StrategicRISK

Report 2011

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[May 2011]

Against all odds

From North African wars to cyber crime and recession-fuelled unrest on the streets of Europe, this report explores the top concerns of European risk managers

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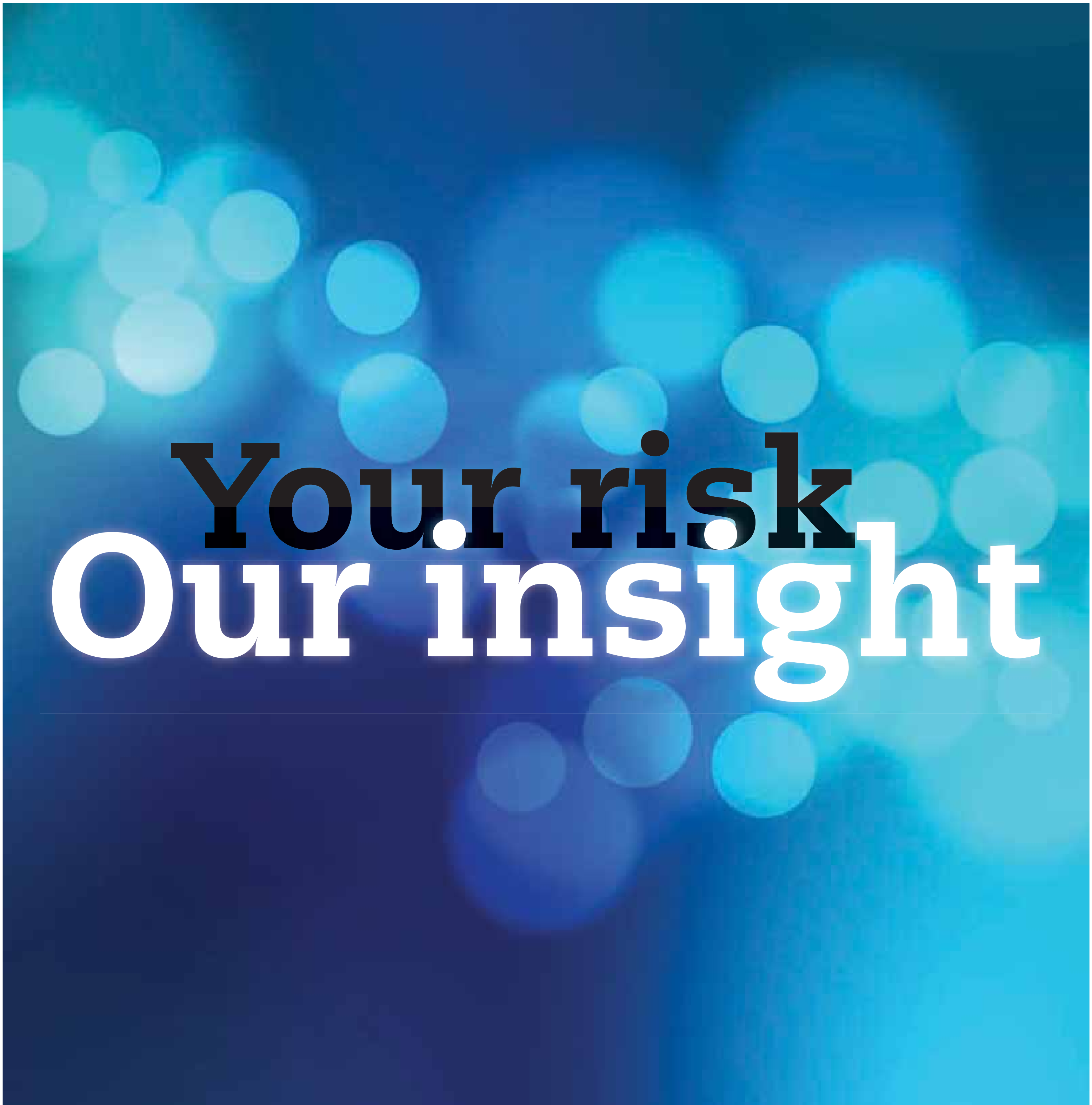
Your risk
Our insight

Foreword & Contents

WORLD OF UNCERTAINTY

From the protests in the Middle East to the rise of cyber crime and the continuing trials and tribulations of western economies, these are nothing if not interesting times. Over the next 20 pages, we analyse European companies' risk concerns in five key categories: economic, environmental, geopolitical, societal and technological

FOREWORD

Risk perception is often the most important factor in determining our priorities when dealing with risk. Our perception of risk is continually adjusted based on the information and impressions that we need to 'compute'. The availability and volume of information combined with increased global dependencies have taught us that a reactive approach to risk is not sufficient to guarantee continuity in an ever-more competitive corporate environment.

A consistent theme that is emerging is that addressing risk and understanding its impacts, both directly and indirectly, requires a comprehensive risk framework. This risk framework should be flexible, responsive and provide organisations with early visibility on both emerging and developing risks, enabling efficient and timely responses to managing them.

Organisations that invest in and adapt their risk frameworks to incorporate external threats and opportunities realise significant benefits and added value. Assessing the financial impact of singular or multi-risk scenarios is a skill embedded within the insurance industry. These quantitative needs have emerged more strongly in business risk-related issues as well.

This report identifies the risks in five categories that should be assessed as to their potential impact, namely: geopolitical, economic, environmental, technology and societal. Our comments on these categories are intended to create dialogue and challenge perception as a risk framework should be more that a set of procedures.

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Now we're all in it together

Research reveals that the interconnectivity of risk across the globe is a major challenge

KEY POINTS

01: Interconnectivity and unpredictability are the defining factors of risk.

02: Perception is reality. So geopolitical risks, which were at the forefront during the research for this report, figure highly.

03: Terrorism and pandemics were not among the top five risks.

04: Companies need to address the effects rather than the uncontrollable causes of risk.

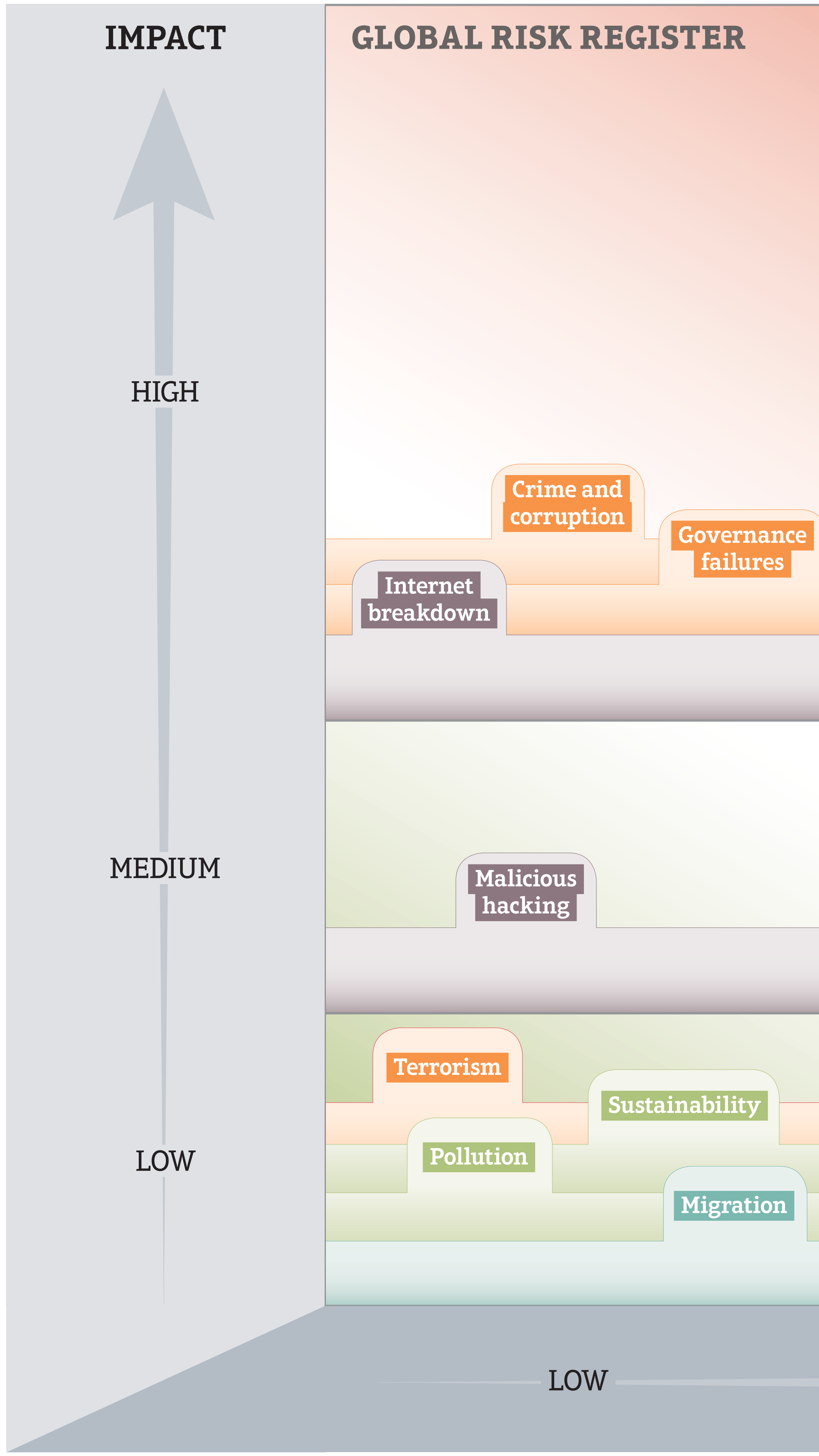
THIS REPORT SUMMARISES THE comments of 30 leading risk management professionals in European companies. While views on the different aspects of risk to some extent varied, reflecting different sector concerns, the single issue that all risk managers voiced, directly or indirectly, was the interconnectivity of risk and its unpredictability.

Just one example of this is the effects of last year's ash cloud resulting from the Icelandic volcano eruption. Companies that did not have suppliers in Iceland, and perhaps felt they had little or no exposure to natural catastrophes, suffered disruption in deliveries. As one risk manager said: "There seems to be an increase in one risk triggering another risk – and that's a risk in itself."

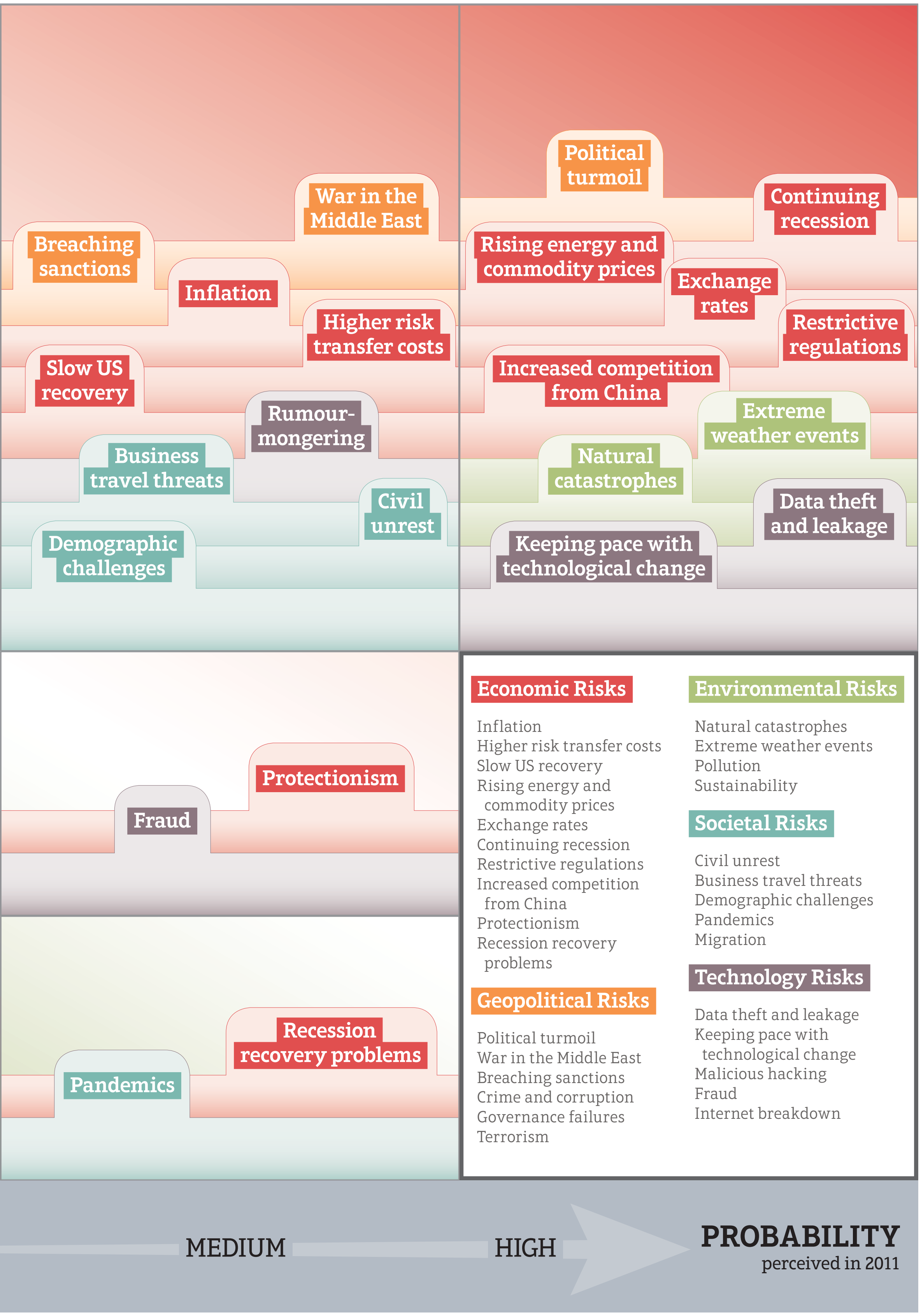
Another risk manager foresaw problems arising from the Australian floods. The company has no direct suppliers in Australia but the country does supply raw materials to some of its producers and the floods may well affect the availability of these.

Interconnectivity is probably most apparent in the economic risk spectrum. The 'butterfly effect' – that is, a small change in one place in a complex system that can have large effects elsewhere – has never been more apparent that in today's 'global village'. The financial markets are particularly interdependent.

Research for this report was undertaken in the first three months of 2011. It was a period when unforeseen political turmoil in some countries was very much to the



KNOWLEDGE Butterfly effect
A small change in one place in a complex system can have large effects elsewhere.



forefront of everyone's minds so, not surprisingly, geopolitical risks shared first place with economic risks in European companies' concerns. However, if comment had been sought six months earlier, it seems likely that economic recession in Europe would have headed the list.

Similarly, research was just coming to a close when the horrific Japanese earthquake and tsunami struck. Would risk managers have rated the impact of natural catastrophes higher in the risk league if the research had been concluded a month later?

It is natural for commentators to react more strongly to the issues of the moment. In this regard, it is interesting to see that terrorism and pandemics were not among the top five risks – although governments and health organisations would probably rate them much higher.

It is clear from this research that companies need to address the effects rather than the unpredictable and often uncontrollable causes of risk. For example, risk management of supply chain disruption – a major risk for most companies – needs to be robust however that disruption is caused. Companies need to be able to repatriate employees quickly and safely regardless of where in the world problems may arise.

How has today's risk environment affected the role of risk managers? Some of our commentators volunteered views. "The good news for risk management is that its relative importance in the eyes of the board has increased" was one comment.

Another respondent stressed that risk managers cannot afford to operate in silos. "We have to help our business managers think more about what the knock-on effect might be of their actions and decisions, how things may happen in conjunction with other risks the company may be running and the ultimate major impact that might result – without getting in the way of the company's ability to do business."

Sue Copeman, editor-in-chief, StrategicRISK, and Rob de Jonge, EMEA leader of Marsh Risk Consulting

"Companies need to address the effects rather than the causes of risk."

The top 10 risks

SECURITY OF IT SYSTEMS

Fraud and malicious hacking attacks are bringing into question the security of companies' – and governments' – IT systems.

Some companies believe that IT risks and the best way to address them are not generally understood by businesses, or even the consultants they employ.

>> see Technology Risks pages 19-20

REGULATION

Regulation in one form or another is a key risk issue for many European companies.

With risk managers often overseeing or directly involved in risk transfer, the impact of the pending European regulation for insurers – Solvency II – was a particular issue of concern.

Companies are concerned about the impact of the insurance regulation Solvency II, with the anticipated requirement for them to provide more information on exposures, with potential confidentiality issues. A more cautious attitude from insurers, promoted by the regulation, could stifle business innovation.

The UK Bribery Act is a concern for British businesses who feel it may place constraints on them that will impair their competitiveness.

Additional EU regulations are likely to be regarded as something of a threat and constraint for European businesses, as well as probably adding to their costs.

Multinationals are concerned about regulatory differences in the countries in which they operate. A mismatch between European and national regulations can mean that they have to approach the risk on two different levels.

>> see Geopolitical Risks pages 9-12

ECONOMIC RECESSION AND RECOVERY

With economic recovery slow or negligible in many countries, companies are concerned about the possibility of double dip recession, putting additional strain on their financial wellbeing as well as their customers and suppliers.

Some suppliers have been severely weakened during the recession. Companies need to review their understanding of the risk in their supply chain.

Large international conglomerates have been able to counter problems from European and US recession to some extent by diversification into emerging growth markets.

Slowing down of China's economic growth is not seen as a key issue but the country's evolution into a global competitor in some industries does present a challenge.

US economic recovery is an important factor for European business in general.

A slowing of the global economy in the next 12 months could ultimately result in political issues in some areas like Europe.

European companies that have downsized in the recession need to be able to gear up resources quickly to benefit from economic recovery. Higher interest rates and inflation would impede some companies' ability to invest and grow.

>> see Economic Risks pages 6-8

EXCHANGE RATES

Currency exchange rates are a big concern for many European companies, particularly in respect of the euro and the dollar. They are understandably concerned about the perceived weakness in both.

>> see Economic Risks pages 6-8

POLITICAL TURMOIL

Political turmoil in North Africa and the Middle East has directly affected European companies with operations, outlets or suppliers in the countries concerned. Other countries fear indirect impact, particularly if unrest in the Middle East results in higher energy prices.

Companies with projects or service contracts in affected countries fear that these will be jeopardised by new political regimes or that terms will change. Safeguarding their people in these markets is a key concern.

Indirect effects perceived by some European companies include possibly adverse impact on their exports to these countries and a reduced number of business and private travellers to the areas.

Companies that derive a significant part of their income from investment have some exposure to political changes since many of the companies they invest in may face business disruption.

>> see Geopolitical Risks pages 9-12

DATA THEFT AND LEAKAGE

Data theft is a growing risk, both in terms of sensitive customer information and intellectual property.

Leakage of confidential data, particularly in an area of competitive advantage, is also an increasing concern. Businesses feel that this is most likely to occur – maliciously or inadvertently – through employees or business partners on social networking sites.

Some companies believed that businesses should be more prudent in identifying and securing their key business information.

Companies see the need to make sure that their people understand the value of information and its protection. But putting the right security and policies in place to manage risk exposure globally is viewed as fairly difficult.

Outsourcing to third-party providers may present data theft and leakage risks, in addition to issues relating to the robustness of suppliers' business continuity planning and the potential impact of extreme weather and other natural catastrophe risks. Companies may also be vulnerable to competitors starting damaging rumours to erode their market share.

Information leakage and rumour-mongering are difficult to manage because of the speed of knowledge transfer inherent in the internet, and reputational damage is an important concern.

>> see Technology Risks pages 19-20

CIVIL UNREST

The events in North Africa and the Middle East have highlighted the power of mobile and internet communications in mobilising and organising protest.

European corporations recognise that discontented stakeholders have far greater ability, by courtesy of today's technology, to co-ordinate activism that may impact businesses in terms of business continuity, physical asset damage and loss of reputation. For some, the desire to mitigate this may be offset by political, economic and/or other considerations over which their control is limited.

The need to balance societal and economic risks is seen as a particular challenge by some companies that have embraced globalisation by choice or necessity. The economic requirement to diminish or close services or facilities could result in civil unrest in the local community.

Good citizenship when expanding globally can reduce the likelihood of civil unrest, as well as ensuring the ability to obtain a good-quality workforce. In Europe, some companies predict a potential adverse reaction, such as industrial disputes and strikes, when economies start to recover if that recovery is not accompanied by increased jobs and wages.

Businesses seem to take a somewhat fatalistic attitude towards terrorism – that there is little they can do if people are in the wrong place at the wrong time.

>> see Geopolitical Risks pages 9-12

CLIMATE CHANGE

Most European businesses are concerned about the apparently increasing frequency and severity of extreme weather events.

Some governments have been unable to afford investment in required infrastructure improvements.

Most large companies consider their own businesses to be adequately protected against extreme weather conditions but perceive vulnerabilities in their supply chains, which could disrupt business.

In addition to supply chain and continuity risks, some companies are concerned about the economic effects of events on local production, food supply and prices.

Supply chain resilience is key to the success of big companies. In the long-term, if climatic changes force large numbers of people to move location, supply chains may inevitably be affected.

>> see Environmental Risks pages 13-16

CRIME AND CORRUPTION

Some companies note a rise in organised crime over recent months, and predict a rise in crime generally in the next year, spurred by civil unrest, rising food prices and difficult economic conditions. Somalia's pirate attacks are a concern in relation to delivery of goods from the Far East. There are also fears that Mexico's gang warfare might permeate neighbouring states and could also result in attacks on the USA.

Corruption is generally viewed as becoming rarer in large companies because of the need to comply with legislation, coupled with fears of the damage to reputation and potential penalties that would almost certainly result from being found out.

>> see Geopolitical Risks pages 9-12

THE TOP 10 RISKS

- ECONOMIC RECESSION AND RECOVERY
- POLITICAL TURMOIL
- CLIMATE CHANGE
- DATA THEFT AND LEAKAGE
- REGULATION
- SECURITY OF IT SYSTEMS
- ENERGY AND COMMODITY PRICES
- CRIME AND CORRUPTION
- CIVIL UNREST
- EXCHANGE RATES

ENERGY AND COMMODITY PRICES

Rising energy and commodity prices are a continuing concern.

Most manufacturing companies are concerned about commodity prices in general and, in particular, about the inflationary effects of demand from countries like China. Turmoil in the Middle East could affect oil production, pushing up energy prices.

Companies that have diversified into providing energy-saving solutions for customers may offset the adverse direct effects by expanding this ancillary role.

>> see Economic Risks pages 6-8

The great unknown

With European recovery and global trends so hard to predict, economic risk is many companies' greatest concern

KEY POINTS

01: Companies that rely on investment income are particularly concerned about the eurozone.

02: Diversification gives more resilience against economic risks.

03: Uncertainty is a plague affecting many businesses.

04: Some companies think higher interest rates and taxation is inevitable in countries with high public debt.

05: There are concerns that Chinese companies are taking short cuts by unscrupulously copying western technology

ALL COMPANIES THAT ARE EXPOSED to the trends in emerging and developed economies are concerned as to whether the major developed economies will go into a double-dip recession or whether they are seeing the start of proper recovery. This is an important issue both for companies' own financial wellbeing and that of their customers.

Those companies that rely upon investment income from the capital markets are particularly concerned about what will happen in the eurozone, especially in respect of sovereign debt. There are fears that bail-in proposals, if adopted by regulators, would force investors to take losses. Such companies are less able than others to control their risk by diversification because of the close correlation between global financial markets.

In contrast, large international conglomerates have to some extent been able to weather the European recession because of diversification. One risk manager said that the ability to do "natural hedging", in terms of services and products provided and the countries they are provided to, gives more resilience against economic factors.

Some companies are seeing a recovery and this optimism has a fairly direct bearing on which European countries they do the most business with. Other businesses are less sanguine and believe that they have not yet seen the worst of the recession.

The varying speeds of EU members' recovery has prompted some companies to consider the effects on Europe as a whole. To what extent will the countries support each other? There may be a tendency to focus on national problems rather than the big picture, with a reluctance to allow the slower recovering nations to pull the others down.

> *"Could Europe become a backwater economically? What are the implications for us?"*

In any event, large multinationals are looking for the best growth to come from parts of the world other than western Europe and the USA. In many cases, companies have deliberately shifted their strategic focus to the faster growing markets.

One risk manager warned of the risks of diversifying into emerging markets without a clear understanding of them. Each region has its own risk issues and risk managers need to meet the challenge of assisting their boards to assess these issues.

Shifts and uncertainty

While geographic spread has helped to bolster multinationals' returns, Europe's depressed economy is taking its toll of small and medium-sized enterprises (SMEs). Some large companies reported that they have increased their fund for bad debts.

Uncertainty is the plague affecting many businesses. Several risk managers said that it was hard to predict outcomes because this period of recession does not appear to be following the patterns of the past. Indeed, this seems to be why companies put economic risk at the top of their concerns.

> *"Most of us are looking at what will happen with the euro and US debt. But the big unknowns are an even bigger threat"*

Some companies also consider that a slowing of the global economy in the next 12 months could ultimately result in political issues in areas like Europe.

While the shift in global growth from western countries to emerging markets has raised issues for many European companies, some risk managers see a personal silver lining in growing demand for their services from those new markets. One said: "They are looking to show the world that they are in better control of what they do, for example to improve their

COMMENT **Marc Paasch** head of Marsh Risk Consulting, France

ALL EUROPEAN COMPANIES PUT FUTURE trends in the economy at the top of their risk lists. In the case of multinationals, it was on a par with geopolitical considerations. Almost all have been adversely affected by recession which in some countries continues. Even companies whose operations are largely domestic are generally affected by wider international economic trends such as higher prices for energy, commodities and products.

In addition to recession, inflation, volatile currency exchange rates, the effects of changing national, European and other countries' regulation are other concerns.

For some multinationals, China – once seen as an opportunity – is now emerging as a risk as the country seeks to offset its slower growth rate by competing internationally. The trend towards protectionism by some countries can also be a risk issue for multinationals, which are watching with some trepidation how economic recovery in the USA will pan out.

China could also refocus industrial output towards domestic demand in order to reduce inflationist tensions and social unrest and compensate for lower exports. Non-Chinese operators would therefore find themselves competing with Chinese companies.

KNOWLEDGE Sovereign default

When a country can't pay what it owes large losses usually occur across banks holding the defaulted debt and they become more risk averse in their lending policies. Companies with assets and contracts in a devalued country also see their own values sharply diminish.

ability to access capital, and risk management is key to this."

Inflation

In European countries with very high public debt, some companies regard higher interest rates and taxation as inevitable. They are concerned that this, coupled with continuing recession, will impede their ability to invest and grow in these areas.

In terms of individual consumers, as opposed to business buyers, the demographic trend towards older people on fixed incomes will affect some sectors, as this market's purchasing power will be hit particularly hard by inflation. This could reduce demand for what are perceived to be luxury goods.

One risk manager (not working for an insurer) also pointed out that inflation could adversely affect claims for insurers selling "long tail" liability products.

Rising energy and commodity prices

Political events in the Middle East are sounding an alarm bell in respect of possible shortages and higher prices of oil. Businesses have already seen a trend for higher prices for oil and gas as well as other commodities.

Oil price increases affect most European companies, either directly or through their impact on suppliers and customers. But companies that have taken the wise move to diversify into providing energy-saving solutions may offset the adverse direct effects by expansion in this ancillary role.

Most manufacturing companies are concerned about commodity prices in general and, in particular, about the inflationary effects of demand from countries like China (see box, overleaf).

> *"There is massive demand for commodities in the emerging countries – and a potential huge inflationary impact for western countries in particular"*

The risk manager of one company that sources most of its raw materials from the Far East reported increased costs for several reasons. The main two were market forces in terms of availability and the cost of labour generally around the world, which is steadily going up, albeit often by small amounts.

Increased competition from China

European companies did not see the much talked about slowing down of China's economic growth as a key issue. Indeed, the country's target announced in March is 8% this year, which sounds rather promising compared with other markets for companies trading there.

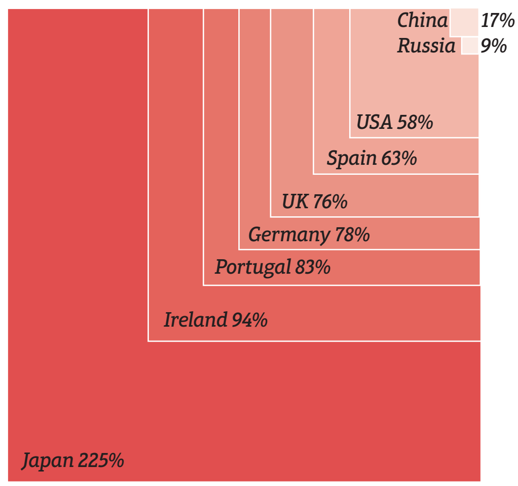
But the ways that China intends to achieve this growth are posing some headaches for Europe's multinationals. In some sectors, it is looking to go from being a major importer to being a producer and exporter, competing with its former suppliers and driving down prices. Those suppliers that provide essential raw materials not available in China can offset the effects of completed product price competition with what they charge for those materials. Others will not be so fortunate.

Demand from China is pushing up commodity prices, adding to the possibility of inflation. Perhaps even more worrying is the concern that Chinese companies are taking a short cut to export growth by unscrupulously copying western technology.

Slow US recovery

European companies that do most of their business in the USA are understandably concerned about how the country emerges from current economic difficulties. More trade-balanced multinationals are looking to demand from emerging markets such as China to offset reduced US business. But many European global companies feel that »

PUBLIC DEBT as a percentage of GDP



Source: Figures accurate for 2010 from the CIA Factbook

FAST FACTS

90%

An unsustainable debt to GDP ratio. If a country exceeds this threshold then the burden of debt reduces median GDP growth by roughly one percentage point.

$1.3t

The value of illegal trade, such as drugs or counterfeit products, around the globe in 2009.

20,000

The litres of water needed for a kilogram of industrially produced meat.

58m

Nigeria's predicted population in 2050.

40%

International Energy Agency forecasts that the world economy will demand at least this much more energy by 2030.

1970s

The last time advanced economies experienced 'stagflation' whereby monetary policy proves unable to stimulate economic activity and there is a loss of confidence in the ability of central banks to control inflation.

Source: World Economic Forum

CHINA PLANS 8% GROWTH

Chinese prime minister Wen Jiabao told the National People's Congress in March that the government was targeting 8% economic growth this year.

Its five-year plan from 2011 to 2015 forecasts an annual growth rate of 7%, compared with an average of 11% over the last five years.

Coupled with this, the country intends to curb its inflation rate, which is threatening to affect social stability and impact low-income people. It is aiming for a level of 4% for the year.

» US economic recovery is an important factor for Europe in general.

"The Chinese economy could offset the USA; the two are so interdependent these days"

While concern was expressed about the debt of some individual states, there was a general feeling that the USA is making a fairly speedy return to growth, perhaps aided by ongoing 'easing' – the Federal Reserve's bond-purchase programme to stimulate the economy. But one risk manager pointed out that, while the profits of many US companies had reached the same level as before the crisis, they were not employing any more people than two years ago, suggesting that purchasing power remains low.

Currency exchange rates are a big concern for many European companies, particularly in respect of the euro and the dollar. They are understandably concerned about the perceived weakness in both.

"A lot of our business is in the USA so any fall in the dollar is significant for us"

Restrictive regulation

With risk managers often overseeing or directly involved in risk transfer, the impact of the pending European regulation for insurers – Solvency II – was a particular issue of concern, albeit more by insurance buyers than by insurers themselves.

Corporate concerns embrace a number of areas. Among these is the anticipated requirement to provide more information on exposures. Some companies consider that it would be difficult to provide advance forecasts because of the need for company confidentiality, for example in respect of potential mergers and acquisitions. Further, risk managers of the largest companies may not have this information because they are not informed at an early stage.

Some companies are also worried that a more cautious attitude from insurers could stifle clients' innovation.

The UK Bribery Act is another concern. Implementation of this act has been delayed and there is uncertainty about its final provisions. Some risk managers who have worked with their legal and compliance colleagues on controls in connection with the act are understandably frustrated to learn that the goalposts may be moved.

2011 PREDICTIONS

BANK OF AMERICA MERRILL LYNCH Global Research forecasts that 2011 will be a year of modest global GDP growth and excess liquidity that will translate into higher global equity prices, led by the USA and emerging markets, modest returns from fixed-income assets, a stronger US dollar and another positive year for commodity prices. Predictions for 2011 include:

- The US economy will grow by roughly 2.8%.
- Global economic growth will slow from 4.9% in 2010 to 4.2%.
- Emerging market growth will remain robust at 6.4%, with domestic demand replacing exports as the primary driver.
- The US dollar will strengthen against the euro and the yen.
- The euro will be the weakest developed market currency, falling to $1.20 by year's end.
- Commodity prices will rise, led by oil, copper, and coal.

"We do not think more European regulation will create a better business environment. It just creates more demands and harder work for companies"

Additional EU regulations seem to be regarded as something of a threat for European businesses, as well as being likely to add to their costs. In addition, multinationals are concerned about regulatory differences in the countries in which they operate.

This is particularly the case with the most highly regulated sectors such as telecoms. Their relationships with national and EU regulatory authorities are crucial, but the mismatch between European and national regulations means that they have to approach the risk on two different levels.

Companies active in the emerging Asian markets are also having to cope with different laws in different jurisdictions. "It's very difficult to implement best practice approaches that are capable of being applied globally," one risk manager said.

Protectionism

Fears about protectionist action tend to fall into two areas. First, companies expanding into emerging markets are concerned about the effects of regulatory action designed to favour national companies. This is not a new phenomenon – both China and India have strict rules limiting the equity that external companies can have in national companies.

Secondly, there is some concern that disagreement between the USA and China about the traditionally pegged value of the yuan against the dollar is prompting the USA to take covert action against Chinese imports.

"Countries must open the doors if they want to continue to grow and be part of the global economy"

While the USA cannot afford an all-out trade war against China, it appears to be singling out some Chinese imports to bar on safety grounds. Some European companies selling goods with Chinese components or sourced in China are concerned that their sector may come into the US firing line.

Higher risk transfer costs

The cost of buying insurance is notoriously cyclical but the current soft market – low premiums and an abundance of capacity – has continued for some years. Many companies see a hardening of the insurance market and a consequent rise in premiums as a risk – not necessarily in 2011 but certainly in 2012 when Solvency II start to bite.

Recovery problems

There are some companies that, by virtue of the products they sell, have thrived during the recession. For them, the threat of recovery comes from their rivals gaining access to increased capital resources.

A more general problem will be the fact that some suppliers will have been severely weakened during the recession – companies will need to review their understanding of the risk in their supply chain.

The challenge for all European companies that have cut costs and staff will be their capability to gear up resources into growth mode. Those that are able to do this will gain a huge competitive edge. SR

The age of revolution

The sudden eruption of popular uprisings in the Middle East means that geopolitical threats now rival economic risks as the biggest worry for European corporations

WHILE THE SUCCESSFUL revolution in Tunisia triggered protests in a number of countries in North Africa and the Middle East, companies, at the time this report was compiled, were focusing most closely on Tunisia and Egypt – where the governments had been overthrown – and on Libya, where protesters were still battling with government forces.

One company expressed concern about the future of its plants in Algeria although president Abdelaziz Bouteflika may have defused a potential revolution by promising in February that the country's state of emergency, in force for 19 years, would be lifted in the near future.

> *"We are a global business and the whole geopolitical environment and how it is changing is of real importance"*

The greatest concern came from companies that have a presence in some form in the affected countries. In particular, companies that have embarked on projects or service contracts are worried that the terms may change under a new regime and that they will lose money as a result.

Also, having established a network of politically influential people under the previous regime, in a sense they feel that they are 'starting from scratch' in gaining contacts and supporters. Perhaps this is best summed up by the sentiment: "If the government changes, will the rules be the same?"

> *"We provide services for emerging markets and most of our contracts are with official institutions like governments, which means we don't have payment problems. If the political system changes, the decision makers change and that may be important for our long-term strategy"*

There has also been the more immediate problem for companies with a physical presence in the troubled countries in terms of safeguarding their people. Several companies reported that they had to repatriate employees from Libya. One company that had just started a project in Tunisia initially forbade employees to go there and later, when the political situation had settled somewhat, authorised a few to go to visit clients but with strict security controls.

Indirect effects perceived by some European companies include the possibility of an adverse impact on their exports to these countries and a reduced number of business and private travellers to the areas.

Recent political events – and in particular the speed with which they have occurred – have also alerted some risk managers outsourcing beyond Europe to potential weaknesses in their supply chains.

> *"Our suppliers are situated in countries like India, China, Pakistan and Vietnam. We're not really well informed about the political situation in these countries"*

In particular, there seem to be some question marks over China, which is due for a change of leadership in 2012. This is a very understandable concern given the degree of reliance by many European companies on the Chinese market.

One risk manager cited Bahrain – at the time of writing the scene of a number of anti-government protests – as presenting particular problems should a revolution occur. As a small oil-producing country with a lot of expatriates living there, there could be a number of issues should the government be overthrown.

There are also fears about the possibility closure of the Suez Canal,

»

COMMENT **Giampaolo Scarso** head of Marsh Risk Consulting, Italy

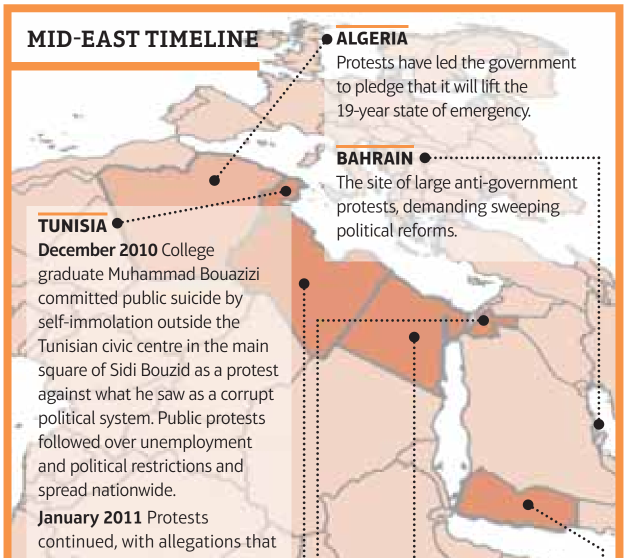
THE POLITICAL TURMOIL TAKING PLACE IN NORTH AFRICA and the Middle East catapulted geopolitical events to the top of European corporations' risk concerns alongside economic issues. Unrest on this scale in the countries affected had not been predicted and the speed of developments took the business world by surprise.

Some companies with operations, outlets or suppliers in the countries concerned have been directly affected, facing serious challenges with respect to expats safety and repatriation, tangible investments protection and continuity of supply. Others believe that they may experience an indirect impact. And all are concerned that new turmoil in the Middle East could affect oil production, pushing up energy prices.

Geopolitical risks therefore determine business continuity and crisis management issues for both private organisations and public administration.

Interestingly, few companies cited terrorism as high on their risk list for the next year, despite the fact that as recently as October 2010 some governments issued warnings to travellers in Europe. Businesses seem to take a somewhat fatalistic attitude that there is little they can do if people happen to be in the wrong place at the wrong time.

MID-EAST TIMELINE



TUNISIA

December 2010 College graduate Muhammad Bouazizi committed public suicide by self-immolation outside the Tunisian civic centre in the main square of Sidi Bouzid as a protest against what he saw as a corrupt political system. Public protests followed over unemployment and political restrictions and spread nationwide.

January 2011 Protests continued, with allegations that the police had killed at least 50 people in attempts to quell unrest. President Ben Ali went into exile, while prime minister Mohammed Ghannouchi announced an interim national unity government.

February 2011 Responding to calls by protestors for a clean break with the past, Ghannouchi resigned.

LIBYA

February 2011 Demonstrations began following the arrest of human rights activist Fathi Terbil. Police and protestors became increasingly violent with fatalities, casualties and destruction of public buildings. There were mass air evacuations of expatriates. Colonel Gaddafi refused to concede power.

March 2011 The UN Security Council adopted Resolution 1973 (2011), authorising member states to take all necessary measures to protect civilians and civilian-populated areas under threat of attack in the Libyan Arab Jamhariya, including the second city of Benghazi, while excluding an occupation force. Attacks by allied air forces followed.

JORDAN

January 2011 A small peaceful demonstration, inspired by events in Tunisia, was held outside the parliament building.

February 2011 King Abdullah II dismissed the government and appointed a new prime minister, Marouf Al Bakhit, to implement political reform.

ALGERIA

Protests have led the government to pledge that it will lift the 19-year state of emergency.

BAHRAIN

The site of large anti-government protests, demanding sweeping political reforms.

EGYPT

January 2011 Protests against president Hosni Mubarak's government began nationwide on 25 January – the 'Day of Revolt'. Initially non-violent, in the following days casualties and some deaths were reported as police attempted to suppress the demonstrations. The authorities ordered the closure of most internet services to disrupt communications between protesters.

February 2011 Despite concessions offered by Mubarak and restoration of internet services, demonstrations continued and violence escalated with Mubarak's continued refusal to step down. On 11 February, vice-president Suleiman announced Mubarak's resignation, with the country's leadership being assumed by the Supreme Council of Egyptian Armed Forces.

March 2011 Prime minister Ahmed Shafik resigned and was replaced by Essam Sharaf. On 19 March, Egyptians voted on new modifications of the constitution.

YEMEN

January 2011 Protests began with calls for president Ali Abdullah Saleh to resign.

February 2011 Despite assurances by Saleh that he would not stand for a further term of office in 2013, protests continued.

March 2011 Both anti- and pro-government demonstrations continue.

» which would have an obvious impact on the movement of goods.

> *"What's happening in the Middle East could occur in other areas in the world where there are dictatorships. If it can happen in Libya, it can happen anywhere"*

European companies that derive a significant part of their income from investment do not have the same direct geopolitical risks as other businesses. But they still have some exposure, since many of the companies they invest in are exposed to these threats. As a consequence, there is a risk of business disruption and of an impact on profitability.

Two additional points emerged on the subject of political turmoil. First, companies looking to transfer the risk of activism are struggling to determine where this should reside in their insurance policy portfolio. It's a possibility that it could be included within terrorism risk. Second, all companies have recognised the power of the internet and other communications media in co-ordinating revolutionary action and initiating the overthrow of governments.

Egypt's initial action in 'gagging' communications during political turmoil (see box, overleaf) is seen as a pointer for the future in how governments might want to control communications media.

War in the Middle East?

One risk manager considered that it was virtually inevitable that there would be a war in the Middle East in the next 12 months, signalled by the big build-up in arms by Israel and other parts of the Middle East, including Hezbollah in Lebanon.

He predicted a major confrontation involving attacks on cities rather than desert military units. There would be consequent effects on oil prices, business travel, Arab investment in western economies and an increase in terrorism.

> *"We have quite a big business in the Middle East, which does well, but war would clearly have a huge impact on that"*

If this is an extreme view, war in the Middle East is certainly a risk issue for those European companies that have a significant presence there.

Crime and corruption

In contrast to political turmoil, crime and corruption are seen as fairly everyday risks – although some companies note that there has been a rise in organised crime over recent months.

Somalia's pirate attacks were mentioned as a concern by several companies, particularly in relation to deliveries of goods from the Far East. Mexico was cited as one country that "is virtually out of control" in terms of gang warfare involving both drug running and attempts to take control of territory. There were concerns that this

FCPA SETTLEMENTS RISE

IN 2010, THE US GOVERNMENT assessed nearly $2bn (€1.4bn) in penalties and fines relating to the Foreign Corrupt Practices Act, and announced eight of the top 10 FCPA settlements of all time. Key cases included:

BAE, February 2010
UK BAE Systems announced that it would plead guilty to one charge of conspiring to make false statements to the US government regarding its ongoing compliance with the FCPA. It also agreed to pay a $400m fine.

Daimler, April 2010
The US Department of Justice announced that Daimler AG and a number of its subsidiaries had agreed to pay approximately $185m in disgorgements and fines to settle FCPA-related charges.

Snamprogetti, July 2010
Snamprogetti Netherlands BV and its parent company ENI SpA agreed to pay $365m – the fourth-largest FCPA settlement to date – to resolve charges stemming from Snamprogetti's role in a multi-entity joint venture in Nigeria.

KNOWLEDGE Mexico drug violence

Most indicators point to a marked deterioration in the security environment in Mexico resulting from the escalation in the drug cartel conflict.

was permeating neighbouring states and could also result in attacks on the USA.

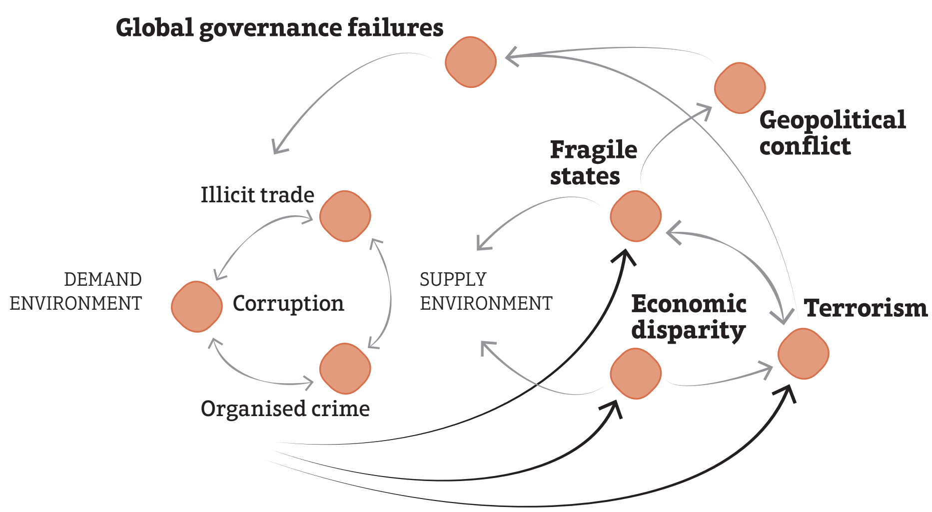
Some risk managers see a rise in crime as likely in the next 12 months, spurred by civil unrest, rising food prices and difficult economic conditions.

> *"To prevent terrorism, the USA needs to look at its borders, not just airports"*

In respect of corruption, a common view was that this was becoming rarer in large companies because of the need to comply with legislation, coupled with fears of the damage to reputation and potential penalties that would almost certainly result from being found out.

One risk manager felt that the UK Bribery Act, in its current drafted form, would put UK companies at an unfair disadvantage because it prohibits facilitation payments. Such payments are endemic to the culture of countries like India and China and it would be difficult to carry on business without them, he said. »

WHAT THE WEF SAYS



Economic disparity and global governance failures emerged from the World Economic Forum's Global Risks Survey 2011 as the two most highly connected risks and were perceived as both very likely and of high impact. They influence the context in which global risks evolve and occur in two critical ways: first, they can exacerbate both the likelihood and impact of other risks; second, they can inhibit effective risk response. Source: World Economic Forum Global Risks 2011

EUROPE'S COMPETITION CODE

Competition must be fair

It is illegal under EU rules for businesses to fix prices or carve up markets between themselves. Companies with a dominant position in a particular market may not abuse that power to squeeze out competitors.

Big companies may not merge if that would put them in a position to control the market, though in practice this rule only prevents a small number of mergers from going ahead. Larger companies planning to merge need approval from the European Commission – irrespective of where they are headquartered: the criterion is the amount of business they do within the EU.

The Commission may agree to a company having a monopoly in special circumstances – for example, where costly infrastructure is involved ('natural monopolies') or where it is important to guarantee a public service.

But monopoly companies must be able to demonstrate that they treat other companies fairly. Natural monopolies must make their infrastructure available to all users. Profits from providing a public service may not be used to subsidise commercial operations, and thus potentially undercut competitors on price.

The large may not exploit the small

In doing business with smaller firms, large firms may not use their bargaining power to impose conditions that would make it difficult for their supplier or customer to do business with the large firm's competitors. The Commission can (and does) fine companies for all these practices.

Its investigations into anti-competitive practices are not restricted to goods. They also cover the liberal professions and services, including financial services, such as retail banking and credit cards.

No props for lame ducks

In addition, the Commission monitors closely how much assistance EU governments make available to business ('state aid'). This aid can take many forms – loans and grants, tax breaks, goods and services provided at preferential rates, or government guarantees that enhance the credit rating of a company compared to its competitors. No state aid in any form is allowed to an ailing business that has no hope of ever becoming economically viable.

Exceptions that prove the rule

Some exceptions to the general rules are possible. The Commission can allow companies to co-operate in developing a single technical standard for the market as a whole. It can allow smaller companies to co-operate if this strengthens their ability to compete with larger ones. State aid will get a green light if there is a real chance that a business in difficulty – or a new venture – can eventually become profitable and if it is in the interests of the EU (for example, by preserving or creating jobs).

The overriding considerations are whether consumers will benefit or whether other businesses will be harmed. Aid for research and innovation, regional development or small and medium-sized enterprises is often allowable because these serve overall EU goals.

Checks and balances

The Commission's extensive powers to investigate and halt violations of EU competition rules are subject to judicial review by the European Court of Justice. Companies and EU governments regularly lodge and sometimes succeed in appeals against decisions.

EGYPT'S COMMUNICATIONS CLAMPDOWN


Reuters

» Some companies made the point that there is a clear overlap between corruption and corporate governance. However, few companies cited governance per se as a major risk.

Governance failures

One risk manager noted that the authorities in Brazil and Argentina were imposing certain constraints relating to governance in his particular business sector.

Another commented that his company was actively addressing the issue of increasing corporate governance and, as part of this, would be formally putting enterprise risk management in place in the next few years.

> *"It is very important for us to have a way of doing business that is consistent around the world and meets our values. We cannot compromise on that. Economic difficulties tend to drive bad behaviour in some parts of the world so we need to focus on that and avoid risks that are contrary to our ways of doing business"*

Breaching sanctions

The EU has imposed a number of sanctions on countries and individuals.

One European company was concerned about the risk of breaking these and stressed the need to track end-delivery of its products.

> *"We have to be very careful where our customers are delivering our products to. We have to make sure that we sell to a reputable company but, unbeknownst to us, they may sell to a third party who will break sanctions"*

Terrorism

Terrorism did not appear to be high on companies' risk agendas – although war in the Middle East would be likely to increase its rating. **SR**

WHEN ANTI-GOVERNMENT PROTESTS BEGAN IN Egypt, the authorities went to considerable lengths to clamp down on mobile telephone and internet communications. Network operator Vodafone tracks the process.

28 January The Egyptian authorities instructed all mobile operators to suspend services in selected areas. Under Egyptian legislation, the authorities have the right to issue such an order and Vodafone was obliged to comply with it.

29 January Vodafone restored voice services to its customers in Egypt. It stressed that the Egyptian authorities have the technical capability to close its network and if they had done so it would have taken much longer to restore services to customers.

2 February Vodafone reinstated data services in Egypt, enabling customers to access all internet sites.

3 February Vodafone stated that, under the emergency powers provisions of the Telecoms Act, the Egyptian authorities can instruct the mobile networks of Mobinil, Etisalat and Vodafone to send messages to the people of Egypt – which they did.

These messages were not scripted by any of the mobile network operators, who were not able to respond to the authorities on their content.

The Vodafone Group has protested to the authorities that the current situation regarding these messages is unacceptable, saying that all messages should be transparent and clearly attributable to the originator.

Likely cost

The Paris-based Organisation for Economic Co-operation and Development estimated the cost to the Egyptian economy of the government clampdown on internet services to be as much as $18m (€12.6m) a day or $90m in total.

Forces of nature

The unpredictability and severity of extreme weather events, in Europe and beyond, is making environmental risk increasingly difficult to forecast

MOST BUSINESSES ARE PREPARED for extreme weather conditions as far as their own premises are concerned, particularly if they are located in a region vulnerable to floods and similar events. But all were concerned about the increasing frequency and severity of such events.

In terms of their own businesses, several large companies mentioned that, over recent years, they have invested quite significant amounts in associated risk management and protections, particularly as insurers have been focusing on extreme weather and natural catastrophe events. They believe that the quality of the risks has become better with more protection.

> *"We have to cope with the fact that we will have more extreme weather in Europe, more water and more snow and maybe more periods of extreme heat, which may lead to certain natural catastrophes"*

But many were concerned that SMEs did not appear to be aware of the consequences of extreme bad weather and were not protected, for example in respect of flooding. A linked issue was that governments, particularly in Europe, were unable to afford the necessary investment in infrastructure improvements. They would deal with emergencies as they occurred but failed to make appropriate investment in assessing the risks and preparing for them.

Both of these issues give rise to particular concern in respect of robustness of supply chains and potential business interruption. For many companies, business continuity planning has increased in importance with the opportunity to see at first-hand how it actually works in practice. Two risk managers had seen their recovery planning put to the test in the Brisbane floods.

In addition to supply chain and continuity risks, some risk managers were concerned about the economic effects of events on local production, food supply and prices. Most companies mainly referred to the volatility of European weather conditions, perhaps because Europe is traditionally not expected to suffer a plethora of extreme weather events.

> *"Some of the power networks are collapsing because of heavy snow. In countries like Germany, Belgium and the UK, rail links are getting bad. More governments are potentially hard pressed so do not have money to maintain infrastructure"*

But, as stated, the Australian floods have affected some businesses, and one company reported an indirect impact from the flooding in Brazil early in 2011 in that its services to customers there were interrupted as a result.

Businesses that feel they are particularly vulnerable may be looking beyond the traditional insurance market for protection. One risk manager said that his company was considering buying nat cat bonds to provide further capacity to cover its flood risk.

> *"Business continuity is probably becoming more real to companies. Rather than just being a science, it has more practical applications. There is more opportunity to see business continuity plans in action and how the company actually deals with an emergency"*

Hard to predict

The unpredictability of extreme weather events – certainly in Europe – makes them difficult to deal with, and also raises questions as to when the next major disaster will occur. Climate change appears to be having a distorting effect on traditional modelling.

For example, one risk manager pointed out that a massive flood affecting Paris was now overdue. Supposedly occurring every 100 years, the last was in 1910. Again, while some large French companies may not be »

COMMENT **Christian Knutson** Middle East and Africa leader for financial advisory services, Marsh Risk Consulting

FOLLOWING THE RECENT EVENTS IN AUSTRALIA, New Zealand and Japan, companies are becoming more cognisant of the risks arising from climate change, including extreme weather and natural catastrophes.

Such events can impact a myriad of interrelated parts of a company's business, such as its workforce, production facilities, supply chain and potentially its customers. As the pace of globalisation continues, it is becoming clear that events in any part of the world could have a dramatic effect on a company's operations.

Companies, therefore, are concerned with the increasing frequency and severity of such events, as well as their occurrence in locations not normally subject to such weather. Interestingly, a number of companies also expressed concern that others, in particular smaller companies and government infrastructure, were not as acutely aware of the risk and less prepared for it.

While most companies felt they were prepared, it is clear many also need to consider and prepare for the fact that others may not have been as diligent.

WHAT THE WEF SAYS

"Climate change is likely to be exacerbated by meeting the growing demand for energy. Over 75% of the global increase in energy use from 2007 to 2030 is expected to be met through fossil fuels, especially coal, and an estimated 77% of the power stations required to meet demand are yet to be built."
Source: Global Risks 2011 report

» affected because they are not located in the city, they could potentially suffer from disruption of power and water supplies and transport.

Unpredictability in respect of extreme weather events is also a major issue for the (re)insurance sector, which has borne the brunt of the losses in developed countries. Claims have increased commensurate with the value of commercial and private buildings' contents.

(Re)insurers' actuaries have the difficult task of deciding whether the companies' common perception of the increasing number of events reflects the reality. Is it a matter of the media informing more people more quickly about what is occurring? If the increase has actually occurred, is it actually a coincidental trend rather than a reflection of long-term climate change? How can they price their products, reflecting experience, while remaining competitive in a market where others may not take the same view? Does the property (re)insurance market have a future if climate change at some point will make covering certain types of events non-viable?

Companies made two other important points in connection with recent weather events and climate change. First, one risk manager of a predominantly national business pointed out that events on the other side of the world could have an unforeseeable impact if they affected the supply of raw products that were essential for the goods they sell.

Global interconnection was an ongoing theme from many companies during the compilation of this report.

Secondly, supply chain resilience is absolutely key to the success of big companies. Looking to the long term, if climatic changes force large numbers of people to move location, supply chains may inevitably be affected.

Natural catastrophes

With a few notable exceptions, like New Zealand's earthquake at the beginning of 2011 and Japan's earthquake and accompanying tsunami in March, there have been few natural catastrophes in the last two years that have hit developed areas where large European companies have a presence. But risk managers are conscious that some modelled catastrophes are overdue, such as an earthquake in Mexico and a seriously devastating hurricane season in the USA, and this is a concern for companies.

As well as the obvious impact of property damage, natural catastrophes can affect European companies' supply chains and the provision of raw materials needed for manufacturing. In an attempt to avoid this problem, more European companies are taking it into account when assessing where to build new plants or distribution centres in disaster-prone areas.

> *"Risk management is involved from the very start of construction planning for new sites and choice of location."*

Green agenda and sustainability

Apart from immediate cost pressure to reduce CO_2 emissions, few companies place

JAPAN EARTHQUAKE AND TSUNAMI


Reuters

COST OF CATASTROPHES

$235bn

The World Bank's estimate of what the 11 March Japanese earthquake and tsunami may cost the country's economy – 4% of GDP. It also warns that disruption to production networks, especially in automotive and electronics industries, could continue to pose problems in East Asia.

$12bn

The cost to insurers of February's New Zealand earthquake, according to Swiss Re.

$5.58bn

The estimated total cost of recent flooding in Australia, according to prime minister Julia Gillard.

KNOWLEDGE Catastrophes pending

Risk managers are conscious that some modeled catastrophes are overdue, such as an earthquake in Mexico and a seriously devastating hurricane season in the USA.

Aftershocks: disruption to global supply chains as a result of the disaster in Japan could last many months

'greening' their operations near the top of their risk lists, although energy saving, partly because of the economic as well as environmental benefits, is a widely considered issue. The exceptions are those businesses that are investing in projects that not only take a long time to construct but also have a long lifespan.

> *"Our projects are long-term and our plants will be around for many years. When deciding where to build them, we have to look at the risks likely to emerge in that period such as water shortage. Water must be 100% recycled, and plants must be designed to comply with problems that might arise in 2060, for example"*

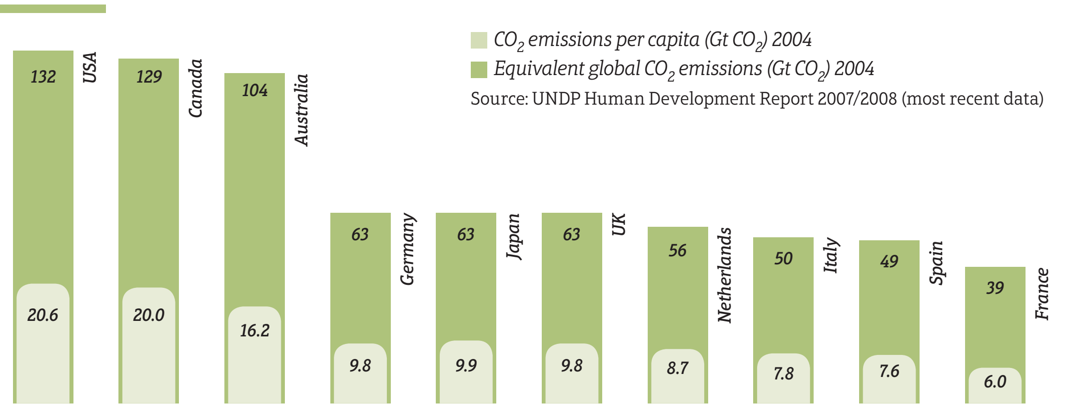
Potential water shortages and the need to pay more for water are also perceived as problems by some companies that otherwise believe that they are not directly affected by environmental issues.

> *"The need for water and other resources has to be well calculated and used in evaluating the risk when considering the approach to projects in different parts of the world. A regional approach is important, acknowledging that companies may begin to develop new techniques and innovative financial solutions"*

»

WHO IS THE WORST CLIMATE OFFENDER?

The UN Development Programme Human Development Report 2007/2008 said that if emissions WERE FROZEN AT the current ceiling of 29 gigatonnes CO_2 (a measure of CO_2 in the atmosphere) we would need two planets. It therefore proposed a cap of 14.5 gigatonnes CO_2. But some countries are running a less sustainable account than others. With 15% of the world population, rich countries are using 90% of the sustainable



» One risk manager pointed out that rapidly increasing population is putting pressure on all resources and stressed that both governments and businesses should have sustainability at the core of all their strategies.

"The role of enterprise risk management is very much linked to sustainability and resilience"

But, as one risk manager pointed out, sustainability and climatic issues are not all threats, as they give the opportunity to refocus on and refine improved efficiency in the business.

Lessons from Iceland's ash cloud

A number of companies mentioned the impact that the ash cloud resulting from Iceland's volcanic eruption had on their businesses in 2010. The resulting disruption in air travel caused problems for companies whose business relies on movement of people.

These companies recognise that their business is also vulnerable as environmental pressure on the aviation industry makes air travel more expensive and less acceptable. But this was generally considered to be a low likelihood risk.

Supply chains were also disrupted by the ash cloud, with deliveries delayed as a result of the disruption.

Even some of those companies not directly impacted by the ash cloud made the point that incidents like this were particularly difficult to deal with because they were totally unforeseen, as opposed to other natural catastrophes which, to some extent, can be predicted and modelled.

Pollution

Pollution was considered to be a risk for the energy sector and, to a lesser extent, other industries in view of the EU environmental impairment liability directive. One company reported some spillage of oil from tanks in its premises so considered that pollution was a definite exposure. **SR**

"Disasters, natural catastrophes and one-off big incidents like the BP leak are always going to happen and we don't see the risks changing very much"

SUPPLY CHAIN WARNING

ORGANISATIONS NEED TO PREPARE FOR THE possibility of extended disruption to global supply chains folowing the earthquake and tsunami in Japan, according to Marsh. Thousands of multinational companies that rely on Japanese manufacturers for goods and services, as well as for sales, can expect significant global supply chain disruptions lasting up to several months.

Gary Lynch, head of supply chain risk management at Marsh Risk Consulting, said: "Given that the immediate priorities in Japan are likely to be social not economic, the aftershocks to the global economies from this disaster may unfold very slowly; many of the economic consequences have yet to be seen. A multinational company whose supply chain could be impacted by the catastrophe should start now by assuming that its business is severely disrupted for an extended period and develop an effective mitigation strategy."

Rather than the physical destruction of the production facilities, most of the supply chain disruption from this catastrophe is likely to be caused by issues associated with infrastructure, energy, utilities, transportation, and restrictions on highway/port access.

The most significant initial impact will be to the hi-tech, steel and auto industries, quickly followed by those that depend on these industries, such as manufacturers of medical devices, communications gear suppliers, car dealerships, and solar, shipbuilding, aviation and consumer electronics industries.

EUROPEAN WEATHER PROJECT

Science Photo Library

FUNDED BY THE EU'S DIRECTORATE General for Research and Technical Development, the WEATHER project analyses the economic costs of more frequent and more extreme weather events on transport and the wider economy and explores adaptation strategies for reducing them in the context of sustainable policy design. The research is carried out by an team of eight European institutes, led by the Fraunhofer-Institute for Systems and Innovation Research (ISI). The project is running from November 2009 until April 2012.

Background

Records of reinsurance companies clearly highlight the rising damages caused by the consequences of climate change, in particular natural catastrophes and extreme weather events. While many studies focus on CO_2 mitigation in transport, little research has so far been developed on the economic costs of climate and extreme weather-driven damages to transport, and even less evidence is available on the options, costs and benefits of adaptation measures.

Objectives

The project addresses extreme events and their impacts from an economic perspective. Its core objective is to "determine the physical impacts and the economic costs of climate change on transport systems and identify the costs and benefits of suitable adaptation and emergency management strategies". This objective has seven sub-goals:

1. Develop a dynamic model on the causal relations between the severity and frequency of extreme events, the functionality of critical sectors and social welfare.
2. Assess in detail the vulnerable elements and manage costs in transport systems.
3. Work out efficient and innovative mechanisms for managing disastrous events, focusing on maintaining the function of transport systems.
4. Identify appropriate and efficient adaptation strategies for transport infrastructure and services to ease the impact of future extreme events.
5. Clarify the role of governments, companies and industry associations.
6. Check the applicability of theoretical concepts of vulnerability assessment, crises prevention and adaptation strategies with practical experiences and local conditions.
7. Disseminate project findings to a wider audience to foster debate on the costs and implications of more frequent and severe events on transport.

The human factor

Pandemics are less of a concern than they were last year, but the growth of civil unrest is showing companies the danger of being seen as 'bad citizens'

THE EVENTS IN NORTH AFRICA AND the Middle East have made European companies very conscious of the ultimate macro dangers of civil unrest when it evolves into political turmoil and even ferments revolution. They also recognise, perhaps as never before, the power of mobile and internet communications in mobilising and organising protest.

European corporations recognise that discontented stakeholders have far greater ability, by courtesy of today's technology, to co-ordinate activism that may have an impact in terms of business continuity, asset damage and loss of reputation. For some, the desire to mitigate this may be offset by political, economic and other considerations, over which their control is limited.

"Our security people are starting to think about social networking, instant messaging and the like. Each by their nature allows people to organise themselves rapidly in a highly unplanned, unstructured way"

The need to balance societal and economic risks is seen as a particular challenge by some companies that have embraced globalisation by choice or necessity. While it may make sound political or economic sense to move the global location of certain services or facilities, the impact on local communities may be severe.

"Cities have grown up around our plants. If we decide that a plant is not doing well and it makes no sense to keep it running, that has a direct social impact that can lead to strikes and unrest"

Some risk managers stressed the need for good citizenship when expanding globally. As well as reducing the likelihood of civil unrest, this can also ensure the ability to obtain a good quality workforce.

"Enlightened companies recognise their future is tied up with the communities in which they operate and in which their suppliers and customers operate. They need to look after these communities"

The perceived behaviour of a business and/or of its senior executives can make that business the focus of attention for demonstrators and adverse internet comment. Bearing in mind that it's difficult for risk managers to dictate how their senior executives conduct themselves, those risk managers raising this point felt that the only thing they could do was to mitigate the impact and have appropriate security against possible activism.

"Media statements might not actually help. There is a danger that activists will see what is going on in other countries and may take more direct action against your business"

The problem of action across multiple locations was raised by several companies. They look to robust, regularly tested business continuity planning to mitigate the effects.

"We look at the extent to which things can happen in several places at once. For example, if a pressure group takes a dislike to you, they might not just protest outside your office but take action at several locations"

Current economic pressures are one of the key causes of civil unrest. However, some companies predict an equally adverse reaction, including industrial disputes and strikes, when economies start to recover, if that recovery is not accompanied by increased jobs and wages.

"When the economy is bad, people expect to suffer

»

KEY POINTS

01: Discontented stakeholders have far greater ability to co-ordinate activism through technology.

02: Multinationals need to pursue good corporate citizenship when they expand globally.

03: Immigration is an issue for many companies, particularly with the need to provide specific services for the new citizens.

04: Companies consider the risk to employees travelling abroad to be underestimated

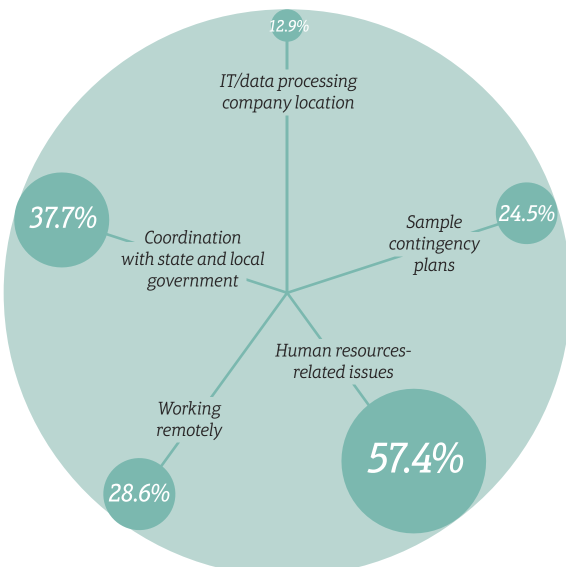
PREPARING FOR AN INFLUENZA PANDEMIC

THE WORLD HEALTH ORGANISATION admits that contingency planning for an event that will occur at an undetermined time in the future is difficult in the face of limited resources and other urgent problems and priorities, especially in developing countries. But it says there are two main reasons to invest in pandemic preparedness.

- Improving public health infrastructure through pandemic planning has immediate and lasting benefits, increasing overall response capacity for all threats to public health.
- Strengthening co-ordination mechanisms at national and international levels contributes to better global preparedness and response for disasters and public health emergencies.

KNOWLEDGE Civil unrest
Some companies predict a negative reaction, like industrial disputes and strikes, when the economy starts to recover if that recovery is not accompanied by increased jobs and wages.

WHAT ARE THE BIGGEST PANDEMIC CONCERNS?



Overall survey results show that organisations have made big strides to prepare for a pandemic. Over 75% of respondents said that their organisations currently have a business continuity plan in place. Within that group, 81% said they have specific contingencies for dealing with H1N1 (swine flu) specifically.

Source: Pandemic Prevention Council

» *financially. When it restarts, they want to get their share of the cake and return to what was normal before. Trade unions will become more active, asking for more wages and greater employment, so strikes could stifle the restart"*

Migration

Immigration was seen as an issue by several companies. Concerns related to potentially important impacts in terms of social instability and the need to provide specific services to cater for the new citizens.

Even those looking at the volume of immigrants as providing an opportunity for selling additional services were cautious regarding credit risks and fidelity issues. This suggests a generally low perception of immigrants' social standing and behaviour.

Protecting business travellers

Many European companies place a great deal of emphasis on protecting their people while travelling abroad and in fact consider that this is a risk that is largely underestimated.

Making sure that people travel safely and understand what to do if things go wrong in potentially hazardous political areas is a key issue for some risk managers.

Further, it goes beyond dangers relating to crime or terrorism to address the basics of safe travel.

"Motor accidents are probably one of the most likely risks for our people abroad. We provide a specific website to give assistance and advice to limit the risk. We also provide a contact point to ensure speedy reaction and help should one of our business travellers have a problem"

Pandemics

European companies regard pandemics as a risk but perhaps not as great a concern as they were in 2010.

All companies acknowledge that they have a responsibility to safeguard the integrity of their business and this includes the safety of their employees.

They also acknowledge that pandemics could have serious affects on their business in terms of employees, suppliers, restricted travel, and so on, and could therefore represent a serious problem. However, this seems to be an ongoing concern rather than an immediate major risk.

"We are prepared for the effects of a pandemic but do not see this happening in the next year"

Demographics and economic effects

Some risk managers were concerned about the effects of recession on young people who are unable to find work, as well as the restrictions on the buying power of older people on fixed incomes who would traditionally be expected to make luxury purchases such as travel.

And clearly the fact that people are living longer has an impact on the cost of pension payments. **SR**

"The difficulty that young people have in finding work can leave a psychological scar that has a long-term impact and may lead to risk aversion later on in life"

COMMENT **Eddie Mclaughlin**, Managing Director, Marsh Risk Consulting

EUROPEAN COMPANIES SEE CONSIDERABLE interconnection between societal risks and the other risk categories. This is hardly surprising because, with very few exceptions such as natural catastrophes and arguably pandemics, it is the actions of people that trigger the causes of risk.

For example, virtually all the main events perceived and categorised as technology risks in this report – for example, data theft and leakage, fraud and other cyber crime – could also be classed as societal.

Economic problems and many of the geopolitical issues have their roots in societal behaviours. Even climate change and concerns relating to greening stem from human neglect of sustainability issues in the past.

In terms of the micro picture and individual corporate risk management, this suggests that the key challenge is to influence behaviours to produce less risky outcomes. Part of this is likely to include influencing perceptions, a process that involves both company culture and robust and demonstrable corporate social responsibility.

The ultimate risk for businesses – and one from which they may never recover – is damage to reputation. History shows that societies are more forgiving of the failures of those companies that they consider to be 'good' and ethical citizens.

Rise of the machines

Cyber crime, and the lack of systems to deal with it, heads the list of risks as companies rely more than ever on the internet

CYBER CRIME IN ALL ITS DIFFERENT facets heads the list of concerns. One risk manager commented that the turnover from cyber crime today is bigger than the worldwide turnover of narcotic trafficking, and it is seen as an easier option because the perpetrators are less traceable.

Data theft is seen as a growing risk. Organisations that market or sell online hold a considerable amount of sensitive information on their systems relating to customers.

While financial institutions appear to have robust systems in place, several risk managers in other areas admitted that they were not sure how secure their systems were. Some were also concerned about the possibility of industrial espionage, with hackers stealing intellectual property.

> *"We put a great deal of effort into security, training and communication about information leaks, because much of the value of our business is tied up in knowledge – and it's not the kind of knowledge you can put patents or copyrights on"*

Companies recognise that data theft is not purely an IT issue. There were some concerns regarding failure to monitor the people handling information, including checks on those joining and leaving organisations.

> *"The biggest possible source of leakage of information walks out of your offices and factories every day – it's your people. They can say what they like and spread all kinds of rumours, which may or may not be true"*

One commentator was particularly concerned about recent thefts by hackers of CO_2 emissions credits (see side bar, right) and said that governments should increase the security levels of some of their IT facilities. This is an area potentially affecting the whole of Europe.

Leakage of confidential data, particularly in the area of competitive advantage, is another growing risk. Businesses feel that this is most likely to occur – maliciously or inadvertently – through employees or business partners on social networking sites. Some companies believed that businesses should be more prudent in identifying and securing their key information.

With the use of mobile phones and the internet having developed faster than the protocols on how to use them, companies also see the need to make sure that their people understand the value of information and its protection. Some – but by no means all – have policies relating to this, and make sure they are enforced. However, putting the right security and policies in place to manage risk exposure globally was seen as fairly difficult.

> *"A lot of the information that people regard as confidential is not … Differences in global legislation mean that people who leak information may be regarded as criminals or information freedom fighters"*

Some organisations that outsource to third-party providers – for cloud computing, for example – recognise a potential security risk here as well, in addition to issues relating to the robustness of suppliers' business continuity planning and the potential impact of extreme weather and other natural catastrophe risks.

Rumour-mongering

Unscrupulous web postings by competitors may also be a problem. Several companies »

THEFT OF CO_2 EMISSIONS CREDITS

One of the latest cyber crimes to hit Europe is the theft of CO_2 emissions credits. The EU requires industrial companies emitting CO_2 to have a certificate for every tonne of greenhouse gas they discharge. These have a tradable value and the worth of those stolen so far has been estimated at nearly €50m.

The European Commission partially closed the Emissions Trading Scheme in January 2011 while it investigated the practice.

It is also facing legal action in Belgium, brought by Toyota Carrelli Elevatori Italia, which is hoping to recover 267,991 allowances that were stolen. It is uncertain whether companies that bought the stolen allowances could be prosecuted.

COMMENT **Rod Ratsma** UK business continuity leader, Marsh Risk Consulting

ISSUES RELATING TO TECHNOLOGY – PARTICULARLY WITH REGARD to the internet – are high on European companies' concerns and seen as an increasing risk in the next year.

Organisations often face complex information and computer security risks by operating in a dynamic environment with increasing dependency on technology systems. They are confronted by increased threats of litigation and regulation, with the resulting potential financial losses and reputational damage.

Three issues stand out in this context:

- Secure data storage is a major challenge for global organisations. The more data-intensive a business becomes, the more value can be generated or lost, and the greater the risk that sensitive customer data may be compromised, lost or stolen.
- New business models from converged business areas and ways of working across industries, including solutions such as cloud computing, add to risk and insurance concerns around data treatment and security.
- Opportunities for data breach, theft or loss due to human error or other factors are leading to increased regulatory scrutiny in certain industries and countries.

KNOWLEDGE Other risks

Nano-technology and electromagnetic fields are not high on the risk agenda – only one risk manager referred to these – probably because the impacts from them are still unproven.

CASE STUDY: INFORMATION SECURITY

ALEX HINDSON, HEAD OF GROUP RISK at Amlin (and this year's Institute of Risk Management chairman), says that the company looked at information security more broadly than just in terms of IT data.

Considerations included physical security of premises and loss of and damage to data, as well as scenarios such as loss of a laptop or mobile phone, or simply leaving documents in the wrong place.

"There's only so much you can do with systems. We realised quickly that the key challenge was culture and raising staff awareness," Hindson explains. "We needed to think about how we store and move information, how it should be classified and what exactly we mean by 'confidential', and the consequences of loss."

This included reclassifying information into new categories, such as "restricted, internal" and "public". The aim was to make the process as simple as possible. Analysis included distribution of documents and the security of shredding arrangements.

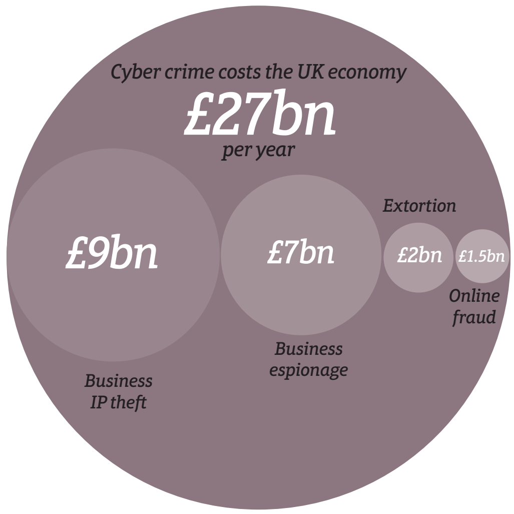
The group's operations, risk, internal audit, legal and compliance functions formed a group information security committee, with representatives from each division.

This oversaw an overall improvement plan, including a computer-based training package – linked to housekeeping and a 'clear desk' policy, and including validation tests for employees – which has been translated for the group's overseas operations.

It is one of the first Amlin training modules to be directed at 100% of staff. The aim is to achieve complete coverage of all staff across the group, in recognition of the fact that it only needs a single point of failure.

An important feature of the training is that it makes the link to the existing risk event reporting process so that the company can learn from issues and seek to mitigate them.

HOW MUCH DOES CYBER CRIME COST?



The main loser from cyber crime is UK business, which loses an estimated £21bn per year as a result of intellectual property theft and damage Source: Detica, for the UK government

» cited the possibility of competitors starting damaging rumours to erode their market share, and felt that all businesses were potentially very susceptible to this. They see information leakage and rumour-mongering as difficult to manage because of the speed of knowledge transfer inherent in the internet, and reputational damage is an important concern.

One risk manager stressed the importance of having a good tool to scan the web and a good communications manager to react quickly.

Security

Fraud, whether online by third parties or internally, has reportedly increased in the European recession. Integrity programmes and whistle-blowing systems were cited as ways of countering the internal threat.

Malicious hacking attacks also seem to be on the increase. Some companies using their computer systems to manage and run many of their operations report a growth in attacks by hackers. They are concerned that companies do not have the same level of systems security as, for example, in the banking industry. "It is a real point of weakness, and we see the risk of civil crime increasing, with people trying to disrupt our activities," said one risk manager.

Doubts about security were voiced by several companies. Some considered that IT risks were not generally understood by businesses, and said that even the consultants they employed did not really understand what the risks were and the best way to address them. As one risk manager said: "We have a firewall but how good is it? It's difficult to assess."

> *"How do you design your systems to be resilient and safer, make the right investment, choose good technology and have good plans if it goes wrong? The key is identifying the nature of these technological-based risks. Mitigating them if they occur is critical"*

Speed of change

Companies believe that the speed of technological change is also producing challenges. In some cases, it has led them to outsource functions in order to achieve the agility they require, although they recognise that this can create its own risks. Companies involved in the technology sector must also compete in the ability to deliver a large number of new services on a continuing basis; the correct investment in systems is crucial.

> *"What we do is at such a high level. Not many people understand how computers work and what can go on"*

Several businesses complained that insurers are not meeting their needs in respect of cyber risks. However, most appear to believe that managing the key risks is a matter of making the right investment decisions and maintaining internal security, with risk transfer, if available, playing a secondary role other than in areas like business continuity.

Internet breakdown

Most companies do not believe that internet breakdown is likely. However, those that do point to the centralisation that has occurred in recent years, with fewer organisations controlling key net cables. They believe that sabotage or terrorist attack is a serious possibility, which would clearly be highly disruptive for businesses. SR

Sue Copeman, editor-in-chief, *StrategicRISK* and **Rob de Jonge**, EMEA leader of Marsh Risk Consulting

***StrategicRISK* would like to thank the following leading European risk management professionals for taking part in compiling this report:**

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head of risk oversight, Prudential

Colin Campbell,
head of risk management, Arcadia

Adrian Clements,
general manager, asset risk anagement, ArcelorMittal

Alessandro de Felice,
group risk manager, Prysmian

Peter den Dekker,
corporate insurance risk manager, Stork, and president of Ferma

Michel Dennery,
deputy chief risk officer, GDF Suez

Marie-Gemma Dequae,
risk manager, Partena group and former Ferma president

Frédéric Desitter,
chief risk officer, Aéroports de Paris

Antonio Negreiros Fernandes,
secretary general, APOGERIS

Anne-Marie Fournier,
risk manager, PPR

Julia Graham,
chief risk officer, DLA Piper

Nicola Harvey,
group risk director, Christie's

Elaine Heyworth,
head of risk management, Everything Everywhere

Alex Hindson,
head of group risk, Amlin

Jurand Honisch,
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Paolo Rubini,
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chief risk officer, Reed Elsevier

David Weymouth,
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Your risk
Our insight