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Terrorism and Political Risk // July 2015

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First line of defence



Sophie Roberts
Deputy Editor
Insurance Day

The devastating impact of terrorism has never been a stranger to societies around the world. From the small, unsophisticated attack to the large-scale atrocity, the world has borne witness to the effects a single event can have on both an economy and the people.

The insurance industry has always held a strong foothold in this space, demonstrating its resilience and ability to absorb the exposures associated with terrorism and political risk. From historic events such as the attack on the Twin Towers in New York in September 11, 2001 and the recently remembered bombings in London on July 7, 2005, to the events in Paris and Tunisia, the industry has proven itself to be a pillar of strength in the aftermath of an attack.

The current threat means the demand for terrorism and political violence cover is unlikely to diminish any time soon and both the private standalone terrorism market and government-sponsored schemes, such as Pool Re, will continue to develop to reflect the risk.

During the panel discussion, for instance, Paul Howe from the National Counter-

Terrorism Security Office (Nactso) revealed that from October businesses that put in place mitigation measures and security improvements to protect public sites and venues from terrorist attack under the government's Crowded Places programme, will have the chance to apply for a loss mitigation credit on their Pool Re terrorism insurance rate.

This measure was regarded as a positive step amongst the audience to encourage risk mitigation and demand, rather simply the reactive purchasing in response to events that has been seen at present.

The abundance of capacity in the market was not overlooked either, with panellists suggesting that a catastrophe bond covering this peril is within the realm of possibility.

There are emerging threats the industry needs to consider. Chief executive of Pool Re, Julian Enoizi is deeply concerned by the threat of cyber terrorism and calls for better modelling techniques in order to gain a better grip on how to view and handle this risk.

The following pages will provide some insight into some of these themes. We live in treacherous times, where our attackers are becoming increasingly more sophisticated in their assaults, opening the doors to new strands of terrorism. Is there more the re/insurance industry needs to do? Yes, but as the discussion showed, progress is being made. The insurance market will continue to prove itself as part of the shield against this threat.

Insurance Day, Christchurch Court, 10-15 Newgate Street, London, EC1A 7HD

Editor: **Michael Faulkner**
+44 (0)20 7017 7084
michael.faulkner@informa.com

Editor, news services:
Scott Vincent
+44 (0)20 7017 4131
scott.vincent@informa.com

Deputy editor:
Sophie Roberts
+44 (0)20 7551 9906
sophie.roberts@informa.com

Global markets editor:
Graham Village
+44 (0)20 7017 4020
graham.village@informa.com

Global markets editor:
Rasaad Jamie
+44 (0)20 7017 4103
rasaad.jamie@informa.com

Reporter:
Alexis Burris
+44 (0)20 7017 4252

Publisher:
Karen Beynon
+44 (0)20 8447 6953

Advertising director:
Andrew Stone
+44 (0)20 7017 4027

Sponsorship manager:
Marcus Lochner
+44 (0)20 7017 6109

Marketing manager:
Sally Rodwell
+44 (0)20 3377 3633

Subscriptions key account manager:
Carl Josey
+44 (0)20 7017 7952

Head of production:
Liz Lewis
+44 (0)20 7017 7389

Production editor:
Toby Huntington
+44 (0)20 7017 5705

Subeditor:
Jessica Sewell
+44 (0)20 7017 5161

Events manager:
Natalia Kay
+44 (0)20 7017 5173

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A Macro View

John Raines, IHS



At IHS we are concerned about certain regions in the world and a little bit less concerned about others. Some of the areas that we're particularly concerned about include Central Africa, West Africa, and Eastern Europe with the situation in Ukraine and Russia.

We are a little bit more positive as far as what's happening in East Asia, specifically with the lower oil prices, and some of those countries out there being able to alleviate some of their fuel subsidy problems.

Right now when it comes to Russia I think the primary thing that we are looking at is a frozen conflict. We are not seeing the situation get alleviated but the good thing is, it is not getting much worse at the current time. We are certainly concerned about certain activities that are occurring in Eastern Ukraine, specifically with the possible advancement of Moscow and some of the operations that they are conducting there, but overall we do not see sanctions getting worse at the present time. But we don't necessarily see them getting better between now and 2016.

The big thing that we are worried about as far as Russia is the possibility of political risk leading to political instability and the possibility of civil unrest as we go forward. Russia has really been hit

with a quadruple whammy: the lower oil prices, the sanctions, lower corporate earnings and of course the devaluation of currency, incurring additional inflation inside that economy.

What has ended up happening is that we are starting to see a more and more disgruntled Russian public, not necessarily specifically with Vladimir Putin himself, but the government at this point only has a popularity rating between 40% and 45%. It could be that Medvedev is on the way out. If this were to occur this could cause some instability with government contracts that are going on inside Russia at this point, also the policy going forward as far as labour reforms, fiscal reforms, also might be put on the backburner as Russia deals with some of its internal political instability. Especially within the Kremlin as you have those two groups vying for power, those that are associated with the intelligence service and also those that are associated with the liberals.

Asia

In contrast to East Asia, another area about which we are concerned is the instability inside Central Asia. We are starting to see migrants having to return to Central Asia either because of the lack of jobs or because of stricter regulations

in respect to immigration. This could cause instability inside Azerbaijan, Tajikistan and even Turkmenistan which have relatively safe regimes. However, as we see a flow of migrants going back, there is going to be additional stresses on social services in those areas. There is also the reduction in remittances to those locations which could cause some instability issues going forward.

Africa

We are really concerned there about the possibility of issues arising from the Buhari administration in Nigeria. There have been a lot of positives as far as his first few weeks have gone and especially during the election campaign, specifically regarding corruption, but what we are concerned about surrounding Buhari is whether he is going to be able to keep his coalition together, specifically between the northerners and southerners, and we're already starting to see a break.

This could cause massive instability inside the country and also of course political instability as far as policy security is concerned. This has specifically been seen in his promises to announce a cabinet with officials that were not tainted by corruption, which has apparently been a lot more difficult to do than he initially hoped. It was one of his campaign promises that within one week of becoming inaugurated the cabinet would be announced.

If this split were to continue we can see further delay as far as the petroleum bill is concerned which has been in the process of creation for several years, and on top of that the threat to fiscal reforms, and labour reforms. If his coalition really falls apart and he really goes on an anti-corruption drive, there is a possibility that he will face impeachment in the future. Remember they only need two-thirds of votes and again if he really goes after enough individuals he's going to have a very disgruntled elite going after him in a big way. This is very similar to what happened to him in his first administration.

UK Terrorism Risk

Julian Enoizi, Pool Re



Pool Re was set up 22 years ago to mitigate against the threat of the time – the IRA. Twenty two years later you have a very different environment. We went through a major renegotiation of our mandate with the government last year. There is also a very different insurance environment, 22 years ago there was just one enemy, the IRA, today there are 18 / 20 odd different terrorist groups all with a very different aim.

What we have been trying to do is to shape Pool Re away from being a simple re/insurer into more of a thought leader, a conduit for the industry, for information to flow to the industry, risk management and modelling information. Really we are moving more to the mitigation side and changing the behaviour of buyers of insurance to build their resilience.

We are working with the NaCTSO on an initiative to change the behaviour and build resilience in the nation.

There is a perception that the risk is in London alone and this is not the case. We have been trying to change the buying pattern so that people outside London also purchase the cover. The modernisation that we have gone through is really to improve the understanding of that risk and expand

it further into the regions, to get more people to buy cover which is an original principle of both Pool Re, but also of insurance.

One of the things we've invested a lot of time in is modelling. We have spent a lot of time in modelling both conventional terrorism, 2D and 3D but then also specific modelling for CBRN and to really understand what the exposure is there and I think that kind of information is something we want to disseminate out into industry, precisely to get more players to start playing in this space.

It is important to have a commercial market writing terrorism cover in an orderly fashion, otherwise what you will end up with is a market that will disappear after the first event. If you read the press they will say it's all now about Charlie Hebdo / Lindt Cafe type events, and that there are no more attempts at creating a marquee type event. I don't know how they know that. The reality is we don't know and the point of Pool Re is to be there to ensure that the economy can continue the day after a loss and I think that rationale remains extant.

In terms of take-up of insurance, I can tell you Pool Re's premium has stayed fairly stable over the last five / six years,

ticked up in the first quarter, possibly in reaction to the Charlie Hebdo and Lindt Cafe events. If you look at the Australian market they have seen a huge spike in the take-up of terrorism insurance post-Lindt Cafe.

In terms of insurance – Pool Re versus the commercial market – there are advantages and disadvantages to both. With the Pool you get the broadest type of cover, whereas with the standalone market you have the ability to purchase cover for just the assets you want to insure. People have different priorities.

The future

For me, cyber terrorism is clearly the big issue. What is going to happen about cyber, and I do not think there's any particular lexicon where we all understand the same thing by cyber risk, so I'm going to talk just about cyber terrorism. I don't even think the Marsh Report that was published earlier this year and was a good report, really answered the question. I think that question is still out there.

I think Pool Re has to play a part in figuring out what the industry is going to do about cyber terrorism and then figure out later on what happens with cyber. I think the government is at the moment saying it wants no part of it but ultimately I think it is going to have to engage in a debate about this subject.

If you want to have a commercial market both in cyber or terrorism you are going to have to have better modelling techniques and I think those modelling techniques are getting better and better the whole time. I was up at Cranfield University a couple of weeks ago and they are continuing to evolve their modelling techniques, but there's still a long way to go and of course the problem with anything, cyber or terrorism, is that you just don't have one element of the equation being probability, and for pricing, that is the real problem.



The Panel



Paul Howell
NaCTSO (National Counter
Terrorism Security Office)
A Different Way of Doing
Counterterrorism Business



Luke Norman
NIIT Technologies
The Technology Effect



John Raines
IHS
A Macro View



Julian Enoizi
Pool Re
UK Terrorism Risk



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Bringing a Fresh Pair
of Eyes



A Different Way of Doing Counterterrorism Business

Paul Howell, NaCTSO (National Counter Terrorism Security Office)



The government in 2013 did a stock take and looked at how they were doing business and they realised there were some gaps in terms of service delivery. As a result of that, the Office for Security and Counter Terrorism (OSCT) a department within the Home Office commissioned my unit to look at a different way of doing business.

We created a new approach which prioritised looking at tiered sites, with the government seeking to promote security at sites with particular cultural, historical, economic or national significance.

The threat and what we were trying to look at and model was around six attack types. It is not just about the low sophistication-type attacks, this is also about the desire for the big event, which has not gone away.

At the National Counter Terrorism Security Office (NaCTSO), following that review and following the support and advice from government departments, we looked at a proactive way of national counter terrorism policing engaging

with site owner/operators across the UK, offering bespoke comprehensive site assessments.

A hundred and seventy highly trained Counter Terrorism Security Advisors (CTSA) are out engaging with some high-end businesses across the UK, looking at how they could better protect against those six attack types and the wider methodology as it changes to promote a wider range of protective security options.

Interestingly it also assisted boards in making judgements based on where they spend, both on insurance and on protective security regimes.

This is not just about the big and shiny, this is about policy, this is about process, this is about training, this is about ownership, things that do not cost money.

We have some very big players involved with this who have taken this on board. This has been rolling for 12 months and there has been some significant take-up. We cover shopping centres, entertainment and leisure,

visitor attractions, sports stadiums, religious sites, health, education, hotels and wider commercial centres, as well as mixed use centres of residential, office and retail.

Where does insurance come into play

Last year, I approached Pool Re with some of the feedback from some of our big players. They wanted to know, if they are doing all of this risk management, where is their reduction in premium which should come with this?

The work we are doing clearly represents a better rated risk for the underwriter. The underwriter is able to look at the work that's been done before the risk even comes to them which is nationally consistent, Home Office supported and has got compliance that sits around it. The figures are also reported into the Home Office. We have got blue chip companies that have bought into the process, suggesting the issues around loss mitigation credit is clearly an issue for them.

Pool Re agreed, and critically there's now 2.5% loss mitigation credit that Pool Re will apply to its members for locations that are adopting the Protective Security Improvement Activity (PSIA). This will then become live on 1st October at renewals for clients who would look to benefit and capitalise on the PSIA and what that actually means to them.

The Technology Effect

Luke Norman, NIIT Technologies



The first challenge that we see a lot from the customers that we engage with is around having a detailed understanding of what “blast zone” exposures people are exposed to at the point of underwriting. Increasing competitive pressures and lower prices are affecting underwriters and it seems like the speed of response to a broker is becoming an important differentiating factor.

Insurers need to be able to do the analysis that they want to do very quickly at the point of underwriting and what we have seen is that traditionally, the tools that are available to do this have been very much geared at cat modelling teams. They have been specialist tools that require specialist knowledge and skills to run those tools and they are not the kind of aimed at underwriting teams themselves.

What we have seen is a number of tools being developed which have looked to fill that gap, so targeting specifically the underwriting teams to help them with that piece of analysis.

I know in terms of our product Exact, we spend a lot of time working with terrorism underwriting teams to work out what information they need at the point of underwriting, what is the best way to

visualise this and how can we make that as quick and easy to use as possible; as opposed to passing it off to a specialist cat modelling team which would introduce a delay in that process.

I think the other side of that challenge in terms of providing this information at the point of underwriting is the need to have accurate information; so there is a clash potentially between doing something quickly and doing something to the level of detail that you would want to be able to do. Historically, some of the systems that are available in this area have had limitations in terms of how accurately they are able to model risk.

On one side you have the probabilistic systems which would provide a very detailed understanding or attempt to give a very detailed scientific understanding of what the effects of an event, for example, a blast zone or a chemical attack, might be. They are very much reliant on having a large set of data available, so knowing what kind of attack it would be, knowing what kind of buildings are in that area, and what that has meant is that that kind of analysis cannot be done everywhere in the world. There would be geographical limitations and therefore from an underwriting perspective it is difficult to understand

the risk fully if all of your exposures are covered by those types of analysis.

On the other hand we see other kinds of techniques which are very commonly used to manage blast zone exposures, so things like grid based analysis or spider based analysis in order to calculate what the largest blast zone would be, but both of those types also have their limitations. Because there is a certain threshold of the spacing between risks in a spider analysis, there is always a chance that exposures are larger than the ones which are known, hidden within that portfolio of risks. So in terms of the regulatory requirement which says underwriters need to report their exposures to their management, to reinsurers, to regulators, this is obviously a concern.

From our perspective, we have put a lot of work in to understanding how these can be managed in a better way and we have developed an algorithm which identifies the precise location of a blast zone which would cause the biggest loss, and this is something which would run around the world. Therefore there are no gaps in geographical coverage and it also can run quickly enough that it can be done pre-underwriting, so essentially the underwriting team would know the precise impact of a new piece of business on their exposures, before underwriting.

What we also see across the board are challenges in terms of getting an enterprise level view of risk. That could be multiple offices around the world writing terrorism business which is geo-located in similar territories other offices are writing business and there could be clashes in that way. So we see a real demand to actually have a system which will bring all of that together and manage it consistently across the world so that management are able to monitor this and so that people understand pre-underwriting if what they are writing clashes with something being written by another office around the world.

Bringing a Fresh Pair of Eyes

James Watt, The Ambassador Partnership



At The Ambassador Partnership we focus on political risk, trying to enhance the ability of our clients to make political risk judgements and get it right. We are a partnership of recently retired British ambassadors who have between us got worldwide experience and have spent all our careers developing the finer arts of political analysis and judgement. We feel that we bring something unique to the mix that is available to the insurance industry.

We feel that the major due diligence reports which are carried out, quite rightly, often come out drawing on a wide variety of economic and political factors. We believe they have got a value, a great value, as a base plate. But we often feel that they have certain limitations which need to be counterbalanced by a more precise and direct knowledge.

We find that the major reporting tends to be a little bit cautious, a little bit “fudging” of its judgements. Also because they take so long to prepare and have to stand for some time they can sometimes be slightly out-of-date when decision makers actually turn to them for some consultation. I have also personally found that sometimes they are significantly off beam.

The dynamics of many of the risk situations in the world are getting

complex, with a lot of negatives, and a lot of positives. They are going faster than before, they are much more complex. When you think the entire intelligence and foreign policy establishments in the western world were caught off balance by the sudden breakout of ISIS just over a year ago, and how much that has changed a lot of the strategic look of the new Middle East, I think that is an example of just how risky it is. I think all of us need to draw both on the systematic analysis but also on the fine judgement that we are at our partnership feel we can provide.

Existing risks

The second thing that we would like to do is to help the industry manage risk once already taken on the risk. Clients usually turn to us when things have begun to go wrong. But it always helps if we are brought in in reasonable time and have a chance of preventing the situation going over the edge.

Often the problem has been tackled first through legal channels, or rather the clients believe that they have a real option of going down the path of arbitral litigation, and it is rare for either party to relish this prospect which causes bad feeling, a loss of reputation and which is expensive, slow and uncertain in its outcome.

I am talking here mostly of those countries in which the mechanisms of government are weak or the state itself is seriously dysfunctional. I was ambassador in Egypt up until a year ago, and the chances of an outside party getting enforcement of a judgement, even if it got a favourable one, are poor. That is where we feel, as the Ambassadors Partnership, we can come in to provide a discreet, direct, personal negotiation facility which bypasses the formal dispute mechanisms which aims to restore trust and a win-win situation.

The third area in which we offer ourselves as experts is in maximising the recovery post-event. Post-event is a nice euphemism of course for when you've had a setback, a major setback, which typically in insurance terms means paying out a large claim. We can bring the same skills to apply to recovering from such a setback.

As you know the story does not end with the payment of the claim: there is the recovery of the claim from the party that caused the problem, related contractual disputes, entangling the investor or exporter in domestic courts, and questions about the disposal of remaining assets. The reputation of the party often, in the cases I am talking about, is the other government, the foreign government whose agencies or state corporations have caused the problem. They do, despite being rather intransigent in their approach, have a reputation due to safeguarding or salvaging credit ratings and that is something that we can work on and leverage and a deal can be done.

Therefore we believe that we can add additional negotiating firepower to any company or group trying to recover a claim and we bring expertise. We also bring a fresh pair of eyes and can play a trusted role in rebuilding the confidence between the two parties and this can be a vital extra resource for senior management tackling these problems.

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NIIT were delighted to host this breakfast briefing with Insurance Day. It was a terrific opportunity to engage with the market on the constantly changing face of risk management. The topic is clearly a high priority for insurers, and at NIIT Technologies we are working to bring together the diverse range of views and to converge them into actionable themes that can help prepare the market to deal with it better.

There is an increasing complexity in the terrorist and political risks that are being covered. The pace at which this change is happening is very high. This was highlighted by the diverse geographical spread of risks that got discussed in the event, and the emergence of threats such as ISIS which would not have been considered a year ago. Not only is this going to continue to evolve, but new emerging risks such as cyber terrorism are likely to force all of us to re-evaluate our risk exposure and hence options. What the industry needs more than anything else, in order to keep pace with this level of change, is agility and flexibility.

On the subject of terrorism it is clear that an apparent shift to less sophisticated attacks has not led to a reduction in the likelihood of a larger, more widespread, planned event. Practices need to be put in place to ensure that companies are advised on how best to protect against different kinds of terrorism. It is equally important that the insurance industry as a whole is able to work with the insureds to improve risk mitigation strategies. The premiums that are charged for insurance and re-insurance need to consider one's preparedness towards terror attacks, or the lack of it.

Historically it is a large loss that forces people and businesses to improve how they manage risk, but I believe it is important that the market is pro-active in identifying methods of risk mitigation and not end up reacting to severe losses. Sound risk management practices are key in building the resilience needed to allow insurers to survive large losses. There are many examples of how insurers have been able to endure monumental disasters due to the quality of their risk management practices. We can't afford to ignore the challenge that new risks pose to the industry as a whole and it is essential to gather as a community and drive forward solid risk management practices.

**Atul Sharma - Senior Vice President and BU Head,
NIIT Insurance Technologies Ltd**

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