Insurance Act 2015: what risk managers should know

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News round-up: March 2015

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Why the IRM's new boss puts people before procedures

New chief executive Ian Livsey urges the risk community to collaborate on professional standards and publicise ERM's benefits

As risk management evolves, more and more risk managers with an ERM focus are being employed to tackle the complex risks of the current business environment. ERM is a function that could be enhanced with risk management standards, says the IRM's new chief executive Ian Livsey (pictured).

In his first interview since succeeding interim chief executive Jeremy Harrison at the beginning of February, Livsey gave a frank assessment of the professional status of risk management and its role in the corporate arena.

Although Livsey is not a risk manager by background, he has extensive experience in working for and leading a number of professional bodies that provide standards and accreditation. It is this knowledge and experience that he will bring to the risk management community while at the helm of the IRM.

Livsey was previously chief executive at UK temporary labour licensing firm Gangmaster Licensing Authority and the Centre for Rail Skills, which sets national occupational standards for traction and stock maintenance.

He also chaired a number of organisations that provide professional trade standards and accreditation to practitioners, such as the UK government's TrustMark organisation, representing the repair, maintenance and improvement sector; and JTL, a non-profit charity that offers apprenticeships and training in building and engineering.

Central role

In his new role, Livsey is an advocate for ERM, an approach that has grown in popularity over the past 15 years. He says the IRM has a responsibility to use its global position to communicate the benefits of ERM to the wider economy.

"The IRM has a central role to communicate to businesses [the

(Continued on page 7)

Civil airliners' security measures in six points

What should risk managers know about the rules and regulations governing civil aviation in the EU?

1. Rules on the minimum crew members required in the cockpit

On 27 March, the European Air Safety Agency issued a recommendation for airlines to observe the "four-eye-rule" in the cockpit; stipulating that in the case of the captain or first officer leaving the cockpit, a crew member should be present in the cockpit with the remaining pilot.

European safety regulations require that pilots shall remain at the aircraft controls unless absence is necessary for physiological or operational safety needs.

There is no European requirement that a member of the cabin crew must enter the cockpit in the event a pilot needs to take a short break for such needs. There is, however, a requirement that the cockpit door can be opened from the outside in case of emergency.

2. Legislation regulating medical and fitness checks of airline pilots

A European regulation mandates that pilots must have a current medical certificate. This certificate is issued by an approved specialist in aviation medicine and revalidated at regular intervals throughout a pilots' career. The European Regulations for Medical Certificates contains requirements that relate to psychiatry and psychology.

These medical rules are binding on every member

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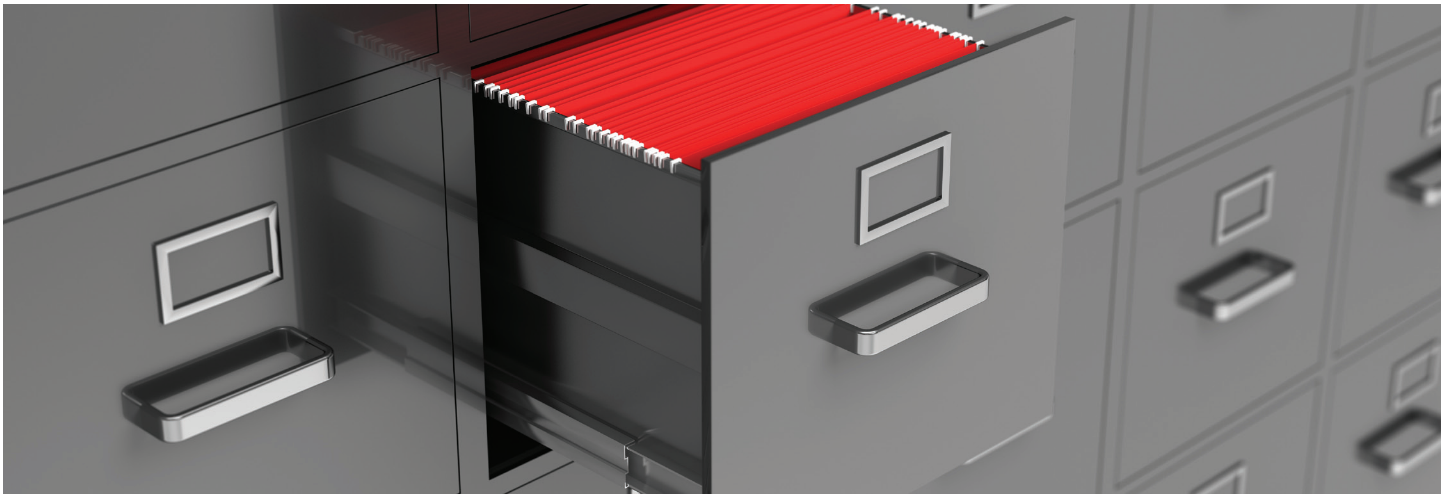

What are the practical considerations of the Insurance Act 2015 for risk managers?

The legislation will introduce fundamental reforms, including key changes to the duty to make a fair presentation

When the Insurance Act 2015 comes into force in August 2016, it will introduce fundamental changes to UK insurance contract law. Risk managers will welcome the reforms and are being encouraged to prepare for the changes well in advance of next year. Airmic has urged the insurance market to implement the reforms as soon as possible and some insurers may be willing to apply the new rules to policies incepting or being renewed before August 2016.

The key changes for risk managers concern the duty to make a fair presentation about the risk before the insurance cover incepts. The duty applies not only when the cover is first placed with an insurer but each time the insurance contract is varied or renewed.

Under the Act, the duty of disclosure will be satisfied if either all material circumstances that the insured knows or ought to know are disclosed to the insurer or sufficient information is given to put a prudent insurer on notice that it needs to make further enquiries. If the duty is breached, the Act introduces a scheme of proportionate remedies, depending on what the insurer would have done had a fair presentation been made. Commercial policyholders will benefit from the reforms, but there are nevertheless important issues that risk managers will need to consider carefully.

Searches for information

A commercial policyholder's knowledge will be what is known to its senior management team and the individuals responsible for its insurance. In addition, what it "ought to know" is what should reasonably be revealed by a reasonable search of information available to the policyholder.

Risk managers will have to satisfy themselves that a reasonable search for information has been made both within the organisation and of any other party that has information about the risk. This will include, for example, making enquiries of agents (including the insurance broker) or individuals covered by the insurance (such as individual directors and officers covered by a D&O policy). If they do not already, risk managers should put in place guidelines and procedures for conducting searches and making enquiries for information about the risks they are insuring. They will want to talk to their insurance brokers about the extent of such searches and may be able to agree the parameters of what is a "reasonable search" with the insurer.

Risk managers will welcome the reforms and are being encouraged to prepare for the changes well in advance of next year

Making the presentation in a reasonably clear and accessible way

The Act says that the presentation must be made in a manner that would be reasonably clear and accessible to a prudent underwriter. The intention is to avoid "data dumping", whereby large amounts of information, often in electronic format, have sometimes been presented to an underwriter in an unstructured form. In future, it is unlikely that a court will find that such an approach satisfies the duty to make a fair presentation.

Risk managers, with their insurance broker, will need to give careful consideration to how to structure the presentation of information, which could include indexing and the signposting of important information to the underwriter.

Contracting out

A key issue for risk managers, and one that they are unlikely to favour, is that the Act allows the parties to non-consumer insurance policies to contract out of the majority of the new rules. This can be done only if the term in the policy is clear and unambiguous and has been sufficiently drawn to the policyholder's attention before the insurance incepts.

The Act does not set out what would be sufficient steps for an insurer to take to draw the term to the policyholder's attention but does say that the characteristics of the policyholder and circumstances of the transaction will be taken into account in deciding whether it has been done. It follows that the more sophisticated the policyholder, the less the insurer will have to do to bring a term to its attention.

Risk managers, with their insurance brokers, will – as always – need to scrutinise the terms of policy wordings and documents cautiously to ensure that they reflect their understanding of the cover being offered.

Ed Foss is the head of the insurance and reinsurance group and Simon Garrett is a partner at CMS

Rising geopolitical tensions amplify BI exposure in the world

A gloomy report from the World Economic Forum suggests that corporate exposure to geopolitical risk is a key concern in 2015

Concerns about the global economy, such as deflation in the eurozone and slow growth in key emerging markets, are far from over. However, rising geopolitical tensions are starting to overshadow – perhaps even compound – these worries.

Given the recent financial crisis, the main focus has been on economic risks. This was evident in the World Economic Forum's (WEF) annual *Global Risks* report, which draws on the perceptions of experts in business, academia and the public sector worldwide. Each year, respondents are asked to rate a select number of risks in terms of their likelihood and impact over the course of the next decade.

For the first time in nine years, WEF's top global risk in terms of impact was not economic. In fact, economic risks were absent from the top five risks with the biggest consequences (a list that has included two or more of them since 2007).

This year, interstate conflict with regional consequences was rated first in terms of likelihood and fourth in terms of impact. High-risk ratings for failure of national governance (third-most likely), state collapse or fall (fourth-most likely) and weapons of mass destruction (fourth-biggest impact) meant more geopolitical risks appeared towards the top of the table than ever.

Almost 900 experts rated 28 global risks between July and September 2014. Given the political environment at that time, it is perhaps unsurprising that interstate conflict with regional consequences was ranked so highly.

This year, interstate conflict with regional consequences was rated first in terms of likelihood and fourth in terms of impact

During that period, for example, Islamic State gained control of cities in Iraq and Syria, and the Israel-Gaza conflict escalated after the Jewish state blamed Hamas for the murders of three Israeli teenagers in June. In addition, tensions in Ukraine led to clashes between the new government and pro-Russian separatists on the country's eastern border and led to the annexation by Russia of Crimea. Political and societal unrest in Hong Kong, Thailand, Egypt and Libya were also significant to the risk landscape in 2014.

In the six months since the 2015 survey was conducted, the geopolitical risk landscape has been exacerbated, according to WEF report advisory board member Steve Wilson, who is Zurich's chief risk officer for general insurance.

"The situation with Russia seems to be increasingly tense, and leading military figures have made many comments warning about Putin's agenda [concerning Russia's influence in Eastern Europe]. In addition, the terrorist attacks in Paris suggest the extremist militant threat is getting worse," he says.

Growing fragmentation

The key risk for corporates arising from such political tensions concern business interruption (BI), according to WEF report steering board member John Drzik, Marsh's president of global risk and specialties.

"The potential sources of BI are diversifying as the world evolves and fragments in a geopolitical sense and develops in a technological sense. This [amplifies] the challenge for

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firms when assessing potential sources of BI and has created a more challenging risk landscape," Drzik says.

Corporate exposure to geopolitical tensions has become a global trend that Wilson says could be a catalyst for growth in the insurance market.

"Economies are connected, trade is connected and when geopolitical tensions arise that threaten trade and contracts between businesses across borders, there is a need for growth in political risk and credit risk insurance markets," he adds.

In terms of risk management, firms should account for geopolitical risk when evaluating investment plans and supply chain strategies, says Drzik.

"Geopolitical events are likely to be more frequent in the next few years and could cause disruption in different parts of the world. A good risk management strategy is to avoid undue concentrations of supply chain, investment portfolio or other risk exposures the firm may have," he says.

Uncertain landscape

Globalisation and the financial crisis have encouraged businesses to invest in emerging markets. It means that firms are perhaps more exposed to conflict and political rivalry than ever before, at a time when the global geopolitical landscape is increasingly uncertain.

The situation in Europe is particularly hard to read: the economy is sluggish, Ukraine's future remains unclear, tensions between the EU and Russia are rising, religious extremism is spreading from the Middle East and the election of Syriza in Greece is raising questions about the eurozone's stability.

As with most risks, circumstances are subject to change and the geopolitical landscape is certainly one for risk managers to watch.

Never mind Grexit – the real worry is deflation

When it comes to economic trouble in Europe, currency and trade credit risks leave the current Greek drama in the shade

The initial hysteria that shrouded talks between Greece and its eurozone creditors has perhaps deflected from the EU's wider issues.

The pound sterling reached a seven-year high against the euro at the start of March, a day after the European Central Bank (ECB) initiated its strategy to curb deflation through a process of quantitative easing (QE). It was the first time since December 2007 that sterling had reached €1.40 after rising 0.4%, according to Reuters. March also saw the euro hit a 12-year low against the US dollar, almost reaching parity before it regained some ground.

Economic growth in the EU is also hindered by high unemployment rates, particularly in Southern Europe. The World Economic Forum (WEF) expects joblessness to remain at current levels until 2018. This "reflects a growing problem of structural unemployment in advanced economies" and "will likely keep wages low, maintaining deflationary pressures", according to the WEF 2015 *Global Risks* report.

The likelihood of Greece exiting the EU or the eurozone (Grexit) may have been exaggerated by the media, but it remains a possibility nonetheless. Discussions with eurozone creditors and the European Commission have not been positive, but there are bigger issues in Europe, according to Lockton senior vice-president Nadine Moore.

"Although the Greek restructuring has driven many headlines, it is a much smaller issue than the economic headwinds, such as deflation, credit losses and currency risks," she says. "Southern Europe continues to have credit losses, although the losses have slowed. There is a consensus that most distressed companies have either closed or become insolvent, but that does not mean there will not be future losses. Overall, trade has declined in the region."

Moore says the Swiss National Bank's surprise decision to abandon the currency cap pegging the Swiss franc to the euro destabilised money flow, and that most firms were unprepared for the strengthening of

the US dollar, which has amplified currency risks for firms trading in or with the eurozone.

Praise for QE

The ECB's decision to introduce QE was long overdue, according to a number of risk analysts. Mike Liu, quantitative analysis director at macroeconomic research firm Roubini Global Economics, says prolonged deflation would likely have dire consequences for EU firms and global corporates.

"There is justifiable concern about the risk of prolonged deflation in the eurozone given structural reasons, such as weak growth potential, high total indebtedness and excess capacity in certain industries," says Liu.

The severity of continued deflation in the eurozone should not be underestimated, according to Lockton's Moore, who says counterparties selling into the eurozone face increased pricing pressure and currency pressure owing to the euro's continued depreciation.

"The effect of deflation is much more severe than recession. If continued, the financially strong countries will likely weather the storm. Those on the periphery, such as Italy, may have a harder time raising capital and keeping credit flowing," adds Moore.

Multinational risk managers will be wise to monitor inflation rates in the next 18 months as the ECB proceeds with its plan to purchase EU government bonds and asset-backed securities for a combined €60bn each month until September 2016. The strategy will see the institute inject €1.1trn into the eurozone economy and Liu is confident that will have the desired effect for the corporates.

"ECB QE will reflate asset prices, generating positive wealth effects, partially contributing to cyclical growth improvement in the eurozone," he says.

Whether the ECB's QE programme successfully boosts inflation rates in the eurozone to the institute's desired level of just above 2% remains to be seen. For the time being, currency and trade credit risks are likely to be prominent factors on the corporate risk landscape in Europe.

Risk management on the up in MENA

In the booming Gulf states, risk managers are still rare, but the problems of turbo-charged growth may offer the profession a way in as the region attracts more and more business investment

Developing Middle East and North Africa (MENA) has made respectable economic progress, with an average annual real growth rate of about 5% since the start of the millennium (lower than developing Asia's rate, but higher than Latin America's). This marks it out as an attractive market for business investment.

The Gulf Co-operation Council (GCC), has benefited from oil and gas reserves and assets that have generated significant financial liquidity. In addition to being resource-rich, the region's population growth, forecast to increase by 30% in the next decade to 53 million people by 2020, has kick-started many construction projects, including new cities, transport links and healthcare facilities. More than 100 major projects are due to be completed by 2030, costing in excess of $1trn (€746bn).

These developments spell opportunities and challenges for risk managers. Although risk management lags behind the region's growth, it is gaining momentum, according to three senior risk managers from Qatar.

During a corporate risk management panel debate held at the ninth Multaqa Qatar reinsurance conference in Doha, Qatar, the panellists – Gregory Irgin, director and group risk, legal and reinsurance at UrbaCon Trading and contracting; Philip Wood, insurance senior manager at Qatari Diar Real Estate Development Company; and Frédéric Desitter, director of enterprise risk management at Sidra Medical & Research Center – gave an overview of risk management in the GCC.

On maturity levels, Wood said: "Risk management, as a practice, is relatively new to the region. Within the GCC and MENA, the focus is on laying the foundation of risk management. Once the fundamental blocks are in place, a more advanced framework can be implemented. Businesses and their employees are building risk awareness and, once this has been achieved, a more consistent and sophisticated risk management approach can be shaped."

The panel commented that project risk management – whereby risks are managed on a project-by-project basis – takes precedence over the holistic ERM framework.

"Risk management, as a practice, is relatively new to the region"
Philip Wood, Qatari Diar Real Estate Development Company

Desitter said: "Risk management is viewed as a governance process and many firms want to implement the function – doing so is seen as best practice. The main objective for many firms in Qatar is to adopt similar governance principles and mechanisms as companies in Europe.

"However, the function is in its infancy, particularly processes such as ERM. Businesses here are more familiar with project risk management and safety risk management than with the ERM concept.

"Having said that, ERM has been successful in some companies. I have started to implement the framework and other organisations have been doing the same."

Irgin cautioned that challenges exist in terms of engaging executive management. "A risk framework may be designed to the point of excellence and sought to be implemented vertically and perhaps horizontally across an organisation, but challenges remain for those who must follow and report upwards on such models. Chief executives lack understanding of risk management and they do not prioritise it," he said.

Talent and resource scarcity

The discussion moved on to the main risks affecting businesses in the GCC. Talent acquisition and resource scarcity are two of the biggest challenges for the region.

GCC states rely heavily on expatriates. Indeed, in 2011, most people in the UAE and Qatar were foreigners (87% and 84% respectively, according to a study by the Kuwaiti-based think tank Diplomatic Centre).

With $1trn worth of construction projects, competition for skilled migrants and materials is fierce. "The scale and pace of developments within the GCC are a catalyst for risk," Wood said. "The region is undergoing so much development and there are many major construction projects, that the availability of resources is scarce and the increased interface risk must also be carefully managed to avoid potential delays/bottlenecks. Companies are competing for skilled staff and materials such as steel and cement."

Desitter added: "One way to improve talent retention is to offer attractive terms and conditions, but this can only go so far. Other limits make talent acquisition and retention ever more challenging.

"Take for instance, the numerous rail projects planned across the GCC – a metro network is being built in Doha and an even larger network in Riyadh, Saudi Arabia.

"There are limits in terms of the pool of skilled workers who have the knowledge, skills and experience to do the job across the world. Then, there are limits in terms of the number of skilled staff willing to leave their home town and set up base in a foreign country to take the job. So, businesses are competing for a limited pool of talent."

Nonetheless, the panel concluded on an optimistic note. Although risk management is less mature than in Europe, the US and parts of Asia, risk appetite is healthy. As Wood said when he opened the debate: "Businesses and their employees are on a journey." That begins with the basic building blocks of risk awareness, risk culture and risk management.

(Continued from page 1)

state and airline. During initial examination, no one can obtain a medical certificate who has a medical history or clinical diagnosis of any psychiatric or psychological condition likely to interfere with the safe exercise of the pilot's functions. During periodic revalidation (at least once a year) the approved medical examiner must also assess the pilot's psychiatric and psychological status to maintain the needed level of psychiatric and psychological quality to exercise the profession.

These psychiatric or psychological tests are carried out by independent specialised aero-medical examiners approved by the member states. Airlines are required to check the validity of their pilots' aeromedical certificates before assigning them to flying duties. Every pilot is obliged to refrain from taking flight duty if they feel unfit to fly.

Throughout a pilot's airline career proficiency checks take place to verify competency. These checks are normally performed twice a year in a simulator, including situations where the pilot's ability to cope under stress is tested.

3. Pilot background checks

European Aviation Security Regulations require that crew members of an EU air carrier are subject to background checks before being issued with a crew identification card. Such background checks include verification of the person's criminal and employment record. The checks are required to be repeated at regular intervals not exceeding five years.

4. Safety and security rules for the cockpit door of airliners

European safety regulations, based on global standards set by the International Civil Aviation Organisation require that all aircrafts above a certain weight carrying out commercial air transport operations must be equipped with a flight deck door. This door must be designed so that it can be locked and unlocked from either pilot seat in the flight deck, to prevent unlawful access. The aircraft involved in the accident on 24 March was covered by these regulations on the flight deck door as well as by the operator's approved security procedures.

Airlines must have operational procedures in relation to the Regulation on the Flight Deck Door. These procedures include access to the flight deck under normal and emergency conditions.

A regulation mandates that pilots must have a current medical certificate

In Europe, the standard procedure is that the cockpit is monitored from the pilot's seat by CCTV to monitor the area outside the cockpit. In some cases, there is a spyhole and not a CCTV monitor. A procedure ensures that another crew member should enter the cockpit in case one pilot leaves the station. This procedure was put in place for the purpose of monitoring the cockpit door so that the remaining pilot can remain in their seat at the controls of the aircraft.

5. How are investigations of air crashes in the EU being carried out?

The causes need to be established through an independent and credible civil investigation conducted in line with European rules (Regulation 996/2010).

After fatal civil aviation accidents, generally two separate investigations need to be closely co-ordinated since they share the same evidence:

An accident (or safety) investigation is conducted by the national accident investigation authority in accordance with European rules; and a judicial/criminal investigation is opened with the aim of compensating victims and punishing wrongdoers.

The safety recommendations resulting from an accident should be considered by the competent authority and, as appropriate, acted on to ensure adequate prevention of accidents and incidents in civil aviation.

Often such recommendations are addressed to the European Aviation Safety Agency (EASA), which takes the necessary action to address the safety issues. Where urgent action is needed, measures are taken even before the investigation is completed.

6. The investigation of the crash of Flight 4U 9525

In accordance with the European Union Rules (Regulation (EU) No 996/2010 on the investigation and prevention of accidents and incidents in civil aviation) the French authorities (BEA - *Bureau d'Enquêtes et d'Analyses pour la sécurité de l'aviation civile*) initiated a safety investigation.

The BEA leads the investigation, as the accident took place on French territory (France is also the state of design and the manufacturer). Germany is entitled to participate in the accident/incident investigation, as the country of registration of the aircraft and the home country of the operator. EASA, the certifying authority of the Airbus A320, has the possibility to send an advisor to assist in the investigation and has done so.

(Continued from page 1)

value of ERM] and that taking an enterprise-wide approach will be achieved through people and not procedures. Procedures underpin what people believe," he says.

Livsey says establishing standards for professional risk managers could help enhance ERM. The institute will launch a certification scheme in the coming months that will include standards of practice, behaviour and a code of ethics, using a framework that benchmarks risk competence and includes qualifications and continuing professional development.

The IRM's plans pit it against FERMA, which is also aiming to launch a certification programme this year. FERMA's European certification programme of competence for risk managers will offer risk managers the opportunity to earn a European Certified Risk Manager certificate.

Collaborative approach

Livsey says the similarities between the programmes reflect a need to enhance the professional recognition of risk management and raise standards of practice and training. Moreover, he says there should be a collaborative approach between organisations in the risk management community.

"There will be offers from us to collaborate with organisations doing similar things," he says.

"There is a need for the risk management community to work together. We are all going in the same direction and collaboration will avoid any confusion, augment what we are doing and help us all reach our goals faster."

Whether Livsey's appointment ushers in a more united approach, his enthusiasm for ERM and enhancing professional recognition for risk managers is likely to add verve to discussions among the risk management community.

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