

LUGANO 2007

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JARDINE LLOYD THOMPSON
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JARDINE LLOYD THOMPSON
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Introduction

Our appreciation goes to our key CommTech Partners, panellists and participants who have made this Forum such a big success for the 4th year running. Their input from the planning stages of the event to their active participation in debates and discussions have proven that dialogue and open debate are possible between all parties from corporates to insurers to advisers.

In this publication you will find a selection of articles from some of the experts present at the Forum, providing a further insight into the issues raised as well as reports from some of the sessions held during the Forum.

While this publication focuses on some of the key topics, we will be holding smaller sessions throughout the year to go in-depth into issues and risks that are high on the risk management agenda of CommTech companies.

I look forward to welcoming you at future events.

Peter Hacker

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Current D&O issues in telecoms

By Kenneth McKenzie, Partner, Davies Arnold Cooper

For a couple of years now, the ever-competitive D&O market has been characterised by falling rates and widening coverage. Although there are suggestions that the softening is bottoming out, the volume and rate of regulatory change means the nature and extent of insurable exposures continues to expand.

Statistics say the volume of D&O claims settlements generally is falling; average settlement values, on the other hand, have been getting significantly higher, although the latest Towers Perrin report suggests they too are dropping slightly. Class actions are also down, although the class action warriors appear interested increasingly in non-US shareholders. Global comtech seems (temporarily?) to have ceded the unenvied top claims slot to pharmaceuticals.

New obligations for old equipment

But some old issues like Electric and Magnetic Fields (EMF) remain, and new ones keep arriving: the EU Waste Electrical and Electronic Equipment (WEEE) Directive, already partly in force, comes fully into effect in the UK in July. The Directive is one of a series of 'producer responsibility' Directives that makes producers of new equipment responsible for paying for the treatment and recycling of products at the end of their life. It affects any business that manufactures, brands, sells, imports, stores, treats or dismantles EEE within the EU. Producers and distributors of EEE must act now to ensure that they can comply with their obligations to reduce the amount of WEEE being disposed in landfills by promoting separate collection, treatment and recycling of WEEE from 1 July 2007.

A new theory is gaining currency that radiation given off by mobile phones and other hi-tech devices is decimating the bee population: it runs that radiation from mobile phones interferes with bees' navigation systems, depopulating and collapsing their hives with potentially catastrophic effects for natural pollination in agriculture. Some estimates have put the cost to the English economy at £1bn and significantly more in the US. Albert Einstein once said that if bees disappeared, "man would have only four years of life left"; the potential D&O claims pale by comparison.

Climate change

Climate change and environmental impact are on everyone's agenda, including the D&O market's. Insurers discern potential for directors' and officers' liability arising from climate change or other environmental issues, for example, if companies were financially affected as a result of emissions reduction issues. While environmental risks are commonly excluded from some aspects of D&O insurance, there are frequently carve-outs in respect of defence costs and, potentially, in the less restrictive context of Side A only covers. Some insurers are said to be introducing questions on climate change in renewals notices for directors' and officers' liability policies. Ultimately, the answers will be factored into levels of cover and costs of premium. The effect could be two fold - insurers hope that they can properly assess risk levels with this information; environmental groups see it as serving as an educational function and potentially acting as an incentive for corporate behavioural change. Will D&O buyers get what they need?

New reporting obligations

The EU Transparency Directive is one of the major measures in the EU's Financial Services Action Plan and sets out minimum requirements for producing periodic financial reports by issuers of securities traded on an EEA regulated market. These include a fair review of the issuer's business and the principal risks and uncertainties that it faces. There is now liability to pay compensation to an investor who has suffered loss as a result of any untrue or misleading statement in, or omission from, published periodic financial information where a director or senior executive at the issuer with responsibility for the published information knew the statement to be untrue or misleading, or was reckless as to whether the statement was untrue or misleading, or knew the omission to be a dishonest concealment of a material fact. Enacted in England as part of the Companies Act 2006, the directive is also recognised in changes to existing FSA disclosure rules to form the new Disclosure and Transparency Rules, along with some changes to the FSA's Listing Rules.

The Companies Act

Much has already been said about the Companies Act 2006 and we now have a timetable for implementation over the course of the next 18 months. Part 10, governing and codifying the director's duties, and Part 11, on derivative actions, mainly come into force on 1 October 2007. While the received wisdom is that major upsets are unlikely in D&O claims experience as a result (and the introduction of auditors' caps and electronic communication of company documents may yield more), only time will tell. The Act replaces many of the current common law and equitable rules and provides a statutory list of factors to be taken into account by Directors in the exercise of their duties, while extending the potential for derivative actions. Not all the language used in the Act mirrors existing case law, and inevitably some new ground will be broken.

Perennial issues arise from global policies - consistency of cover, insurability and eligibility of non-domestic insurers continue to cause problems, particularly in Latin American jurisdictions. Although in many cases the indemnity will still be payable, there may be sanctions imposed, including fines for the insurer (in the República Dominicana up to ten times premium).

Severability also tests the market's ingenuity in competing to find ways to protect the interests of a director innocent of another's non-disclosure under regimes which vary widely even in Europe. In the UK, until the Law Commissions' proposals are implemented, policy language alone will have to do the job.

Back to the future

Finally, back dated options, particularly popular in global com tech and telecoms, are not worrying D&O underwriters too much it seems, the risk seen as essentially that the director may have to discharge the profit. But what about defence costs? And the allegation of fraud cannot be ruled out in every case. Perhaps they are also comforted by what has come to be called the "apple rule" - that some people are just much more valuable to their company share price than a few back dated perks. One for Mr Spitzer?

It takes two or more to tango – Ways to resolve issues in placement and claims

By Paul Wordley, Neil Braakenburg and Alison Proctor, Holman Fenwick & Willan

Introduction

This article focuses on the issues debated in and arising from the Business Interruption and Interference Losses workshop at the Lugano Global Communications & Technology Forum 2007. The workshop was centred around information flows between insurers and the insured in both the placement and claims processes and in particular, insurers requirements and the insured's response. The discussion that took place was lively and at times heated.

Background

There are two key points at which the worlds of the technology and communication industry and the insurance industry come together. Like many relationships, the difficulties arise in trying to understand the reasonable needs of each other and naturally the relationship is tested by unforeseen events.

The communication and technology industry is relatively young, having evolved rapidly over the past 30 years. Although the insurance industry has evolved to meet the needs of the technological world, by the very nature and age of the insurance industry and the fact it can only respond to an insured's needs in a reactive way with new products and new systems, there is still some distance between the two.

In order to try to bridge that gap, it is necessary to consider the two key stages of the relationship between the insured and insurer in more detail. These are at placement of the risk and when a claim is made.

The relationship between the insured and the insurer is influenced by, among other things, market cycles in the insurance industry, meaning that a long term relationship is sometimes difficult to achieve.

Therefore the ability of the insurance industry to understand the subtleties and nuances of and changes to the insureds' industry is sometimes hampered. This issue is equally difficult given that within the insureds' own organisation, insurance and risk management is sometimes seen as a cost, in financial terms, with benefit only if the insureds' business suffers an insured loss. Increasingly however, corporate governance has placed a greater focus on sound risk management and risk transfer issues.

Placement

The understanding by the insurer of the requirements and the nature of the insured's industry and business should take place at inception of the relationship, at the time of placement of the risk and formulation of the insurance policy terms.

The insured, when placing his insurance programme in the insurance market, should ask a number of questions. What am I insuring against? How much cover do I need? How much of the risk am I prepared to bear myself? The role of the broker is crucial. The broker's role is to facilitate the communication of the, often esoteric, nature of the insureds' business, to the insurance market (albeit specialists in that sector) in a relatively short space of time.

Inherent frustrations exist in trying to ensure that the information from the insured (who is best placed to know their own business and under a legal obligation to disclose material information as part of the negotiation process) is communicated effectively to the insurer, and that the information requested by insurers accurately reflects insurers needs to understand the nature of the insureds' business and the risks within that business. On the other hand, insurers need to "fit" that information into their general methodology for analysing the risk, and to ensure that the nature and format of the information provided by the insured is acceptable to the reinsurance market, in the event of further risk transfer by insurers to reinsurers.

Often an insured wonders why he is being asked for so much information, especially when the insured does not consider it relevant or practical to provide it.

The information issue can lead to difficulties in establishing the correct risk profile for the insured and in turn might mean the policy terms, especially if the policy is a standard wording, do not accurately reflect the intentions, expectations and understanding of the parties. In an ideal world, bespoke policy wordings would be produced for each major placement – and increasingly major corporate insureds are recognising the need to have bespoke negotiated wordings - but due to time constraints and financial and reinsurance considerations, to name but a few issues, this is not always possible.

When the relationship is tested

The relationship between insurer and insured is inevitably tested when a claim is reported. This results in the insurance structure or architecture and policy terms governing that relationship being critically reviewed and the claim assessed against the background of what insurers have been told about the risk. Some of the key terms to consider in a claims scenario relate to the provision of information, claim notification, role of loss adjusters, proof of loss, limitation of actions, interim payments, warranties, conditions precedent to liability and so on. Few of these terms are focused upon at placement where the parties worry more about breadth of coverage and price.

Practical solutions

So how can the insured and the insurer best prepare themselves to maintain their relationship when the insured is demanding payment under the policy for a claim they consider to be covered? The starting point, as referred to above, is that the documentation is in place at inception and would ideally include a clear bespoke policy wording reflecting the understanding and intention of the insured and insurer regarding the terms of coverage.

In addition, the claims process can be facilitated by the insured and the insurer having a clear and binding agreement, in the form of a claims handling protocol, setting out in principal how claims, if they arise, are to be dealt with, including how disputes are resolved as they arise.

Maximising your insurance claim recovery - an action plan

By Michael Brown and Richard Farnhill, Allen & Overy LLP.

These two key factors, if in place, will greatly assist the insured and insurer / avoiding a polarisation of views and the adoption of a confrontational attitude regarding claims.

Although there is nothing to stop the insured and insurer from agreeing a claims handling protocol once a major loss has happened or is happening, this is often more difficult to achieve, with the insured in crisis management mode, with financial and operational pressures to mitigate loss and identify recoverable financial assets; whereas the insurer is potentially faced with a large initial claim estimate, limited and often fragmented or conflicting information regarding the claim and naturally feeling exposed by the claim situation, perhaps with reinsurance concerns as well. It is often during this period that the insured and insurers' positions become polarised and a confrontational approach is adopted. This is again often due to a lack of adequate or understandable information being made available to the insurer both at inception and in a claim scenario.

Claims preparation

It is increasingly recognised by insurers, and catered for in costs recovery provisions in the policy, that specialist claims professionals, including lawyers, acting for and assisting the insured, help facilitate the effective flow of information in a form understandable and expected by the insurance market. The effective flow of claims information between the insurer and insured reduces the risk of a polarisation of views, which can lead to an adversarial form of dispute resolution, significantly eroding the insured/insurer relationship envisaged at the beginning.

Conclusion

The relationship between insured and insurer is a contractual one, and the only way to ensure that each party gets what it wants, is to have clear, and ideally bespoke, terms reflecting each parties expectations. An insurer who knows and is familiar with the insured's business will assist information flow and in this regard, the role of the broker is key. In a claim scenario, the documentation put in place at inception will have a huge impact on the resolution of issues and smooth running of the claim process. A claims handling protocol that reduces the pressure and the importance of specialist claims consultants cannot be stressed enough. The key however, is the flow of information at all stages.

At the JLT CommTech conference in Lugano last April Allen & Overy ran a workshop with this title. We aimed to use our own experience representing insurance buyers with problem claims, and that of our panel, in helping the forum focus on some vital dos and don'ts that can have a major effect on the outcome of a difficult claim dispute.

We painted an E&O claim scenario that gave rise to a large, problematic liability claim; and used that example to focus the discussion around four topics. This article will summarise a few of the key issues that arose under each of those topic headings:

1. Identifying the need to notify an event

Circumstances that lead to liability claims and litigation often develop with a slow fuse, and do so within an operational unit rather than in the administrative centre of an organization: so it can be tricky, sitting in the centre, to spot that there is an issue that needs to be notified to your insurers on a timely basis so as to avoid the response that the notification has been made too late and in breach of a policy condition to notify "as soon as possible".

We called for a culture to be embedded into the organization at two levels: firstly in terms of involving line management in good coverage purchase decisions: to help decide what insurance was actually needed, and how it should be structured so as to be most useful in practice. This is crucial with such covers as E&O and technology rights protection covers, for example. Embedding this practice, and teach-ins associated with it, also increases consciousness of the availability and importance of the insurance programme to the operational unit itself, and hence joint ownership of the responsibility to identify possible problems to those who manage the programme and claims.

The second level of systems embedding that we discussed was one that ensured an active and regular line of communication between Group Legal and Group Insurance: ensuring that Group Legal was fully familiar with how the insurance programme operates, and was comfortable with the policy language generally, and the arrangements for notifying and handling insured liability claims in particular; and that there was a regular dialogue between the two over potentially insured matters and as to what information and documents (including privileged communications) could properly be shared with insurers.

2. Communications

This topic broke down into two elements: internal "home team" communications; and communication with insurers.

We felt it crucial that both internal communications and those with insurers needed to be carefully and centrally managed as soon as it was appreciated that the claim would be a large one or otherwise likely to be contentious. We have seen too many cases where an insured's claim has been damaged by well-intentioned but misguided communications and admissions.

Maintaining a dialogue with one's insurers during the course of a disputed claim is, of course, important, so long as it is handled sensitively, and coordinated to avoid giving mixed messages or inappropriate

disclosure of tactics or documents. To what extent can you afford to fall out with your insurer over this claim? Nor should you overlook to ask your insurer whether he has other experience of a similar third party claim and thus be able to offer expertise to the process of handling this claim. It is inevitable, however, that the nature of the relationship and future contact with insurers will be affected once an insurer has threatened to deny liability for the claim by reserving its rights – a step which too many insurers short-sightedly do at too early a stage, in our experience.

It is equally important to control the creation of a new paper trail – all of it liable to disclosure to the other side in the event that the claim becomes the subject of legal or arbitration proceedings. Sharing one's private views on weaknesses in one's case in e-mails can be extremely damaging when that e-mail chain has to be shared with the other side. Such e-mails etc may well have been created before the author realized that the problem had the potential to become litigious. Those messages, once written, cannot be unwritten and cannot be concealed from insurers in the event of a formal dispute resolution process. So the lawyers, in particular, have a responsibility to create an awareness of the dangers of inappropriate written communications: at Allen & Overy we give clients a simple message: If you don't have to write it down, DON'T; if you write it down, DON'T destroy it.

The lawyers also have important advice to give on what privileged communications can be shared with insurers: including legal advice on the third party claim you are facing. Insurers expect to see that advice; but their right to shelter under the principle of common interest privilege may be lost if insurers have reserved their right to deny the claim, and it may then be positively damaging to the insured's interest (and hence to his insurers' too) for privileged legal advice to be shared with insurers as it may open the third party claimant to demand to see that advice too. Where the third party litigation is happening in a different jurisdiction, with potentially different disclosure and privilege rules, one needs to be sensitive to the impact of those laws too. We strongly recommend that no policy claim should ever be pursued without legal advice after insurers have threatened to reserve their rights, or have done so.

3. Liability claim management

Plan first, act second; and plan for the long haul were the key messages.

Planning involves being predictive of how matters may develop so as to be able to influence events; capturing the core data necessary to quantify and prove one's loss; and being realistic as to the strengths and weaknesses of one's case after undertaking a thorough, independent, evidence-based, review. For example, if the third party claim has arisen from an alleged human error, think hard before penalising the individual(s) if you think they may become your most important witnesses in your insurance claim.

Get a well integrated team together at the outset with representation from the operating unit, Group Risk and Group Legal, and your broker or claim consultant and external legal resource expert in handling large, difficult policyholder claims. Share information and do so on the basis of advice on the protection of legal privilege in the communications between you.

Difficult insurance claims tend to have a complex underlying factual and valuation matrix behind them. Locating existing documentation necessary to evaluate the merits and quantum of the claim and for future disclosure purposes can be a major exercise in its own right. Law firms like Allen & Overy have excellent systems that record documents and allow them to be searched, and these are a very efficient way in which to manage large, document heavy, cases. Lack of data, inaccurate data and late data will all damage your claim.

There is often the potential for tension between the way in which you wish to handle the underlying claim and the constraints imposed on you by your policy obligations to keep insurers informed and involved (indeed you may have agreed to surrender the handling of the third party claim to them). Too often we find internal legal departments who first discover what those constraints are, and their implications, only when the problem claim arises!

4. Dispute resolution forum

The simple legal message from this part of the workshop was that the selection of the forum in which any formal dispute is resolved could significantly affect the result, and the cost of resolving the dispute. It is why some insurers like to take pre-emptive steps by, for example, seeking a declaration of non-liability in a jurisdiction that offers them the prospect of a more favourable outcome, despite that being perceived by their insureds as a very aggressive step that will harm whatever goodwill still exists between insured and insurer.

5. Endpiece

The overall message at the end – one based on ample experience of our firm as the leading adviser to policyholders with significant disputed claims – is that early identification of a claim that could become contentious, whether by reason of its size or complexity, or of valuing the claim, and the way in which the handling of that claim is then managed, can have a huge influence on the value of the claim recovery, and indeed on the relationship with the insurance market.

This brief article mentions just a few of a number of important issues raised during the course of the workshop. A fuller list of the example claim scenario discussed in the workshop and of the issues raised in the course of discussing it follows this article. Our grateful thanks go to Gerhard Nelke of Deutsche Telekom; Adrian Brennan from Echelon Claims Consultants Limited; and to Duncan Cornwall of Munich-American RiskPartners for participating as co-speakers in our workshop.

Allen & Overy is the leading UK law firm specialising in the representation of policyholders with large disputed claims.

Issues – claims identification

- What coverage is relevant? E & O? D & O? Products? Credit Insurance?
- Has operational management thought about insurance cover ahead of the problem arising and purchased appropriate insurance?
- Claim identification challenge starts at the underwriting stage: were the operating units engaged in the insurance purchase and scoping decisions to achieve “buy-in” and coverage understanding?
- Do you train operational management to a) spot possible insured claims / circumstances and b) tell the right people up the chain ?
- How will risk management learn of this problem - are people encouraged to report their mistakes, or punished for them?
- Do you (and they) know what the systems are for reporting potential claims, where to find them, and how robust they are?
- Do your group risk management and legal people work together effectively on the notification and handling of claims. If not what are you going to do about it?
- Have people bought in to the constraints imposed by insurance cover?
- Have group legal bought in to the third party claims information provision, claims handling and settlement provisions in your liability policies (and are those provisions appropriate) ?

Issues – communication

- Have management thought about notifying the claim?
- Is the risk management team aware of the issue?
- Are you talking to your insurers? When do you tell them? Who tells them?
- Can the insurer help you? Friends not foe.
- If it helps to bring in the insurer early, do internal structures and politics get in the way?
- What impact does a reservation of rights have? Communication may shut down in part due to concerns about loss of privilege.
- Keep up the communications flow with insurers, even if they have reserved rights or you may sue later; BUT beware loss of privilege after insurers have reserved rights

Issues – liability claim management

- Plan first – act second. Set your priorities for managing the issues at the outset.
- Be predictive. Early SWOT analysis of claim merits, claim value and claim recovery cost will influence all future conduct of the claim.
- What team do you need? What reporting lines? What is the claim management strategy?
- Who has ownership of the issue? Where does insurance fit into the thinking?
- Don't sweep it under the carpet. It won't go away.
- When do you tell the insurer how big the claim may really be? Will it match his reserves? The insurer will calculate quantum from the information he can get publicly – which may not be complete.
- Litigation with insureds holds no fear for insurers. Be realistic about your policy claim.
- Effective management of paper creation is crucial. If you don't have to write it down, DON'T. If you write it down DON'T destroy it. See Allen & Overy's Do's and Don't's guidance notes.
- Don't fall out with those employees who you may need as your key witnesses.
- Identify and preserve the existing evidence: is it essential for a realistic early evaluation of merits, for privilege reasons and for disclosure to insurers. This can be a major exercise. Lawyers have good systems to store and search documents.
- Prepare your systems before the crisis hits: early data capture and accurate information identification will also assist in quantifying your claim. Lack of data, inaccurate data and late data can cost you money.
- THE WAY YOU MANAGE THE PROCESS AT THE OUTSET CAN MAKE A HUGE DIFFERENCE TO THE RECOVERY YOU CAN MAKE.

Issues – forum

- What claims will I face? Where do I want to resolve them? Forum can affect prospects for recovery and claim value, which is why both insureds and insurers squabble over forum. Resolve the issue up front in the policy wording.
- Are insurer proceedings for declarations of non-liability out of favour? It is a very aggressive step that does nothing for the insurer/insured relationship.

Is the world going technology mad?

By Dan Silvey, Property Technical Manager, AXA Corporate Solutions

It's a question we must ask ourselves when we look - and listen - around us.

Advances in technology and nanotechnology have radically changed the way we work and play, from sophisticated IT systems in office or factory to mobile phones and iPods at home or while travelling. Indeed, the speed of advancement on many technical fronts is often mind-boggling.

Nowhere is this more evident than in the communications and telecommunications industry. The insurance industry, both underwriters and brokers, has a responsibility to keep pace with these changes, and to identify what might be emerging risks and persuade all the stakeholders involved to regard risk management as a key priority.

- Risks in cyberspace such as terrorism or a new virus hitting thousands of computer networks across the world is but one example of a fast-changing liability scene.
- Another major e-risk is attack by hackers. These malicious acts are increasing and becoming more complex, and in fact the ingenuity of some attacks is beating hi-tech security systems developed for the internet and websites.

This was the focus of a three-day seminar held recently in Lugano, Switzerland, on Global Communications & Technology, that addressed the 'risk realities of a digital age'. It was the fourth annual forum for risk managers arranged by Jardine Lloyd Thompson and focused on communications.

- One session was devoted to convergence and its implication on business continuity management, supply chain management and IT risks. The aim was to map the path from risk assessment to risk management. In other words, to provide a practical aid to help risk managers identify, audit and control their supply chain.
- Describing the sources of the supply chain, Dan Silvey, who is property technical manager at AXA Corporate Solutions UK, said the physical source was product supply - eg, mobile handset supply/network switchgear manufacturers, while the non-physical source comprised network service providers (eg, national telecoms companies) and services bought in.
- Giving examples of possible bottlenecks in the supply chain, he dealt first with handsets/switchgear: unique features or industry standard, lead times, and subscriber "churn" without the latest technology.
- Then, under national catastrophe perils, came vulnerability of supply, regionalised key components (for instance, semi-conductors from Taiwan), and insurers' accumulations which could lead to rationing of capacity by setting sub-limits.
- Other bottlenecks could involve network providers through: overhead cables (insurer treaty restrictions), underground cables (insurer accumulation to national telecoms provider), undersea cables/satellites (possible accumulation issues or treaty restrictions), and internet service provider (business continuity planning issues). Also, outsourcing of critical business functions, especially IT and call centres, to Europe and elsewhere, with the risk of reduced control.

- Discussing solutions for minimising or eliminating these risks in the supply chain, Silvey said that network providers could carry out surveys of critical third party sites. In the case of business continuity planning, these questions should be asked.
- Are alternative supplies available?
- Undertake an analysis of ability to re-route telecom/data facilities - ie, adequate capacity? and real-time information?
- Is there a risk management culture at the supplier?
- Are there favourable contractual conditions in the event of loss?

Moving on to catastrophe modelling, Silvey said there should be dialogue with insurers to map exposures as better information might result in higher limits. And as insurers and reinsurers now work to more sophisticated programmes of cover, precise information was critical to capacity.

Finally, as there could be different solutions for a different media "mix", there was a necessity to carry out individual assessments and audits.

Chris Rigby-Smith, from JLT, the following speaker in the session, also emphasised the rapidity of change, which meant ever more complex supply chains and the need to maintain an understanding of the interruption risk. Further, increasingly critical dependencies exacerbated the interruption risk.

- Another issue was today's increasingly competitive insurance marketplace. Assessing the risk values was imperative, he said, and he gave examples of checklists which could be used to identify special or critical locations in the supply chain. And on the matter of audits, assessing the compliance of critical suppliers with good practice in business continuity management was vital.
- The overriding message to emerge from this forum is that effective risk management planning is absolutely vital in any industry.
- Last year, the Lloyd's market teamed up with The Economist Intelligence Unit and carried out some extensive research on risk management, speaking to more than 100 business leaders throughout the world.
- The research established that the amount of time spent on risk management in the boardroom had risen four-fold in just three years.
- Distinctly encouraging, but it was also found that over half of companies had at least one 'near miss', that one in three companies suffered significant damage as a result of failure to manage risk, and that, despite last year's terrorist attacks, less than half of companies reassessed their risk management strategies, and for natural hazards it was less than a quarter.