond the initial terms.

Gibbs said the new process could help encourage faster turnover and other moves by the government could make things easier for companies. “Licence areas are now allowed to be auctioned off under new modifications with the licence area boundaries based on the continuity of mineralised areas,” she said. “Furthermore, a new royalty framework was introduced that scales according to commodity prices.”

She said the government’s efforts to reduce regulatory obstacles had been largely welcomed by foreign investors. “Investment in Turkey is often approached with caution on account of the country’s unstable legal and regulatory environment that is characterised by lengthy, bureaucratic delays with widespread bribery and corruption. Such laws demonstrate the government’s commitment to the development of the burgeoning mining industry and are expected to create further investment into the country in the long term.”

The new law states that the Ministry of Energy and Natural Resources will now be directly responsible for licence transfers. However, Çağatay Orak said he had his doubts as to whether this would actually streamline the entire process.

“In fact, the Mining Department has always been attached to the Ministry of Energy and Natural Resources under the Turkish administrative law system and it is still attached to it. The Mining Department has traditionally managed the licence transfer issues, among other things. Therefore [the fact] that the Ministry of Energy and Natural Resources is now solely authorised to decide on licence transfer may provide a consolidation in the review process and increase control over such transfer processes.
“However, whether or not such change will facilitate and speed up the transfer process is doubtful as no fundamental change has occurred in the organisational structure of the Mining Department. We may make a more accurate assessment after seeing the developments in practice.”

He said it was too early to say whether the changes have had or will have much impact.

“Frankly speaking, in order to see the concrete outcome of such changes, we should wait for a reasonable period — let’s say 6-12 months from now. In any event, I think that the administrative fine concept may provide some [temporary] relief to investors.”

MORE REGULATION, HIGHER COSTS

Of course these are not the only legal changes to affect Turkey’s mining industry in recent months. In May last year 301 miners died after an explosion took place in an underground coal mine owned by Soma Holding, Turkey’s largest underground coal producer.

Even prior to the Soma disaster Turkey was already home to the highest rate of worker deaths in Europe, according to the International Labour Organisation (ILO).

Following a strong reaction in both local and international media and widespread demonstrations lambasting the government’s mishandling of the tragedy, in September a wide-ranging Omnibus Bill was passed to improve health and safety and social security provisions in the country’s coal industry.

The new bill entitles underground coal miners to better working conditions, including higher salaries, more annual leave, a lower retirement age – reduced from 55 to 50 – and overtime is now restricted to 36 hours per week.

Given the high volume of temporary, unskilled and unregistered works in the country’s coal mining industry, not to mention Turkey’s soaring unemployment figures, it came as welcome news that the new bill also granted temporary and subcontracted workers greater job security.

Çağatay Orak said the measures were a promising sign. “The Law No. 6645 amending certain provisions of the Law on Health and Safety at Work has been published in the Official Gazette on April 23, 2015,” he said.

“Additionally, Turkey has recently ratified the ILO Protocol no. 167 governing the health and safety at civil works. These indicate to some extent that the government keeps its motivations to improve health and safety rules in the country.”

However, the move has attracted criticism from some smaller companies, which have seen their production costs soar as a result of the amendments and have been forced to shutter their operations.

“While these regulations were largely anticipated and have appeased health and safety regulators, smaller mining producers have struggled to cope with the new regulations that have led to increased labour costs weighing on their profit margins,” said Gibbs. “In line with the Omnibus Bill, a job security expert, a doctor and health staff must all be assigned to each mining project, which for smaller firms is now a significant cost.”
IN MAY LAST YEAR 301 MINERS DIED AFTER AN EXPLOSION TOOK PLACE IN AN UNDERGROUND COAL MINE OWNED BY SOMA HOLDING, TURKEY’S LARGEST UNDERGROUND COAL PRODUCER.

An estimated 36 mine owners are thought to have shut down their operations due to costs hikes, but the Zonguldak province, where the Soma mine is located, was the worst affected, said Gibbs.

“Zonguldak province, in the heart of coal mining country in Turkey, was the hardest hit, with 22 mine operations shutting up shop, leaving over 5,000 workers jobless. This trend is expected to continue as medium-sized firms begin to struggle with heightened production costs, coupled with the volatile gold price.

“In 2014 the end of the commodities super cycle saw commodity prices fall to their lowest levels prompting mining giants to freeze investments and stall production. While gold prices are no longer falling and have now plateaued at $1,200/oz, mining companies in Turkey will struggle with reduced returns, which may see some capex frozen.”

Even some of the industry’s biggest players are struggling. Eldorado Gold owns the country’s largest operating mine, Kışladağ, which produced 2% more gold in 2014, yielding 311,233oz.

However, recently Eldorado said the current weak gold price environment had forced it to delay the planned Phase IV expansion programme at the mine and instead prioritise development projects in Greece. This spells bad news for Kışladağ, where production now isn’t expected to return to more than 300,000oz until 2018 once expansion has been completed.

Some of the country’s other large mines are progressing, such as Alacer Gold’s Çöpler mine, which produced a record 227,927oz last year and is awaiting approval of land use permits required for an adjacent sulphide project, which is set to boost the mine life by 22 years. However, even positive developments like these may not be enough to offset the fall in production at Kışladağ and other gold operations like Koza’s across the country.

As the country’s presidential election looms large and the trial of 45 managers and employees charged over the Soma disaster rumbles on, Gibbs said legal and regulatory risks will remain heightened.

“As the trial continues we can expect to see an uptick in demonstrations and violence if politicians remain absent from the trial, despite the persistent calls for government personnel to stand, on account of relaxed safety regulations,” she said.

“Whilst it is too close to call whether AKP will win a majority or will form a coalition, Erdoğan will hold power which is a concern for investors in relation to his views on the economy, such as control of the Central Bank which has led to the lira to depreciate. Business and consumer confidence will remain uncertain in the medium term following the election.”

For all the country’s potential, gold output is unlikely to grow much this year or next – at least not at pre-2014 levels – meaning Turkey has little chance of reaching its ambitious 50t production target by 2016.
Although recent legislation indicates government willingness to ease the permitting burden on miners, with the likes of Ariana Resources’ Red Rabbit project set to benefit from the recent introduction of lower forestry permits for lesser impact work, other major projects such as Alamos Gold’s Ağı Dağı and Kirazlı projects and Altıntepe – a joint venture between Stratex International and Turkish company Bahar – continue to come up against administrative obstacles. In this context, permitting issues – not the potential for further volatility in the gold price or the lira – might just be the Turkish mining industry’s biggest Achilles heel in 2015.

JLT Specialty Contributor Amy Gibbs, Associate, Credit, Political & Security Risk
With the price of coal having steadily dropped from peaks in May 2008 to price points previously seen in 2001, coupled with cooling Chinese demand for lower grades of coal, coal exporters, especially those with insufficient domestic demand to offload excess supply to counter falls in global demand (including Australia and Indonesia), have been impacted. Coal mining in Russia, however, offers a glimmer of hope. The Russian government is making a concerted effort to put coal mining at the forefront of its investment agendas. With oil prices remaining far below both countries’ fiscal and production break-even points, coal mining is set for a revival.

Blessed with an abundance of oil, natural gas, coal and gold, Russia was always set to capitalise whenever the global commodities price cycle shifted to an upwards trajectory. As such, Russian economic growth hit new highs when oil prices rose during the supercycle, with energy dominating exports and delivering approximately 50% of government revenue. Coal, traditionally the force behind Russian industry, remained important to the economy both domestically for power generation and as an additional source of export revenue. However, despite vast reserves, Russian production did not outstrip coal export rivals Australia and Indonesia.

Between 2000 and 2009, although Russia retained its share of the coal export market, it is important to note that coal production had been in decline since the fall of the Soviet Union. Despite a concerted effort to ramp up production since the late 1990s – and despite having proven reserves of 173 billion t, second only to the US's 263 billion t – Russia fell behind in the coal export race. From 2000, Australian and Indonesian coal exports increased dramatically as China’s appetite for coal boomed. Investors raced to invest in both countries, enabling Australia to increase exports from 200 million t in 2000, to 300 million t in 2009. Indonesia boosted exports from 60 million t in 2000, to 260 million t in 2009. Russia meanwhile, only reached 140 million t for export in 2009, an increase of only 95 million t in eight years.

By 2015, with the global price of oil having collapsed, the Russian coal mining industry is set for resurgence. Last year, sanctions were imposed on account of Russia’s role in escalating and prolonging the Ukrainian conflict. While large corporations and financial institutions have borne the brunt of the sanctions, the coal mining sector has taken less of a hit. Securing finance remains a challenge, since the domestic banking market has weakened under the weight of sanctions. However, owing to the dominance of domestic Russian mining players and the strength of domestic demand, the coal industry can weather the storm.

If there was not already sufficient reason for a Russian ‘pivot east’ towards Asia, given that the continent accounts for 67% of coal global consumption, sanctions, the freezing of US and European trade with Russia will simply accelerate this trend. A large number of Asian economies require power infrastructure upgrades to
secure sustainable GDP growth over the next decade. Increasing volumes of coal will be required as a result. In addition, despite the fact that Chinese GDP growth has slowed in recent years and that the Chinese government has indicated its long-term commitment to reduce the country’s reliance on coal (particularly lower grades), Chinese demand for high-grade Russian coal will increase in the next 10 years.

With China unaffected by Western sanctions on Russia, the country has an opportunity to significantly increase trade and investment with its neighbour. This trading relationship is further bolstered by the dramatic fall in value of the Russian rouble, which fell by approximately 50% in value over 2014. While the rouble’s collapse has severe repercussions across the economy on account of its connection to inflation and given Russia’s reliance on imported goods, for the coal mining sector, with the rouble at a low, exports have become more competitive – particularly compared to US coal exports.

Russian coal producers have already increased output for export and are likely to increase these volumes further to capitalise on the weakened currency. Between January and November 2014, Russian exports of coal jumped by 8.8%, with Macquarie Bank attributing the jump in exports to an estimated 40% reduction in local currency mine operating costs. As such, it is unsurprising that Chinese-Russian relations have highlighted the coal sector as a key area for future collaboration.

While traditionally the Russian government has prioritised the position of its own coal miners – to the extent that foreign investment in Russia’s coal mining industry is almost negligible – Russian-Chinese joint ventures (JVs), and perhaps Russian-Indian JVs, may start to emerge. With Russian coal producers such as Kuzbassrazrezugol (KRU/UGMK) and Siberian Coal Energy Co. (SUEK), which together account for approximately 40% of Russian coal production, struggling to raise additional capital since the imposition of sanctions, Chinese investment should be welcomed. In September 2014, China’s Shenhua Group and Russia’s Rostech signed a deal worth approximately US$10 billion that will include the construction of coal-fired power plants across the Siberia region.

Meanwhile, in February 2015, India’s Tata Group announced plans to invest alongside SUEK to develop a range of energy opportunities. In a clear indication of Russia’s changing attitude toward foreign investment in its strategic industries, in March 2015 Russia announced that it would consider allowing majority Chinese ownership in Russia’s strategic oil and gas fields. Even six months ago, such an about-face on policy for Russia’s fiercely guarded energy assets would have seemed near impossible. If Russia is willing to court Chinese and Indian investment in its oil and gas projects, further investments in the coal industry will surely follow.

In addition to foreign investment, the Russian government has also announced its own commitment to invest in the coal mining industry. This is in a bid to free up more of the country’s natural gas reserves for export and to instead use coal to satisfy 31 – 38% of domestic electricity demand by 2020, as well as to capitalise on Asian coal demand.

Russia is geographically well placed for exporting coal to Asian markets, yet infrastructural weaknesses have long weighed on export potential. Russia’s coal transportation
WHILE THE GOVERNMENT HAS INDICATED THAT IT IS WILLING TO FURTHER OPEN UP STRATEGIC SECTORS TO FOREIGN INVESTMENT, RUSSIA HAS A LONG HISTORY OF GOVERNMENT INTERFERENCE IN HIGH PROFILE PROJECTS.

costs are currently some of the highest in the world (between US$80 – 90/t), which has previously prevented Russian exporters from making lucrative spot sales. Upgrades on ports, including Servernıy (which is receiving US$190 million of funding from the Chinese Bank of Development), Primorye and Vostochny, as well as intermodal infrastructure, such as upgrades to highways and the Trans-Siberian railway, will help reduce transport costs and cement Russia’s pivot to the east.

The plan will help attract new investment and trade partners across Asia; however, for those coal mining investors that do wish to partner with Russian coal companies, significant political risks remain. While the government has indicated that it is willing to further open up strategic sectors to foreign investment, Russia has a long history of government interference in high profile projects. As a result vital changes to the regulatory environment will also need to be made. While such risks can be transferred to the private political risk insurance market, issues such as corruption are more challenging to manage, with the awarding of licences being notoriously opaque and therefore subject to later government interference.

Written by Amy Gibbs and Daisy Jackson. Edited by Jonathan Rowland. This is an extract of an article that first appeared in the May 2015 issue of World Coal.
Senior heads of security don’t trust cyber-insurance products, viewing with scepticism the chances of getting a payout in the event of a cyber-attack, according to research from KPMG.

Based on a survey of senior information security professionals from organisations which are members of KPMG’s International Information Integrity Institute (I-4), 74 percent of businesses have no cyber insurance.

Given that 79 percent of companies believe that cyber threats are likely to increase in the next 12 months, the results would be inexplicable except for the fact that at least half of businesses believe that a cyber-insurance policy may not pay out when needed.

Mark Waghorne, head of I-4, is concerned that many businesses would rather not have insurance against a threat they believe is inevitable.

He revealed that 30 percent of information security professionals in the survey believe the cyber insurance industry has yet to mature. “Insurers will need to deliver more comprehensive packages in order to convince the business community that they can and will protect against losses on cyber-crime,” Waghorne said.

Sarah Stephenson, head of cyber, technology and media E&O at JLT Specialty, told SCMagazineUK.com that she “couldn’t disagree more that might not be effective”.

“Like any emerging line of insurance, there is going to be scepticism about its efficacy,” she said. “But it’s been around since 2000, and while it may feel brand new, it’s been paying claims and helping to mitigate the effects of cyber disruption for 15 years.”

She said there was an impression in the media that insurers weren’t paying out on cyber insurance policies based on a failure to distinguish between the specialist insurance policy and more general policies like crime.

“Almost all that litigation has been with general liability and crime insurance and was not cyber specific,” she said. “The policies that aren’t paying out aren’t cyber policies at all.”

Cyber is still a niche sector which unlike other insurance markets doesn’t have the history or case law to allow insurers and brokers to develop standardised terms and conditions. “Companies that are purchasing cyber-insurance now understand better how it’s a partnership with the underwriting community, that there will be a sit-down meeting with the underwriter, broker, chief information officer and CISO to understand your cyber risk,” she said.

“They will want to understand not only your adherence to polices but also your culture. They are underwriting not only what you do today but also your ability to adapt to new risks,” Stephens said.
Waghorne’s supported Stephens’ final point. “Discussions during a later debate at the most recent I-4 forum showed that the availability of specialist, focused cyber related insurance has much improved during the past year with clear evidence that carriers do pay out, indicating that those organisations which have avoided cyber-insurance in the past should perhaps revisit their positions,” he said.

Meanwhile, Daljitt Barn, director, cyber security at PwC wasn’t surprised by the figures which are broadly in line with other reports he’s seen including a report co-authored by the Cabinet Office and insurance broker Marsh which found that 81 percent of big businesses and 60 percent of SMEs had suffered a cyber-security breach. The report found that half of firms surveyed were unaware that cyber-insurance was even available – hardly surprising then that only ten percent of firms have armed themselves with cyber-insurance.

Barn was sympathetic with business owners who may be worried that their cyber-insurance won’t cover them in the event of a major breach. With technology evolving so quickly, it is perhaps natural to question whether the details in your policy are still applicable.

However, Barn said that if organisations believed their cyber insurance won’t pay out, it indicated that they hadn’t done their research. “They need to understand their risk and what they are buying,” he said. “They need to ask, do some of my existing insurance policies cover me for the affects of a cyber attack? They need to understand their cyber exposure and risk and then tailor their purchase according to what they need.”

The suggestion that cyber insurance policies won’t pay out in the event of an incident is not supported by the facts, he added. In the case of Target Stores in the US, they had a US$100 million (£66 million) policy which paid out. “But was it enough – we don’t know,” Barn said.

Barn’s advice is that when purchasing cyber insurance, understand what you are buying and scrutinise all the detail under the heads of cover. The more work your organisation does to reduce the chances of a cyber attack and mitigate the consequences of a breach, the more you will save on cyber insurance while also lessening the business disruption that simply can’t be insured for.
Reactions, in association with Russell Group, brought some of the London market’s leading cyber insurance experts around a table to fathom how well insurance is responding to the much talked about cyber threats.

Panellists:
- Chris Cotterell, partner at Safeonline
- Alessandro Lezzi, technology, media and business international team leader and underwriter at Beazley
- David Benyon, EMEA & Asia editor, Reactions (moderator)
- Suki Basi, managing director at The Russell Group
- Stephen Cross, chairman at Aon Centre for Innovation and Analytics
- Mark Camillo, head of network security & privacy at AIG
- Matthew Hogg, vice president, strategic assets, Liberty Specialty Markets; vice chairman Cyber Risk and Insurance Forum (CRIF)
- Sarah Stephens, partner, head of cyber, technology and media E&O at JLT Specialty
- Dan Trueman, class underwriter, cyber at Novae
- Tom Draper, technology & cyber practice leader at Arthur J Gallagher London
- Odile Vidot, underwriter at Ascent Underwriting

Are we seeing heightened demand among corporate risk managers and insurance buyers – in the context of recent cyber hacks and geopolitical threats – for buying cyber cover?

Dan Trueman, Novae: We’re definitely seeing more demand. I don’t know whether that’s driven more by geopolitical events, or by the huge amount of fear mongering that’s going on. It’s very difficult to read any news source without seeing some talk of cyber threats, and this amorphous concept of cyber risk.

Sarah Stephens, JLT Specialty: Cyber is a short, sexy word, so we’ve all gone with it. For a lot of organisations, what cyber means within an insurance context is different to what it means in an information security context. So when you’re talking to a buyer – typically a CFO or a risk manager – and when you’re talking to a chief information security officer, they think of cyber as two different things.

Matthew Hogg, CRIF: We’ve seen a huge uptick in some UK corporates, rushing in and buying cyber covers. But many more are making their best efforts internally – in cyber risk management terms, for example by looking at the supply chain, to get their own house in order before approaching the insurance markets.

Tom Draper, AJ Gallagher: The geopolitical actions we’ve seen have not been against the companies, a year ago, we thought they’d be against. So, the actions against Sony pictures because of a film they produced was not top of our list for North Korean hacktivist attacks.
Matthew Hogg, CRIF: Yes and the impacts have been broader, too; people were thinking about credit card data, intellectual property and R&D. However, Sony is a good example, releasing sensitive information such as private emails, rather than trade secrets. The reputational harm that can come out of that is a concern to all businesses.

Stephen Cross, Aon: We’re seeing a preponderance of US concerns around cyber; then Europe some way behind in second; Asia and Latin America way behind that. I also think that if you were asking me to give you a trigger as to what’s driving cyber concern now, it’s more legislative and regulatory than geopolitical. The biggest area of cyber growth for us is US healthcare – not a sector exposed to geopolitical concerns.

Sarah Stephens, JLT Specialty: Often, the Achilles heels are still human error by employees, just stupid things people do, and the vendor cyber risk that is posed by all of the third parties they depend on, for everything from janitorial services and HVAC systems to cloud computing or payment processing. They can’t fully engineer those risks out of existence or fully control them, so that is one of the key places where cyber risk insurance really steps in to help.

For the 2014 Sony Pictures event, previous breaches had reportedly led Sony to obtain comprehensive cyber cover. But presuming most corporates aren’t so well insured, and that the risk is expanding, how well is insurance keeping pace to fulfil its traditional role?

Tom Draper, AJ Gallagher: I think, on the breach coverage side, we’re pretty set: we cover vendors; we cover merchants; we cover any loss disclosure. What we do need an evolution in, is in the capacity deployed. I think, that’s the distinction, for the industry to have the ability to react to some of these larger events effectively.

There’s so much shared DNA now between cyber products available, that the ability to build towers is much better than it probably was five years ago. People are increasingly willing to follow similar products because it’s the same product that they’re offering themselves. There is certainly a lot more capacity available now.

Matthew Hogg, CRIF: The big breach from last year raises other issues – around reputation and around intellectual property – which I think the insurance industry still hasn’t got to grips with from a capacity perspective. I’m talking about the theft of things that are valuable and once they’re gone, you cannot recreate them; they’re gone.

Odile Vidot, Ascent Underwriting: That’s partly driven by the regulatory element. There has been a lot of purchasing effectively focused on regulatory demand, and it’s always focused on how you protect the data and how you react. However, the source of the drive for insurance buying is switching somewhat over time.
IN SOME CASES, DISMISSING INSURANCE SOLUTIONS BECAUSE CAPACITY HASN’T BEEN AVAILABLE, OR ONE ELEMENT ISN’T COVERED, EVEN THOUGH 90% OF THEIR RISKS WOULD BE, IS A WAY TO PUT A HEAD IN THE SAND AND AVOID THE ISSUE FOR A LITTLE BIT LONGER.

Matthew Hogg, CRIF: There are always going to be people who do breach insurance, which can be more easily commoditised, and then there are going to be cyber markets that focus in some of these more niche intangible areas. It probably needs to become a bit more commoditised for further capacity.

Dan Trueman, Novae: Capacity is increasingly available, initially at a small level but we need the brokers to communicate this more. That’s where the partnership has to work, to be most effective. Because trade secrets range from the formula for toothpaste to how to build nuclear missiles. It’s amazing, the range that people are willing to look after.

Matthew Hogg, CRIF: There are some highly R&D-led companies, for example in pharmaceutical life science, that really don’t take out as much insurance for cyber as you would think.

Sarah Stephens, JLT Specialty: I think sometimes there is this perception, from a client’s perspective, where they say things like: ‘cyber doesn’t cover my own IP; it’s really just for data breaches, right?’ And they just haven’t had a conversation where anybody told them that it was really available. Once you do have that conversation, they tend to respond: ‘Actually, there are a lot of risks that could lead to real material financial loss and these can be addressed – now I’m really interested.’

In some cases, dismissing insurance solutions because capacity hasn’t been available, or one element isn’t covered, even though 90% of their risks would be, is a way to put a head in the sand and avoid the issue for a little bit longer.

How much is senior management involving itself in these risks?

Matthew Hogg, CRIF: I think the general awareness about this risk within companies has helped, not just from the risk management perspective but also with the board of directors. I think, that’s what’s really helping to drive the demand for this. That’s something we didn’t see before.

When we’ve seen some of these large data breaches, we had clients who were kicking their tyres for a couple of years and saying: ‘we have to get insurance coverage now’. The message is: ‘don’t wait until things start blowing up until you start buying the cover’. We’re trying to educate clients that they need to come and have that discussion now before they start seeing losses in this area.

Stephen Cross, Aon: That’s quite like the directors and officer’s liability crisis of the 1980s; the market starts to really kick off; and suddenly there’s insufficient capacity.

Mark Camillo, AIG: The sales cycle gets a lot shorter when the board gets behind it. We had a surprise when a submission came in from the Middle East in December and it actually bound in January. I just hadn’t seen that before: it was only around one month, from the time we got the submission in to actually closing the business. These things can stretch out for a very long period of time, but if the board gets behind it, it’s a much shorter sale cycle.
Tom Draper, AJ Gallagher: I think, most of our UK enquiries are because a FTSE company’s board has been asked whether they are taking cyber risk seriously. And so someone senior has begun to ask questions, and it goes down the chain quickly to risk management.

Stephen Cross, Aon: I’d be curious of others’ views on this, but we haven’t come across a single client that we haven’t managed to spend their budget for this risk area, and it’s hard for them to get a budget to start with. So, they’ve got an unbudgeted item; I’m sure it’s like pass the parcel at the board table as well, you know, from the CTO, to the marketing guy, to the insurance guy, because no single role has overall responsibility.

Is there is a shortage of technical expertise for cyber risk, to get the right people in place who understand these risks to broker and write them effectively?

Tom Draper, AJ Gallagher: I think in two or three years’ time, the entire London market for cyber will probably double its size, in terms of written premium, if demand in Europe takes off. That will generate a lot of demand for relevant expertise.

Dan Trueman, Novae: I think people are definitely our greatest challenge, as a market. We’re working hard to meet the current demand. Ten years ago there were 30 of us doing this, now there are 100 companies trying to do it. There aren’t enough people at each of those places with senior level experience.

Sarah Stephens, JLT Specialty: I don’t know if as an industry we’ve been proactive enough at going after individuals with the information security expertise and correct background. I think, we’ve tended to say: ‘Okay, get me a professional indemnity underwriter and I can turn him into a cyber-underwriter’ and the same applies to brokers.

So, we’ve recruited people who understand existing insurance, thinking they’ll learn the security bit, perhaps in partnership with outsourced service providers. Maybe that’s fine for this current stage of growth, but we will probably have to re-evaluate that in order to build this capability, because there just simply aren’t enough people already in the insurance industry that we can move across from other lines.

Matthew Hogg, CRIF: We’ve got a transitional generation of underwriters and brokers at the moment. I got my first email account when I was at university – not when I was five years old. Maybe a lot of the people in this area count as pioneers for their age but there is this gap between our generation and the people who have grown up with the technology from birth.

Stephen Cross, Aon: Ultimately, I’m not sure that the capability to keep up with a very fast-moving target will ever really reside appropriately in a broking firm or in an underwriting firm. The skill sets for a CTO within a business are moving rapidly. For brokers and underwriters, I’m more towards the aligning of interests with external parties that have the ability to stay on focus, stay on target, and stay current with all the movement that’s going on. Otherwise, I feel you’d end up with a linear approach to what’s in your mind but you’re dealing with an exponentially changing risk.
YOU’VE GOT INITIATIVES AROUND PUBLIC AND PRIVATE INFORMATION SHARING. AND ALL OF THOSE AFFECT THE WAY THAT WE’RE GOING TO BE ABLE TO MODEL CYBER RISK FROM AN INSURANCE PERSPECTIVE.

Suki Basi, Russell Group: Yes, we’re already having to play catch up. It is a different challenge to try to stay ahead of the curve in technology and changing regulatory developments, while also having to deal with the day-to-day business processes.

Dan Trueman, Novae: On that regulatory aspect, in Europe we keep debating when we going to get this EU directive, but the reality is the last one was introduced before Google was a verb. So, we’re a long time from it, and how do we actually deal with enforcing and policing compliance?

Stephen Cross, Aon: Potential legislation that’s seen as appropriate today is probably barely suitable for purpose by the time it ever gets enacted. So, it’s never going to really catch up with reality.

Suki Basi, Russell Group: The credit insurance industry is very good at monitoring sovereign risks and credit flows within markets, providing a good service to the end client. I think that this sort of approach is needed for this segment as well. So, because the threats faced are truly global, it requires a global perspective. You have to be able to help clients through the risks involved in trading in different parts of the world.

In addition to paying out on claims, how much bundling of services is there for cyber risk, like we’ve seen in other niche specialty lines, such as reputational risk, kidnap and ransom, and political violence covers?

Matthew Hogg, CRIF: There can be a lot of forensic investigation costs that people had looked at as something of an afterthought. It started off in the US, and we’ve seen losses in the market seeking insurance with $50-60m spent on forensics.

Stephen Cross, Aon: If you think of just general insurance, it’s an eightfold payback for a dollar spent on risk prevention, that’s $8 saved after, when everybody comes to the party to try and mop everything up. We’re selling an intangible about an intangible and I just don’t think they’ve grasped it appropriately.

Dan Trueman, Novae: I think the issue for insurance has always been around selling an intangible. Selling an intangible about an intangible can be a tough sell. So you have to show some evidence for the process, giving the phone number to call when there’s a problem and saying ‘these guys will help you sort it out’. That is part of it. The other part is showing them a roadmap, together with some ancillary searches that go alongside the product, in terms of how they can harden their assets.

Alessandro Lezzi, Beazley: This can be a very important point outside the US, because there is lack of certainty over legislation in some countries. For example, in France the definitions of financial loss in a general liability policy can be very broad, so what you start by demonstrating your team’s capacity to help the client within a breach scenario.
Matthew Hogg, CRIF: But it’s something that’s horses for courses. If you take a big financial institution, you’re necessarily going to witness all their IT security processes. These guys know how they want to handle a breach. So we don’t always need to push things on people who have got appropriate contingency plans and structures in place.

Chris Cotterell, Safeonline: The part that mitigates the loss is the services, though. The loss could be substantially bigger if any company – a big company or a small company – used the wrong services.

Alessandro Lezzi, Beazley: We have a mixed approach, whereby services can be included or entirely voluntary. If you want to use it, you use it; otherwise, you can use your own capabilities to mix and match.

How much progress is the industry making on the data front, such as efforts to produce models for cyber risk?

Matthew Hogg, CRIF: Any modelling capability is only the start of a very long journey. And in the first instances, it’s potentially all new to the auditor’s or an actuary’s eyes, in many ways, by the cyber professionals, in terms of what the exposure is and where the systemic risk is. They’re going to need that data and information, and the principle of garbage in and garbage out applies to any model.

Sarah Stephens, JLT Specialty: But it’s okay if the modelling isn’t perfect at the moment, right? I think we’re starting to see a bit more collaboration, which is important. In a lot of cases, the appropriate place for the modelling capabilities to sit is with some of the risk modelling firms and maybe on the reinsurance side of things, where we can get some of that loss information fed into the reinsurance firms and look at it on a broader basis.

But getting the data is a huge issue. If you look at the information security industry, they’re all talking about how they can share threat intelligence more effectively, more often and in more detail. You’ve got initiatives around public and private information sharing. And all of those affect the way that we’re going to be able to model cyber risk from an insurance perspective.

Suki Basi, Russell Group: If more cyber risk is being taken on by the reinsurers in a soft market, while accepting more underlying exposure, there is a question as to whether that’s sustainable. Cyber exposure management is a real issue, which can be addressed by improving quality standards and data protocols. Better data capture and naming conventions can play their part.
Underwriters need also to capture better data on the relationship between vendor technology and client risk profiles, so that potential threats can be evaluated and adequately priced for. At the same time, the global insurance industry needs to collaborate much more and instigate a united response based on better exposure management systems and frameworks.

Stephen Cross, Aon: I sat on that committee with the World Economic Forum in Davos this year, and there’s very much heightened awareness around this topic, from the top down. I think, one of the better initiatives is towards trying to get standardisation of data. Everybody’s shooting at different targets all over the place, and the problem of actually getting data is how do you actually put out the elements of the data that are relevant by industry group?

So we’ve seen a strong approach by the WEF to try and get companies signed up to agreeing for a collaboration. That’s probably a two-year body of work to just get people to talk to each other in a more rational way for a common purpose; regardless of whether you’re all pharmaceutical companies or all retail or all media, you need common targets.

But the acknowledgement is you have to start somewhere, and you have to start accumulating in a systematic way. I think, that brings it down to the insurers in a way that you’re measuring the same elements, and that allows you to model a bit more. We can’t say completely accurately because it’s very hard but at least it allows a commonality of price.

I think a lot of our customers are extremely confused around the different offerings in the marketplace. And there’s some paranoia about what’s missing. As a CEO, all I want to be able to do is stand in front of the media when there’s been a public breach and tell them I’ve got cover; not that I’ve got 55 policies and I’m trying to find the exclusions.

It’s slow progress, and I hate to say this but there probably has to be a very big catastrophic incident, which results in numerous fatalities, because people seem prone to ignore the financial and reputational events we’ve seen, which become yesterday’s news extremely fast. We still talk about Sony, but it’s already yesterday’s news, nobody lost their job and nobody died.

With soft market pricing and relaxing of T&Cs, are some underwriters building up unwanted or unknown cyber exposures?

Dan Trueman, Novae: I think from the underwriter’s perspective the regulator is taking a fairly dim view of that approach. I don’t think the rest of the market is including cyber on an ad hoc basis, in the way that they might historically have been. They are certainly being asked to analyse what cyber risks they have.

Matthew Hogg, CRIF: I was speaking to an IT security accreditation body recently and one of their questions for accreditation was: ‘do you have cyber insurance?’ Apparently over 40% of people applying for the accreditation are ticking that box. And this accreditation body is not only working with the largest FTSE 100 level of companies.
They’re doing everything from almost the corner shop upwards. And people were ticking that they’d got it because other insurance covers may tip their hat to some small element of data breach or whatever it might be, and people say, suddenly, they’ve got cyber insurance, but in reality they probably haven’t.

There’s got to be integrity in the market, with all involved, including brokers. That should apply to their stance on including certain types of cover within different types of product, whether or not a soft market might tolerate it.

Sarah Stephens, JLT Specialty: In every individual renewal case, a broker is going to do whatever is best for their client. However, if the client can get a risk covered within property, then why would we say they should buy something separate when they can get it right here, right now? But it’s our responsibility to be talking to those clients to say: it’s not going to be this way forever.

Cyber is not a risk that’s going away. This approach is untested. In some ways, leaving cyber in a programme where underwriters haven’t asked detailed questions; where they haven’t really figured it into their rating model; where they probably don’t understand what could happen, we’re rolling the dice a little bit, to say that you’ve got certainty.

The responsible thing is to say to the client that they may be rolling the dice. We want them to know there is a specialist market to consider for separate cover both now and in preparation for the future.

Stephen Cross, Aon: The other solution to an underwriter’s problem would be for the CEO to insert a mandate for their underwriters to say that it’s not tolerable to allow contamination of risk across product lines.

Chris Cotterell, Safeonline: I’m pleased to hear people recognising that these things shouldn’t be placed into the wrong markets and that people are now recognising that there is an established market where some of these niche risks should be consulted and potentially placed. At least we’re talking about that and people at the senior end are thinking about it.


JLT Specialty Contributor Sarah Stephens,
Head of Cyber, Technology and Media E&O,
Financial Lines Group
In the UK FCA investigations, whether formal or informal, can be time consuming and expensive.

In 2014 the FCA imposed financial penalties of £1.4bn, almost three times the £472.2m it dished out in 2013.

The average length of time for an FCA-related criminal investigation in association is approximately 41 months.

The UK regulator can also issue a Section 166 review with the cost of these investigations (by companies such as KPMG, EY and Deloitte) borne by hedge funds.

The cost of Section 166 investigations can be extremely high and in Q3 2014 the FCA conducted 14 Section 166 reviews for issues such as loss of client’s assets, financial crime, and loss of data, governance, control and risk concerns.

In the US SEC investigations are generally considered to be even more expensive than in the UK. In 2013 the SEC filed 686 enforcement actions resulting in $3.4bn in sanctions against wrongdoers.

All SEC investigations are conducted privately and after an investigation the Commission can authorize their staff to file a case in federal court or bring an administrative action. In many cases, the SEC and the party charged decide to settle a matter without trial.

While court proceedings are perceived to be more costly and time consuming, regulatory investigations can be just as expensive.

And hedge funds should sit up and take notice as regulators shift their focus away from their traditional ‘hunting grounds’ and towards the alternative asset management sector.

Moreover, the ongoing investigations into the actions of a number of high profile hedge funds across the globe show the growing collaboration between regulatory bodies.

In spite of this, many hedge funds continue to view the chances of an investigation being taken out against them as remote.

But some insurers have designed new products that can actually cover the cost of regulatory interventions in some cases.

The FCA and SEC has a specific ban on insuring against the cost of its investigations but firms are still covering the legal costs.

In the Libor rigging and foreign exchange investigations against major banks legal costs could run into the tens of millions of dollars, almost as high as the fines themselves.
Here are some examples of real claims where insurance policies have paid out for the cost of regulatory action.

Firstly, a fund manager employed by an investment manager was suspended following an internal investigation into certain trading activity on his desk. The investment manager notified the FCA, who commenced a formal investigation into the fund manager’s actions. The investment manager declined to indemnify the fund manager for FCA investigation as there was no specific provision in his employment contract that required them to do so and they did not want to been seen by the FCA as supporting him.

The second case involves a clawback claim against a fund by a bankruptcy trustee in the US seeking recovery of interest payments made to the fund by insolvent financial institution. Insurers paid into a commercial settlement to bring a close to the case.

Thirdly, an investment manager discovered that, in breach of its internal procedures, the foreign currency exposure of certain funds it managed had not been properly hedged, resulting in a loss incurred of €2m that should have been avoided. The insurer agreed to indemnify the investment manager for a payment made to the funds.

Increased collaboration between the FCA and the SEC in particular, and their push for firms to self-report, has seen an increased number of circumstances being reported to insurers. In 2012/13 alone the FSA received over 855 requests for assistance from overseas regulatory bodies.

The costs for investigations by the FCA, SEC and the CFTC can be extremely expensive and the number of investigations is rising. It is imperative that hedge funds consider the detail of the coverage from their insurance policies.

Insurance policies are not designed to protect the reputation of a hedge fund with a regulatory issue, rather they assist the investment managers for liabilities arising from the event.
JLT EXPERT SEES OPPORTUNITY IN RISK TO WORLD FOOD SUPPLY
Published 22 June 2015, Best’s News Service via Bestwire

The prospect of disruption to the world’s food production system is creating insurance opportunities in lines ranging from product contamination to political risk, according to Simon Lusher, food and agri practice leader at JLT Specialty in London.

“The reinsurance industry is already responding,” Lusher told Best’s News Service. “There are a lot of products out there.”

Not only is political risk insurance growing, Lusher said, but a scandal in the United Kingdom, in which horse meat was found to have been substituted for beef, gave a boost to contaminated product insurance. After a slow start, Lusher said, underwriters are “starting to respond more to the agricultural and food supply industry needs.”

Lusher was speaking in the wake of the release by Lloyd’s of “Food System Shock,” one of its series of emerging risks reports.

“A systemic shock” to the world’s food output, the report warned, could have effects on the economy and politics and the wider society, the report warned. The result, Lloyd’s added, could be riots, food price riots and stock market turmoil.

“The report is obviously quite pessimistic reading,” Lusher said. “It supposed a sequence of events that hopefully won’t happen. But it is a very serious issue.”

Selling these products can be a challenge, Lusher said. Not only are they expensive, he noted, but the underwriting process can be laborious. “The insurance industry might need to make the process simpler and more engaging for clients,” he said.

Lusher described the insurance industry’s response to the varied food-related perils as a “mixed bag.” Parametrics, which delves deeply into probability, has proved useful in predicting weather risk, he said. The parametrics approach lends itself well to the claims process, he said, because its index-linked nature means it does not depend on proof of loss.

It is important for brokers to understand these kinds of complexities of food risk, Lusher said. “As these things take off — and they are slowly — it will become a more streamlined process,” Lusher said. “And as more people buy it, then hopefully it will become cheaper.”
There are warnings from the recent past, Lusher said. In 2008, he said, a combination of drought and high oil prices led to a “massive increase in food prices. That’s still recently in government memory,” he said.

Lusher noted the strong focus of the Lloyd’s report on climate change. “Wind patterns are changing,” he said. “They are blowing viruses around. Climate change is completely tied up with the whole global food supply system. What we don’t know yet is now climate change is going to affect agriculture.”

On the positive side, Lusher also sees the possibility of greater agricultural efficiencies. Food production, he predicted, will spread into new territories, with some areas producing double harvests. “Yield per hectare is growing at an increasing rate,” Lusher said. “So it could be that we could compensate.”

Emerging markets will be particularly vulnerable to food price increases, Lusher said. Food shortages are likely to divert output to wealthy customers. The lower-income markets are also less likely to have sophisticated insurance cover, he added.

Lusher expressed concern that modelers may not be well connected on a global basis or fully attuned across the various classes of risk. He wonders, for instance, if a weather-related policy would offer adequate coverage for political risk.

The prospect of increased droughts, Lusher said, raises the profile of genetically modified foods. This has been a subject of controversy in Europe.

“Our sources of food will change,” Lusher said. “We’re probably going to have to put up with genetically modified food in the future.”

JLT Specialty Contributor Simon Lusher, Partner, Risk Practice
It’s not often that the London broker market is compared with the ancient Incan civilisation, but believe it or not, the parallels are there.

Once upon a time, there were two Incan factions fighting for control of a huge amount of money, power and the adoration of everyone around them.

Two brothers led these two factions. One was named Huáscar, who was the established incumbent, physically bigger and on paper the rightful recipient of the gold, power and adoration. However, he was largely recognised as bit of a tyrant likely to refuse offers of allegiance – and a bit pompous and arrogant, to boot.

The smaller, nimbler brother, Atahualpa, was less well known, but loved by those he worked with. He was also recognised to be superior when it came to strategy, cunning and dexterity. See where we’re going with this?

Much like Atahualpa in 1529, mid-tier brokers are feeling the squeeze in 2015. The Incan prince had to deal with armies invading his land, imprisonment and his messengers being sent back to him dressed as women (true story) in the run-up to the great Civil War that marked the beginning of the end of the Incan era. Mid-sized intermediaries may be facing less deadly troubles, but they could result in great pain for their market – and perhaps a completely changed broker landscape.

Most of the problems are not new. Indeed, a quick look at the opening paragraph for a feature on the mid-tier broker market in 2010 ("Grow your own way", IQ, summer 2010) could well have been written today:

“Here is a problem for London. EC3 relies on brokers to bring business, but today’s global broking community inhabits a post-consolidated world in which most meaningful, mid-sized players have been absorbed and a top table of three global brokers is firmly established.”

Fast forward to 2015 and the M&A trend has accelerated. Back in 2010, AJ Gallagher had bought FirstCity for $32mn, while Marsh picked up HSBC Insurance Brokers for $130mn. In the past 12 months we’ve seen Hyperion acquire RK Harrison to create a “super independent”, Miller get bought up by big three broker Willis, and others, such as RFIB, invite private equity into their business to improve their scale.

Ultimately, the pressures of being a smaller player are driving these deals. These include, firstly, the burden of regulation. In 2010, the UK Financial Conduct Authority had only just taken on the brief for regulating insurance brokers, and five years later the cost of complying with the rules around client money, conflicts of interest and more are spiralling. Besides this, in no particular order, there is the fact that the big three brokers are setting up ever more facilities to sweep up treaty money, the mid-tier market’s continued lag with technology, and the need to become more global in order to remain relevant.

Despite these heavy burdens, the future for brokers that are willing to fight to retain their place looks bright. There is an abundance of capacity sloshing around EC3, and
not all insureds want to go with the big three brokers. There are ways to survive, and even thrive, in 2015.

Like Atahualpa, these intermediaries must take advantage of their positive reputation, their ability to be nimble and a superior strategy to see off competition from the bigger global brokers – and here, IQ reveals the top six ways to do just that.

BUY UP OR SELL OUT

It may seem a bit negative to dive straight in with giving up your independence, but increasingly for the mid-tier market (which we’re classifying as approximately £25mn–£100mn in terms of revenue), it appears that if you’re not looking to acquire, you’re effectively up for sale.

The first key part of the strategy is to work out which end of the spectrum you are – or to quote one of the broker CEOs IQ spoke to: “You need to work out if you’re a shark or a fish.”

What’s changed from five years ago is it’s no longer just the big three brokers using M&A as a way to prop up revenues when organic growth stalls. Now we’re seeing a push to find the right partner, both culturally and financially, to pair up with – usually using money from the private capital markets.

“Families are being formed right now, and you need to pick your family before someone else picks you,” says Frank Murphy, CEO of THB. “We’ve got a dual-pronged attack at the moment: make acquisitions where they make sense, and pick up disaffected teams from others who have merged.”

Despite the recent rush of deals, most brokers think more are on the horizon. John Lloyd, CEO of JLT Specialty and former CEO of wholesaler Lloyd & Partners, said that further consolidation was inevitable.

“The reality is if you’d asked me five years ago whether any of the deals that have taken place recently would have happened, I’d have said it was very unlikely, but these passionately independent firms clearly felt they had to do something,” he says.

Stephen Skeels, valuations partner at Mazars, also believes that the recent UK general election result will lead to more M&A transactions, as the stabilising effect of having a majority leadership in charge of the country is beneficial from a macroeconomic point of view.

“We certainly had a conversation with a client who’s thinking about selling up, [but] who wanted to wait to see what the environment would be like [post-election],” he says. “The likelihood is if Labour had got in, backed by the Scottish National Party, that would have made life a lot more difficult in terms of economic confidence.”

A word of warning for would be buyers and sellers, however: Skeels says that the multiples being bandied around for brokers are starting to look frothy.

“We’ve had quite a long period of 1.5x to 2x revenue and 5x to 7x Ebitda, but now it’s more like 2.5x revenue and 12x Ebitda,” he says. “Once you start looking at 12x Ebitda, it becomes unsustainable. To make that pay, you’ve got to grow so quickly to get the return, and to do so organically is tricky, so you put yourself on a conveyor belt of growing by acquisition.”
"FOR THE FIRST TIME IT LOOKS LIKE THERE WILL BE A CONSENSUS TO ARRIVE AT SOMETHING WHICH WILL DRIVE EFFICIENCY INTO THE MARKETPLACE."

BRING IN INVESTORS

The second option, if M&A doesn’t suit your particular brokerage, is to consider inviting in private equity backers to swell your coffers.

Insurance – and here’s a phrase I never thought I’d write – has become sexy, as far as private equity money is concerned. As BMS CEO Nick Cook notes: “We just haven’t seen trade and private equity acquisitions both being as hungry as each other before.”

BMS, as readers of sister publication The Insurance Insider will remember, agreed to sell a minority shareholding to US buyout firm Capital Z in May 2014, using the cash injection to expand both the broking business and the underwriting activity of its Pioneer managing general agency.

Capital Z has previously invested in UK brokers SBJ and Jeff, while its past underwriting stakes include John Charman’s corporate Lloyd’s vehicle Tarquin, class of 2001 Bermudian Endurance, 2005 start-up Lancashire, UK protection and indemnity insurer British Marine, PXRe and Catlin.

Speaking about the decision making process BMS went through last year, Cook says finding a capital partner was essential due to the reality of needing more capital to cover the increased cost of regulation, obtain the scale to compete with the big three brokers, increase its distribution and diversify its lines.

“We didn’t want to take on debt and didn’t want a trade sale as we saw that there was still an opportunity to grow, so we opted for the long-term view with Cap Z,” Cook explains.

Others were less positive about whether private equity was the right route. JLT’s Lloyd describes it as “selling your soul to the devil”, given that “private equity always requires an exit”. Mazars’ Skeels also talks about a “bubble building” in the broker space, meaning that in a few years’ time some private equity owners may feel that they overpaid, and will seek a quick exit.

Having said that, Skeels is adamant that there remains a huge amount of interest from PE houses, not only to help existing brokers grow but also to boost the coffers of those seeking a management buyout or to launch a start-up.

TECH UP

One area where Willis, Aon and Marsh have taken advantage of their size and resources is technology. Cat modelling, analytics and big data were once considered a differentiator, but now are increasingly seen as a must-have for anyone looking to compete.

“Technology is vital. We’ve got to be quick, we’ve got to be slick, but we’ve also got to be at the forefront of governance,” remarks Barnaby Rugge-Price, CEO of RKH Specialty.

JLT’s Lloyd is one of many brokers who support the development of a single market platform, adding: “For the first time it looks like there will be a consensus to arrive at something which will drive efficiency into the marketplace.”

Besso chairman Colin Bird goes a step further, and insists that if insurance is to remain relevant in London it’s got to recognised that most of the business could be commoditised.
“Brokers will have to relinquish their control of the data,” he says. “If they keep their head in the sand about this, the world will pass them by. Business is moving on, and they need to evolve or get left behind.”

It’s a topic that Michael Donegan, CEO of Price Forbes, feels passionately about too. While he’s in favour of market-wide initiatives to try to commoditise elements of placement and claims systems, he remains sceptical about whether they will be able to do the job as well as assigning the job to a real person.

The Electronic Claims File (ECF) service is a case in point. Price Forbes uses it, but Donegan says he can’t rely on the service to pay his clients “or we wouldn’t have any left”.

“Our brokers still have to negotiate the claim and get it paid, which at the end of the day is what clients hire us for,” he continues. “The ECF proves that IT only goes so far; transmitting paper is only half the story.”

Outsourcing elements of the tech question could be part of the solution. Many firms have introduced a form of internal outsourcing where the broker hires staff that work in a satellite office, either elsewhere in the UK or, often, in India. But brokers must determine whether the cost savings are worth the potential loss of control – something many said they were still investigating.

BECOME MORE GLOBAL

The fact that more policies are being written overseas by domestic insurers (and are being placed by domestic brokers) has risen up the agenda recently.

London brokers have desired footholds in up-and-coming regions such as Singapore, Zurich, China and Latin America for some time, but now it’s become more of a need than a want. And simply having a few people on the ground isn’t enough – overseas marketplaces need proper resources.

This is part of what several people described as a fundamental change in how insurance broking is carried out. Traditionally, the model was that London brokers travelled to a region and brought it back to EC3, but now there’s much more business being done through joint ventures and building regional hubs.

The attention called to this change by the London Matters report, written earlier this year by the Boston Consulting Group and the London Market Group, has made that need more acute.

“Inga [Beale, CEO of Lloyd’s] has got the right idea about making sure Lloyd’s remains relevant, but she’s got a tough job ahead of her to try to develop the business,” says TH&B’s Murphy. “She’s got a difficult line to walk in not upsetting the distribution chain both here and in other territories.

“We as brokers have to grow up and realise that even if we don’t like it, more business is staying locally, and if we don’t go and bring it back, Lloyd’s will have to go and get it.”

Others believed that while the importance of overseas markets will continue to grow, once the bottom of the soft market has been reached business will return to London – even in the challenging area of wholesaling.
ONE LAST AREA WE ASKED INTERVIEWEES TO PONDER WAS WHAT THEY THOUGHT THE LANDSCAPE WOULD LOOK LIKE IN FIVE TO 10 YEARS’ TIME FOR THE MID-TIER BROKER.

JLT’s Lloyd was one such advocate, saying: “Of course London has a diminishing share of the pot, but a smaller share of a bigger pie doesn’t mean London’s becoming irrelevant. People talk about the London Matters report as though we should be on suicide watch. I’m not criticising the report, but the paranoia which is surrounding it.”

BECOME A SPECIALIST

The question of whether mid-tier brokers could survive simply by offering some niche specialisms within their business lines was a complicated one for the market to answer. Some, like BMS’s Cook and Besso’s Bird, feel that diversification is key to midsized brokers’ survival, and that small specialists will either get swallowed up in a trade sale or will struggle to make ends meet in these times of pressured margins.

Others felt that by concentrating on what mid-tier brokers do best – providing bespoke, individual placements and policies for clients in specialty areas – they could beat off the competition from the big three brokers and would be rewarded with their customers’ loyalty, even if they chose to write across only a few lines.

Price Forbes’ Donegan was told in the 1990s that the days of a niche broker were dead and that the future was all about global players. More than 20 years on, he thrives on his firm being an independent specialist that its clients depend on.

“The smaller broker is more willing to ‘think outside of the box’ on behalf of a client. We’re more prepared to design a programme around their needs, rather than presenting them with one we’ve already designed. That’s what clients want, they want to feel listened to,” he stresses.

RK Harrison’s Rugge-Price says the future of the combined Howden and RK Harrison super independent will be in specialty broking. “We must have industry and product expertise allied to the best broking resource,” he says.

“As an example, what was a general casualty business has evolved into a series of niches within the broad umbrella of casualty – healthcare, product recall, D&O, E&O and so forth – and as the risk evolves, so the cover has to.”

And, as has always been the case, the mid-tier broker must offer exemplary service. While clients want an element of choice in the broker market, if the service they receive isn’t up to scratch there’s no reason why they wouldn’t choose Aon, Marsh or Willis instead.

Finally, service means that brokers must offer in-house analytics, cat modelling and/or meaningful data to secure loyal custom – something that, as highlighted earlier, almost all of the mid-tier specialists agree is now imperative.

SUCCESSION PLANNING

Whether your brokerage intends to remain independent or whether it is lining up for an M&A deal, succession planning is key. Traditionally, the broking sector both in general insurance and the London market has been poor at planning for the future.

Partly, this comes down to how senior executives have become leaders at these intermediaries. Most have been good producers who have found themselves promoted into the upper echelons of the boardroom and have had little or no management training.

Mark Grice, partner at Mazars, speaks for much of the industry when he remarks that while most brokers believe they have succession plans in place, how they are executed is another matter.
“Fundamentally, this is about wealth generation for most of these people – you don’t make your fortune by being in the big three brokers, you do it by building your business, growing and selling it. If you’re lucky, you’ll do that two or three times in a career,” he says.

The need to sell up at the right time, returning to the first step in our survival strategy, is precisely why succession planning is so important.

The situation is the same for private equity partners, which will often insist on a fully detailed three and five-year plan.

With so much on the line, many brokers and financial backers won’t entertain getting into a transaction with an intermediary unless there are firm plans for the management once the deal has been completed.

“We’ve seen the issue across the market, but particularly in London and the wider market, and it’s tough to plan for,” says RK Harrison’s Rugge-Price. “Answering that question successfully will be the key to making these M&A deals work.”

THB’s Murphy agrees, saying there has to be a “seamless” transition between the old management and those coming through before his firm would even consider partnering with another.

One last area we asked interviewees to ponder was what they thought the landscape would look like in five to 10 years’ time for the mid-tier broker.

Most thought the number of brokers would be about the same, perhaps slightly fewer, but the names would be different. As each new takeover or merger completes, it creates a gap in the market that the next ambitious wannabes will aspire to fill, whether through organic growth, their own M&A or through private financing.

Already, people are talking about the £50m-£100mn space being ripe for development following Miller’s takeover by Willis.

Most also agreed that the number of managing general agencies will increase, and that there will be fewer pure London market wholesalers.

But the overriding message was that the future was bright for mid-sized brokers because clients would always want that element of choice, the bespoke programmes and the closer client relationship that a mid-tier broker provides.

This is a darn sight better than the future that faced poor old Atahualpa. When the Spanish arrived in South America, he decided to let conquistador Francisco Pizarro choose which brother should rule the Incan empire, and offered to ride out to meet him.

Atahualpa however, became paranoid ahead of the meeting, and decided to murder his brother rather than risk being placed runner-up. His reward was to be garrotted by Pizarro’s men a few months later. And thus the decline of the Inca Empire began, brutally hastened by a host of European-borne diseases such as smallpox, diphtheria and influenza.

There may be something of a lesson for mid-tier brokers here. It was an external threat in the form of Pizarro that ultimately did for the Incan empire, so perhaps midtier players should look to external threats to their industry, such as the threat of disintermediation, instead of focusing on the pressures from the big three brokers.

JLT Specialty Contributor John Lloyd
CEO of JLT Specialty
AIRMIC CALLS FOR BROADER REPUTATIONAL RISK COVER

By Stuart Collins
Published 16 June 2015, Commercial Risk Europe

Insurers say they are willing to work with the UK risk and insurance managers’ association Airmic as it looks to broaden the scope of reputational risk coverage.

At its annual conference this week, Airmic is launching a guide to understanding and evaluating reputational risk. “After the report is launched at the conference in Liverpool, we will sit down with insurers and ask them how far they may be willing to go in offering a broader range of reputational risk transfer products,” said John Hurrell, Chief Executive of Airmic.

All of the insurers and brokers CRE spoke to for this article welcomed Airmic’s initiative and would be prepared to work with the association on reputational risk transfer.

However, difficulties in defining and quantifying reputational risk have so far limited the insurance industry’s response to growing demand from risk managers for risk transfer solutions. Only a handful of insurers offer standalone reputational insurance, and even fewer cover the loss of profits or revenue.

Airmic accepts that some aspects of reputational risk are challenging for insurers. As a result, it will initially work with insurers on extending existing insurance to cover the costs of mitigating a reputation-damaging event.

“The quickest and easiest route is to broaden cover under existing policies,” said Mr Hurrell. “At first this could be for restricted limits and agreed reparation, such as the cost of crisis management,” he said.

Extending cover to loss of profit or revenues as a result of reputational damage is currently not on the cards. “For now, balance sheet protection is unlikely to work.

This is a difficult risk to articulate, so focusing on extending existing policies to cover costs is a good first step,” said Mr Hurrell.

Airmic does, however, recognise that some insurers have been looking to develop more innovative standalone covers. “We are pleased to see individual underwriters going further than just looking at extending existing covers but we need the wider market to move forward in step and this is more likely if we are able to build out from where they are more comfortable,” said Mr Hurrell.

Ideally, risk managers would like to have broad all-risk cover that does not require a big investment in time and information to underwrite reputational risk, according to John Scott, Chief Risk Officer, Zurich Global Corporate.

“However, in reality reputational risk is complex to understand and quantify. An all-risk reputational insurance would be too difficult to quantify, price and open to moral hazard,” said Mr Scott.

“A better approach would be for insurers and their clients to work together and identify the root causes of reputational risk, develop good risk management around these risks and look to transfer specific aspects where possible by extending existing products, like product recall,” he said.

According to Mr Scott, it is possible to go a long way with existing insurance policies by ‘stretching the understanding’ of what insurance can provide. “Insurance is a powerful risk transfer tool and it can be used to mitigate aspects of reputational risk, such as the cost of crisis management and PR consultants,” he said.
Kiran Nayee, a partner at JLT, also believes that extending reputational-type coverages under existing policies is the way forward. “This is a difficult risk for buyers to articulate and a difficult one to underwrite. While there are standalone products out there, take-up is likely to remain limited because most clients would see that as an additional insurance spend,” said Mr Nayee.

“You first need to get reputational coverages into existing insurance policies. You have to start somewhere and in that regard the approach suggested by Airmic is heading in the right direction,” said Mr Nayee.

There are a range of existing insurance products—namely product recall, D&O, cyber and supply chain insurance—that can include some cover for reputational risk, usually related to crisis management costs. These types of cover could be developed further.

“If risk managers look at the threats to reputation, their existing insurance could be part of the solution. So talk to your insurers to see how to round-out your policies and to understand the triggers and quantum,” advised Mr Hurrell.

For example, JLT has extended the scope of reputational cover in its product recall insurance and included a trigger for recalls linked to reputational risk.

Product recall policies typically only respond to a recall where there is the threat of bodily injury or physical damage, explained Mr Nayee. JLT’s extension will respond to incidents that have no threat of bodily or physical injury, but do pose a threat to a company’s reputation, explained Mr Nayee.

Cyber insurance is another line of business that looks to address damage to reputation as part of cover. Although loss of business related to damage to reputation is currently not insurable, cyber insurance can cover the costs of crisis management and managing a breach, according to Paul Bantick, Cyber UK Focus Group Leader at Lloyd’s insurer Beazley.

Protecting reputation is one of the key drivers behind purchasing cyber insurance and managing the downside of a data breach, he explained.

“Certain risks contain a crisis element and can pose a significant risk to an organisation’s reputation,” according to Mr Bantick. “As a result there is a growing demand for insurance that comes with services like crisis management, and a high degree of expertise and experience,” he said.

Beazley is now adapting this approach to other lines of business. For example, the insurer has added a response service to its US management liability insurance, as well as a weather insurance product.

While some insurers will extend existing lines of business to include crisis management, there are a small number that have created standalone products.

According to Tom Hoad, Underwriter at Tokio Marine Kiln, reputational risk can be covered through standalone coverage. Tokio Marine Kiln is one of the only insurers that will cover loss of earnings, as well as the costs of crisis management through a standalone reputational insurance solution.
FOR EXAMPLE, JLT HAS EXTENDED THE SCOPE OF REPUTATIONAL COVER IN ITS PRODUCT RECALL INSURANCE AND INCLUDED A TRIGGER FOR RECALLS LINKED TO REPUTATIONAL RISK.

“There are sceptics that have not taken the time to understand reputational risk insurance. But we have been working with clients for a number of years to give them a product with real commercial merit,” he told CRE.

Tokio Marine Kiln has written a number of standalone reputational risk policies, targeting consumer-focused industries such as luxury goods and franchise operators. The product, which has subscription market support and capacity in excess of $100m, has seen an uptick in demand and sales, said Mr Hoad.

The insurer is also developing a business to business reputational risk product, but this requires a third party to measure media or public sentiment. For consumer risks, Kiln taps into the point of sale systems many companies have to monitor product sales.

“Much of the value in business today is often intangible, but the insurance industry is still pre-occupied with physical loss. Risk management has moved on and the scope of risk managers has expanded to include crisis management and preparedness, so it is only natural that they look to insure,” said Mr Hoad.

Allianz Global Corporate & Specialty (AGCS) also offers a standalone reputational risk product that covers the cost of crisis management and public relations based on named triggers or linked to existing insurance contracts.

For example, the policy would respond when one or more traditional property casualty policies—such as aviation, marine hull, D&O, property and crime—are triggered. Clients can also name their own perils.

However, AGCS’ cover does not extend to loss of profits or revenues. “Loss of income or revenue is not currently possible to underwrite on a standalone basis because it is difficult to quantify losses and attribute directly to a crisis,” argued Terry FitzGerald, Head of Commercial D&O at AGCS.

“Demand for standalone cover has been growing but not as fast as we would have liked,” said Mr FitzGerald. Retail, leisure, food and drink and aviation sectors have all shown interest, he added.

“Reputation is insurable and we have a product that is selling in several territories, so I hope that it will become a more common purchase and we are engaging with clients to raise awareness,” explained Mr FitzGerald.

Risk managers are enquiring about reputational risk transfer products and there is growing demand for innovation in this area, said Robert Barnes, Client Executive in the Financial and Professional Practice at Marsh.

“The insurance industry needs to innovate in the area of reputational risk. Clients have an articulated need so the insurance industry needs to provide a product. There are only a handful of standalone products out there and they have not gained traction,” he said.

Standalone reputational insurance products will contain potentially unacceptable exclusions, such as those for known events, said Mr Barnes.
Limits can be small relative to the size of companies that are interested in cover, he added. Insurers also have only limited appetite—some sectors, such as financial services and pharmaceuticals, fall outside the scope of underwriters, he explained.

“As an industry we should take a step back and start with first principles. If clients can get firm data, they can throw the gauntlet down to brokers and insurers to craft a solution and see if there is capacity and a product that unambiguously transfers reputational risk,” according to Mr Barnes.

“This can’t be solved by a traditional inflexible insurance product, it is too complex an issue. But if you can get good data, the market is soft and insurers are looking to drive the top line and respond to client needs…the ingredients are all there,” said Mr Barnes.

http://www.commercialriskeurope.com/cre/4321/15/Air mic-calls-for-broader-reputational-risk-cover/

JLT Specialty Contributor Kiran Nayee, Partner, Risk Practice
An end to U.S. sanctions on Iran would be a boon to global marine and energy insurance markets, but insurers will still need to exercise caution in their dealings with the country.

The sanctions on Iranian oil exports and financial transactions in place since 2012 forced the marine and energy insurance sectors to sever long-standing business ties with the country. Insurers also have had to tread carefully in dealings across the Middle East for fear of indirectly breaching sanctions — a marine insurer, for example, would have to ensure the oil being transported by an Iraqi vessel was not of Iranian origin to avoid legal action.

But talks earlier in April ended with a broad understanding that Iran’s ability to produce a nuclear bomb would be restricted in exchange for relief from sanctions. A final decision is to be made by the end of June, although the timeline for the removal of sanctions is unclear, and Iran’s apparent seizure April 28 of a Marshall Islands-flagged ship provided a reminder that the situation is far from simple.

Nevertheless, the start of the process would incite a collective sigh of relief from the marine and energy insurance industry, as well as a renewed flow of business in a time where growth is hard to come by.

**AWAKING A SLEEPING GIANT**

With sanctions removed, insurers would once again be permitted to underwrite the oil and gas assets of Iran, which, according to the U.S. Energy Information Administration, holds nearly 10% of the world’s crude oil reserves and is the world’s third-largest dry natural gas producer, after the U.S. and Russia.

The scope for underwriting also encompasses the export oil cargo and the fleet of Iranian tanker vessels, explained Bob Pellow, executive director for central and eastern Europe, the Middle East, and Africa at Willis.

“Lifting of sanctions would, almost certainly, also create something of a consumer boom, causing an uplift in imported consumer goods and increased global shipping movements into Iran,” he told SNL.

Indeed, academic sources have told SNL that the lifting of sanctions could trigger economic growth of between 4% and 6% in 2015, although the IMF forecasts a much more sedate 0.6% growth rate, due to the collapse in oil prices.

Iran’s domestic insurance market has dramatically increased its expertise and sophistication as a result of taking on the work that sanctions render off-limits for international firms, said Peregrine Towneley, chairman of Jardine Lloyd Thompson’s Middle East and North Africa division.

“[The Iranian insurance market] has done a remarkable job — the companies have become much more sophisticated at managing the risks themselves,” he told SNL. “But these risks are huge, and they clearly would much rather spread them over the wider international market than they would keeping them to themselves.

“I imagine that as soon as they are able to, they will be as keen to re-engage with us as we were reluctant to stop engaging with them.”
Iran has a long history of international insurance transactions, Towneley said, adding the Iranian insurance market is a “sophisticated and intellectual” base to deal with. JLT were “the last people out, and we’d like to be the first people in [after sanctions have ended],” he said.

**CLARITY NEEDED**

However, even when barriers are lifted, insurers will still need to exercise caution. The opacity created by the oil sanctions means that energy insurers in particular have had no insight to the maintenance of or investment into oil refineries and petrochemical complexes.

What is known, however, is that sanctions crippled Iran’s GDP, and potentially available spend. GDP contracted 6.6% in 2012, then a further 1.9% in 2013, according to the IMF. By 2014, GDP growth had bounced back to nearly 3%.

“We don’t know what the loss record has been like on the major plants, and we don’t know how badly the economy has had an impact on infrastructure or maintenance investment,” Towneley said. “There will be huge interest from insurers as to how well these assets have performed over the last few years — if they have had malfunctions or have been badly maintained. This would then have an impact on the appetite, pricing and deductible levels.”

Furthermore, no clarity has yet been given on whether insurers will pay for claims arising from before the sanctions end date, creating further uncertainty around insurance clients, insurers and reinsurers.

“It’s that sort of confusion which really ties people up in knots and doesn’t benefit any party involved. We would want to avoid that,” Towneley said.

**KEEN COMPETITION**

The influx of new business, however, is unlikely to have any effect on the overcapitalized state of the marine and energy insurance markets. The new business emerging from Iran is likely to be fought over intensely, and pricing will be competitive, Towneley noted.

Peilow observed that the end of sanctions will reopen international reinsurance options to Iranian insurers.

“At the same time, their net retentions will add to the global overcapacity,” he added.

From a competitive standpoint, however, Iran’s insurance market still has work to do to establish itself as a rival regional business hub in the Middle East.

“The Iranian insurance market, historically, has enjoyed close connections with the international insurance and reinsurance markets,” Peilow said. “Lifting of sanctions will see these relationships rapidly rebuilt, but it will take some time for Iran, if indeed it has any ambitions in this direction, to rebuild to the point of being able to challenge Dubai and the Qatar Financial Centre as regional hubs.”

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**JLT Specialty Contributor** Peregrine Towneley, Chairman, MENA
Week in, week out, broker Sally Swann is negotiating complex insurance cover for companies with a turnover of more than a million pounds. Richard Tresidder finds out more.

She is in her fifties, achieved a First in economics at the University of Nottingham and three years ago moved to set up an East Midlands base for an international insurance brokers in Nottingham.

Who is she? Sally Swann.

She was born in Doncaster, likes fashion and shops in Jaeger in Exchange Walk.

Today, as we sit in a plain boardroom in her office, she is wearing a neat mid-brown tweed skirt and matching blouse.

In 2012, she left a competitor to open the first Nottingham office of insurance broker JLT – Jardine Lloyd Thompson.

It was a huge and brave decision to take in her fifties starting all over again, but already the office has grown to eight staff. JLT specialises in finding competitive insurance for large, complex risks, frequently cover for millions of pounds.

Already, Sally and her team have acquired at least 40 clients, largely firms of a £10 million plus turnover.

While sitting in her simple boardroom offices on Pilcher Gate in the Lace Market designed by Victorian architect Watson Fothergill, Sally is called away. She is in the middle of placing cover for a new client with various insurance companies.

The i’s have to be dotted, the t’s crossed, everything disclosed which would affect a prudent insurer’s judgement and terms in agreeing cover. These are insurance contracts made in uberrimae fidei, in utmost good faith. Anything likely to affect an insurer’s judgement which is not disclosed may render a policy voidable.

Everything has to be declared that might influence an insurer: The number of staff, the nature and extent of fire safety; the method of construction of the premises; the qualifications and training of staff; a claims history; neighbouring properties and their uses. And so the declaration goes on and it is this which gives Sally professional pride and pleasure, the intellectual challenge.

Each policy will have its own terms and conditions and a unique premium. In a way, a policy is necessarily bespoke for each client.

“It is not just about price, although it is important,” said Sally. “What we try and do because we are dealing with large, complex risks, is understand a business – where it gets its raw materials from, who their customers are, where their supply chain is, how it operates, what processes they use, what hours they work and the contracts with third parties. Everything.

“They all affect the risk. We will design an insurance programme around what is appropriate and necessary for the client. When you put a presentation to the insurance company, you are presenting that risk to them and the underwriter will decide what price to put on it.”

The underwriter will look at every factor, including how far away the nearest fire station is. Can the fire engine get there quickly?

“Our job is to collect all the information and take it to the underwriter who will decide what the premium is,” continued Sally.
“One of the most complicated risks is construction because of the varied roles and responsibilities – a main contractor, a sub-contractor and who is responsible for what. They have very complex contracts and we have to determine who is responsible for each element and how it will work in the event of a claim.”

Cyberspace also presents complex risks, with the potential for outsiders to hack into a computer system. “We have to think about what happens if hackers steal money or destroy systems.”

The Nottingham office of JLT has its own areas of speciality such as construction and real estate; food and agriculture; communication technology and media companies; and engineering and manufacturing. It is the only East Midlands broker to provide cover for mergers and acquisitions and insurance due diligence reporting on M&As. This will include warranty and indemnity insurance, for instance, when a seller warrants a turnover of £10,000 a day.

The detail demanded of a client is far more than when Sally Swann started her career. “We drill down in far greater detail and placing risk in the insurance market has become far more complicated,” she said. “We didn’t have the internet or mobile phones and computers didn’t do what they do now. Now it is a totally different ball game.

“Previously, it was property and basic liabilities – things like that. Now there are complicated, intangible risks. When I started, professional indemnity was about lawyers, accountants, bankers and insurance brokers. Now it’s needed for many more sectors, for example construction and manufacturing. Society has become far more litigious. The volume and size of claims go up constantly.”

JLT’s market approval committee has the task of constantly vetting insurers to make sure they have the financial security and resources to pay claims and, importantly, will pay out quickly and not leave clients waiting indefinitely. All insurers have a Standard & Poor rating of their financial stability. “We discuss on a regular basis the financial security of insurers, how good they are at paying claims and what their service is like,” said Sally.

One of the services provided by a good broker is to warn clients about what is and isn’t included in a policy and the consequent implications.

Said Sally: “It is a people business, about relationships. People come to me because they trust me, they can rely on me and they know that what I say is correct. It is about knowing I will look after them. You give people the right advice and you are there when they need you.”

She taps the table several times with her finger nails to reinforce her points and her silver bracelets jangle.

Sally knows the game inside out. She evidently loves it and is well known to insurers, dealing with a long list of valuable clients whose businesses she has come to know she needs to know inside out so as to find insurance cover at the right price and on the right terms.

The Nottingham office of JLT is part of a worldwide network with headquarters in London where it is quoted on the Stock Exchange. JLT is 40 per cent owned by Jardine Matheson and employs 10,000 worldwide.